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	Positive
Performance	Neutral
People	Positive
Parent	Positive
Price	Neutral

Role In Portfolio
Supporting

Fund Performance MASFX

Year	Total Return (%)	+/- Category
YTD	5.63	4.40
2015	-0.77	1.81
2014	3.58	1.77
2013	6.32	2.16
2012	9.41	5.55

Data through 9-30-16

4-20-16 | by Jason Kephart

Litman Gregory Masters Alternative Strategies is underpinned by a strong cast of subadvisors and a management team that doesn't get in their way. Although fees could be cheaper, this remains one of the best choices in the multialternative Morningstar Category. Its Morningstar Analyst Rating remains Bronze.

Portfolio manager Jeremy DeGroot and the manager research team at Litman Gregory look for subadvisors that are comfortable running high-conviction strategies. For this multistrategy alternative fund, they've selected five managers that run strategies with historically low correlations to one another and to traditional equities and bonds. They've done a good job selecting 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 managers all have Positive People ratings, an indication of superior manager talent and resources.

DeGroot and team don't make top top-down allocation shifts, which have tripped up many peers in the category. Instead, management's high conviction in each manager's ability to meet or exceed their objectives--which are generally positive absolute returns regardless of the direction of equity or bond markets--results in a roughly equal weighting to each of the four main subadvisors. The hands-off approach has led to strong results thus far. The fund's three-year annualized return of 2.17% through the end of March tops 75% of all peers in the category.

One warning sign is that the fund's heavy reliance on non-traditional bond strategies, which make up 50% of assets, has led to a high correlation to high-yield bonds. The fund's 0.91 correlation to the BofAML U.S. High Yield Master II Index, an index of below-investment-grade bonds, during the past three years is the highest in the multialternative category. That means the fund may expose investors to a fair dose of credit risk.

Still, this fund remains a standout choice in the category for its access to a solid mix of diversified strategies run by proven managers.

Process Pillar Positive | Jason Kephart 04/20/2016

Litman Gregory's manager research process has proven it can identify top-flight managers across multiple mandates. And the firm's aversion to trying to time strategies gives it an edge over more tactical peers. It earns a Positive Process rating.

The fund's portfolio is designed to replace an equal portion of stocks and bonds from a traditional portfolio. For that reason, the fund's benchmark is 40% stocks and 60% bonds.

Litman Gregory's six-person manager research team is responsible for selecting and monitoring the underlying managers and for the fund's allocation to each manager. Before a subadvisor can be added to the portfolio, it must also be approved by the manager research team. For this fund, the manager research team looks for subadvisors that are comfortable running high-conviction strategies, usually best-ideas portfolios, and have a demonstrated an orientation toward preserving capital. The team also looks for strategies with a low correlation to each other.

Management maintains a strategic, roughly equal weight, allocation to its four core subadvisors. The allocation is the result of management's view that each manager has an equally good chance of meeting or exceeding its expected return target. 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 actively.

The fund's strategic asset allocation is close to its benchmark, with 50% in bond-related alternative strategies and 50% in alternative strategies with exposure to equities.

The subadvisors generally run concentrated versions of strategies that they are managing in other vehicles. The Loomis Sayles absolute return bond team, for example, is running a more concentrated version of Neutral-rated Loomis Sayles Strategic Alpha LASYX. In this fund, it has a 29% allocation to high-yield bonds, 12 percentage points higher than the stand-alone mutual fund as of the end of the year. FPA runs an absolute return strategy that relies heavily on cash (it had a 35% stake as of Dec. 31, 2014) to manage equity market risk. It can allocate more to small caps and illiquid investments in this fund than in Gold-rated FPA Crescent FPACX. Water Island's portfolio focuses on its 20 best merger-arbitrage ideas, compared with the 50 or more deals in its Bronze-rated Arbitrage ARBNX.

DoubeLine runs an opportunistic mortgage-backed security strategy that manager Jeffrey Gundlach has run in a hedge fund since 1991, while he was with his former firm TCW. Passport's long-short equity strategy blends a mix of macro views and fundamental company research. The strategy typically holds 40-70 stocks long and 10-25 stocks short. Positions are based on management's macro views and fundamental research.

Performance Pillar Neutral | Jason Kephart 04/20/2016

This fund has been one of the top performers in the category, but it's had a hard time keeping up with its own benchmark of 40% stocks and 60% bonds. Since the fund was launched in September 2011, its 4.5% annualized returns trounce the category norm of 1.15%, but it trails its internal benchmark's 7.75% return by just as large a margin through the end of February. For that reason, it earns a Neutral Performance rating.

The diverse mix of subadvisors has done a good job of balancing each other out. There hasn't been a single quarter since the fund launched where they all had negative returns. Still, there have been periods of struggles for each during the past two years.

Water Island Capital, which runs a merger arbitrage strategy, stumbled in the second half of 2014 along with many other merger arbitrage strategies as a number of deals widened over regulatory concerns tied to tax inversion deals, primarily in the healthcare space. Loomis Sayles and FPA both stumbled in the third quarter of 2015, losing 3.5% and 5.2% respectively, thanks to bets on energy equities and credits. Passport Capital also had a poor showing in the third quarter of 2015, losing 4.33%. DoubleLine's positive 2% contribution in the quarter helped the fund stay ahead of peers, though; its 2.3% loss was much better than the multialternative category norm of a 4% loss.

People Pillar Positive | Jason Kephart 04/20/2016

Litman Gregory's proven manager research team has assembled a strong group of managers to run this fund. It earns 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, which ultimately has to agree before a subadvisor can be added.

This fund's People rating is boosted by its subadvisors. 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 who have successfully run similar strategies in their own funds. Jeffrey Gundlach had a storied career investing in mortgage-backed securities at TCW before founding DoubleLine in 2010, and the strategy he runs here relies heavily on that background.

Tim Garry, former head of risk management at Passport Capital, is the only departure among subadvisors since the fund launched. He left the firm in late 2015. Founder John Burbank remains, though, and Litman Gregory is confident that the risk management process Garry established won't be compromised by his exit.

Parent Pillar Positive | Jason Kephart 04/25/2016

Litman Gregory has been a fine steward. Since it first rolled out mutual funds almost 20 years ago, the firm has stuck with its philosophy, adding a limited number of funds run by groups of proven subadvisors that each contribute a small number of their best ideas to the portfolios. (There are four funds in all, including Litman Gregory Masters Alternative Strategies.) The firm has also kept some key funds small and flexible--the Equity and International funds both closed to new investors in the past at under $1 billion in assets (although both are now open, and the latter is at $1.1 billion). Limiting fund sizes has allowed the firm to keep the number of subadvisors at each fund to a manageable number, rather than adding ever more and winding up with sprawling, bland portfolios.

The funds fall short in terms of manager investment, although they still look better than most subadvised funds. Two subadvisors (out of a total of 20 across the funds) invest more than $1 million in a fund, one has between $500,000 and $1 million in a fund, and nine others (including the two principals from Litman Gregory) have $100,000 to $500,000 invested in at least one fund. And on the fee front, most of the funds look pricey. Alternative Strategies is an exception: The expense ratio of its Institutional shares is below average compared with other multialternative funds.

Price Pillar Neutral | Jason Kephart 04/20/2016

This fund is offered in two share classes. The bulk of assets (87%) are in the fund's Institutional share class, which has an annual report net expense ratio of 1.49%. It's cheaper than most multimanager funds in the multialternative category, which charge closer to 2.00%, but just average compared with all alternative funds. The fund earns a Neutral rating for Price. The Investor share class charges 1.74%, still cheaper than the multialternative category average, but above average compared with all alternative funds.