

Litman Gregory Masters Alt Strats Instl MASFX

Strong subadvisors give this fund an edge.

Morningstar's Take MASFX

Morningstar Rating ★★★★★

Morningstar Analyst Rating Bronze

Morningstar Pillars

Process	● Neutral
Performance	⊕ Positive
People	⊕ Positive
Parent	⊕ Positive
Price	● Neutral

Role In Portfolio

Supporting

Fund Performance MASFX

Year	Total Return (%)	+/- Category
YTD	0.43	1.06
2017	4.51	-0.64
2016	6.87	5.49
2015	-0.77	1.81
2014	3.58	1.77

Data through 2-28-18

3-19-18 | by Jason Kephart, CFA

A capable manager selection team and strong subadvisors support Litman Gregory Masters Alternative Strategies, but a recent subadvisor addition heightens the risk of underlying strategy overlap. As a result, we have downgraded its Process rating to Neutral. Nonetheless, the fund retains its Morningstar Analyst Rating of Bronze, as we have confidence that it can outperform peers and hit its return goals given the high-caliber underlying management teams.

In 2017, management added DCI, a long-short credit manager, because its market neutral strategy should have little to no correlation to broad market indexes. Arguably a much needed attribute since this fund's correlation to high-yield bonds has been uncharacteristically high for this alternative strategy. Since its inception in September 2011, its average three-year rolling correlation to the Bloomberg Barclays US High Yield Intermediate Term Index is 0.87. The high correlation signals it has

offered limited diversification benefits to a traditional portfolio of stocks and bonds.

Adding DCI into the mix may make the fund a better diversifier, but it also increases the risk of overlap among underlying managers, as three other subadvisors have significant flexibility to invest in credit. In 2015, for example, both FPA and Loomis Sayles were opportunistic buyers during the high yield energy sell-off. That bet paid off over the long run, but it led to higher correlation among the underlying strategies in the short term. Still, we have high confidence in the individual managers; four of the five strategies are similar to what the subadvisors are running in separate mutual funds, like Gold-rated FPA Crescent FPACX. Those four funds all receive Positive People ratings from us, an indication of superior manager talent and resources.

Although our confidence in the process has decreased, we expect the fund to continue to perform well over the long haul. This remains a solid choice in the multialternative category for investors who are comfortable with its high correlation to risk assets.

Process Pillar ● Neutral | Jason Kephart, CFA 03/19/2018

We have confidence in Litman Gregory's ability to evaluate and monitor underlying managers, but the recent addition of a credit-focused subadvisor increases the risk of manager overlap in what was already a credit-heavy multi-alternative fund. We have downgraded its Process rating to Neutral.

In 2017, Litman Gregory added long-short credit manager DCI as a subadvisor to the portfolio. Management was looking for an additional subadvisor that wouldn't have a high correlation to global markets and DCI takes a market-neutral approach to building portfolios, so it should fit that bill. Its focus on corporate credit, however, could lead to overlap with other managers in the portfolio such

as Loomis Sayles, FPA, and DoubleLine. DoubleLine's portfolio has historically focused on mortgage-backed securities, but, like the other subadvisors, it has a lot of leeway. Management anticipates it would look to add corporate credit if high yield spreads were to widen considerably. Given the focus on value at Loomis and FPA, they would also likely be opportunistic buyers in a credit sell-off.

Still, the process has some strengths. Management doesn't try to market-time the underlying strategies. Timing strategies is a difficult exercise, so taking that out of the process should lead to smoother returns over time relative to funds that switch strategies more regularly.

Management strategically allocates roughly equal amounts to its five subadvisors. It believes each manager has an equally good chance of meeting or exceeding its expected return target. As of the end of February, it had a slight overweight to the DoubleLine strategy (25%) as management favors its ability to manage through the late stages of a credit cycle. FPA has the smallest allocation (18%) because it is the most volatile of the five. The remaining three each manage 19% of the fund's assets.

The subadvisors generally run concentrated versions of strategies that they manage in other vehicles. Water Island's portfolio, for example, focuses on its 20 best merger-arbitrage ideas, compared with the 50 or more deals in its Bronze-rated Arbitrage ARBNX. At the end of 2015, for example, the Loomis team had a 29% allocation to high-yield bonds, 12 percentage points higher than the mutual fund. As high-yield bonds rallied in 2016, it removed much of that overweighting. FPA runs an absolute return strategy. Compared with FPA Crescent FPACX, its mutual fund counterpart, this strategy tends to hold more equities.

DoubleLine runs an opportunistic mortgage-backed security strategy that manager Jeffrey Gundlach has run in a hedge fund since 1991. DCI runs two market-neutral credit strategies composed of a mix of cash bonds and credit default swaps.

Performance Pillar + Positive | Jason Kephart, CFA 03/19/2018

This fund targets annualized volatility of 4% to 8% and we expect the fund to deliver returns in a similar range. Since its inception in September 2011, the fund's annualized return of 5.2% falls within our expectations and tops the category norm of 1.9%. Its risk-adjusted returns, measured by Sharpe and Sortino ratios, are also well above most peers. The strong results support a Positive rating for Performance.

The subadvisors have done a good job of balancing each other out. The third quarter of 2015 is the only quarter since the fund launched where four of the five subadvisors lost money at the same time. Loomis Sayles and FPA both stumbled in the quarter, losing 3.5% and 5.2%, respectively, thanks to bets on energy equities and credits. The energy bet paid off for both managers in 2016, though, as oil recovered in the second and third quarters. Loomis gained 5% in the second quarter, and FPA gained 5% in the third quarter. The strong performance of the two helped push the fund to a 6.8% return for the year, topping 90% of peers.

While the fund's returns have been above average, it has fallen short as a diversifier. Since its inception, its average three-year rolling correlation to the Bloomberg Barclays US High Yield Intermediate Term Index, an index of below-investment-grade bonds, is 0.87. Investors should keep its correlation to risk assets in mind when allocating to the fund.

People Pillar + Positive | Jason Kephart, CFA 03/19/2018

Litman Gregory's proven manager research team has assembled a strong group of managers to run this fund, earning it a Positive People rating.

Jeremy DeGroot, chief investment officer, leads the six-person manager research and due-diligence team at Litman Gregory. The team oversees the manager selection, manager allocation, and ongoing monitoring of each subadvisor. Before new subadvisors can be added to a portfolio, the analyst assigned to them must make a case to the research team, and all members must agree before a subadvisor can join the lineup.

This fund's People rating is boosted by its subadvisors. Four out of five subadvisors earn Positive ratings for People on the similar mutual funds they manage. Matt Eagan, Todd Vandam, and Kevin Kearns of Loomis Sayles, Steven Romick of First Pacific Advisors, and the team at Water Island Capital are all veteran managers. Jeffrey Gundlach, ceo of DoubleLine, has a storied career investing in mortgage-backed securities and the strategy he runs here relies heavily on that background.

DCI, LLC, a long-short credit focused-firm was added as a subadvisor in 2017. Several individuals from DCI were added to the manager roster, including the chief executive officer Tim Kasta and heads of research, risk, and portfolio management.

Parent Pillar + Positive | Jason Kephart, CFA 03/13/2018

Litman Gregory was founded in 1987 as a financial-advice firm and rolled out its first mutual fund at the end of 1996. Since then it has launched five more (but merged away two large-cap funds in 2013). Today, the Registered Investment Advisor manages more than \$5 billion in client assets, plus nearly \$3 billion in four funds run by proven subadvisors that each contribute a small number of their best ideas to the portfolios.

While Litman Gregory has made changes to its subadvisor lineups over the years, the firm generally maintains long-term relationships with its managers. The firm's conservative approach to launching products is also a positive attribute as it allows the management team to focus on its existing fund set. The firm's manager-selection and monitoring effort is well supported by six individuals with an average tenure at the RIA of 10 years. Jeremy DeGroot leads that group. Litman Gregory has also proved

committed to limited fund sizes--at one point both Litman Gregory Masters International and Litman Gregory Masters Equity were closed at under \$1 billion in assets (though both are now smaller than that and open).

The firm falls short on fees--most of the funds look pricey. Still, the quality of the underlying managers has helped the lineup stand out. Two funds earn Morningstar Analyst Ratings of Bronze. Overall, the firm earns a Positive Parent rating.

Price Pillar ● Neutral | Jason Kephart, CFA 03/19/2018

This fund is offered in two share classes. The bulk of assets (90%) are in the fund's institutional share class, which has an annual report net expense ratio of 1.47%. It falls right in line with the 1.45% median expense ratio for similarly distributed multi-alternative funds. It earns a Neutral rating for Price. The Investor share class charges 1.74%, which is slightly above average for that share class.