

Litman Gregory Masters Intl Instl MSILX

Not a simple story, but worth getting to know.

Morningstar's Take MSILX

Morningstar Rating ★★

Morningstar Analyst Rating Bronze

Morningstar Pillars

Process	+	Positive
Performance	○	Neutral
People	+	Positive
Parent	+	Positive
Price	-	Negative

Role In Portfolio

Core

Fund Performance MSILX

Year	Total Return (%)	+/- Category
YTD	-5.46	-7.04
2015	-5.52	-3.93
2014	-2.72	2.26
2013	21.47	2.03
2012	19.96	1.67

Data through 8-31-16

9-01-16 | by Gregg Wolper

Although Litman Gregory Masters Select International has question marks, its impressive lineup of subadvisors, thoughtful approach, and respectable parent earn it a Morningstar Analyst Rating of Bronze.

This fund has an unusual structure. Unlike the typical multimanager offering, subadvisors are limited to just eight to 15 holdings apiece. Moreover, the subadvisors are not chosen with traditional diversification in mind, such as filling specific spots in the Morningstar Style Box. Rather, the overseers at Litman Gregory look for topnotch managers who they believe have proven effective at managing very focused portfolios and who relish taking on that challenge.

This process has yielded impressive results over the long term. During the 10-year period through July 31, 2016, the fund lands in the 30th percentile of the

foreign large-blend Morningstar Category, and during the 15-year period, it's in the 20th percentile.

Two elements need further examination, however. First, the current manager lineup can't claim that long-term record. While David Herro of Harris Associates has been on board since the fund's 1997 inception and a trio from Northern Cross since 2007, others have come and gone through the years. Of the other three current subadvisors, Thornburg's Vinson Walden arrived on this fund in 2008, Lazard's Mark Little in 2013, and Pictet Asset Management's duo in mid-2016. Second, performance during the past 12 months or so has been awful. The fund lost 16.7% for the 12 months through July 31, 2016, 10 percentage points worse than the category average. The main culprits have been European financial firms owned by several subadvisors (including Herro, who remains confident in his picks) and Valeant Pharmaceuticals VRX.

Painful as such losses are, managers with strong convictions will suffer setbacks at times. That said, while the fund's current lineup is strong, and its concept has merit, its recent stumble shows the risk of focused portfolios chosen by unconventional managers, and the current lineup doesn't have a long record altogether.

Process Pillar + Positive | Gregg Wolper
09/01/2016

This fund is managed by multiple (typically four or five) subadvisors, each typically receiving an equal percentage of assets to invest in eight to 15 names. The overseers from advisor Litman Gregory are not, however, trying to provide maximum diversification with their selection of subadvisors—that is, they aren't looking to fill a large-growth slot, a small-value slot, and so on. They're more intent on finding topnotch managers who are willing to select a small, focused portfolio for this fund and have proven a capability to manage effectively in that format. This approach gets a Positive Process rating.

The lineup has changed much over time. As of August 2016, the fund has five subadvisors, each of whom is slated to receive 20% of assets (though the newest addition, Pictet, began with 10% in mid-2016 and won't get to 20% for a year). The current lineup consists of Vinson Walden of Thornburg, investing in a mixture of basic-value names, consistent earners, and emerging franchises; a trio from Northern Cross, following a moderate blue-chip value style; David Herro of Harris Associates, who focuses on stocks trading at steep discounts to their intrinsic value; Mark Little of Lazard, who takes an all-cap relative value approach; and a duo from Pictet with a core, all-cap approach. The portfolio tends to hold 60-75 names, with turnover rates varying. In 2015 it was 52%, but it was 70% in 2014 and more than 100% for three years before that.

The current portfolio is not entirely reflective of where it has been or where it's going, since it has been in a transition period with just four subadvisors and doesn't yet reflect the decisions of the just-added fifth subadvisor. The total number of stocks is lower than usual, at just below 50 versus the typical range of 60-75, and 10 stocks have 3% of assets or more with several above the 4% mark. Typically three or four names have more than 3% of assets and just one, at most, has 4%.

Viewed more broadly, though, the current portfolio is typical. It is diversified among a wide variety of sectors and countries but shows unusual weightings that reflect Litman Gregory's mission of choosing managers willing to break from the pack. In addition, the managers select just a few stocks for this fund—they couldn't provide broad, indexlike weightings even if they wanted to. As of June 30, 2016, the fund had almost no energy holdings and just 2% of assets in basic materials versus 7% for the foreign large-blend category and 8% for the MSCI ACWI ex-U.S. Index. But it had 21% in the consumer cyclical sector, far above the category average and index.

Its country weightings also stand out. The fund has 26% of assets in the U.K., nearly double the index weighting. The Continental Europe stake is also high. However, its Japan stake, at 10% of assets, is far below the category average and index level.

Performance Pillar ● Neutral | Gregg Wolper
09/01/2016

This fund's once-outstanding record has been dented by a very poor showing during the past 12 months. Still, its long-term record remains solid: Through July 31, 2016, the fund is in the 30th percentile of the foreign large-blend category for the 10-year period and the 20th percentile for the 15-year period. But the three- and five-year rankings are 96th and 84th, respectively.

The fund had a rough 2015 and is suffering through an even worse 2016. Several European financials, considered to be selling at bargain prices by some of the fund's subadvisors, have weighed on returns as those stocks have plunged. (Lloyds and Credit Suisse CS were both in the top 10 on March 31, 2016.) The portfolio has also had a substantial overweighting to the United Kingdom. Although not all the U.K. stocks lagged, the British pound's decline in the wake of the Brexit vote hit the fund's returns. (Only two of the subadvisors partially hedge their currency exposure; Litman Gregory's Rajat Jain says only 10% of the U.K. exposure was hedged into the U.S. dollar.) Another culprit was Valeant Pharmaceuticals VRX: Its share-price collapse took a toll even though roughly half of the position was sold in mid-2015.

Besides the recent stumble, there's another caveat to the fund's record: Subadvisor changes over time mean the fund's long-term performance owes only partly to members of the current lineup. For these reasons, the fund gets a Neutral Performance rating.

People Pillar ● Positive | Gregg Wolper
09/01/2016

This fund is managed by a group of subadvisors, each of whom supplies a small number of stocks (between eight and 15) for the overall fund's portfolio. The makeup of the subadvisor lineup--chosen and monitored by two overseers from Litman Gregory, Jeremy DeGroot, and Rajat Jain--has changed substantially over time. Currently, five subadvisors are in place. Jain says the average tenure has been

more than eight years. One manager--Harris Associates' David Herro, manager of Oakmark International OAKIX among other funds--has been on board since this fund's 1997 inception. Besides Herro, the lineup includes Vinson Walden from Thornburg (who has comanaged Thornburg Global Opportunities THOAX since 2006 and was named to this fund alongside a now-departed colleague in 2008); Mark Little from Lazard Asset Management (lead manager on Lazard International Strategic Equity LISIX); Howard Appleby, Jean-Francois Ducrest, and James LaTorre from Northern Cross (who have managed Harbor International HAINX since 2009 and worked on it long before that); and Fabio Paolini and Benjamin Beneche from Pictet, which was just added as the fifth subadvisor on June 30, 2016. Each of the subadvisors has solid credentials at their main funds, and the Litman Gregory overseers (which included Ken Gregory until 2014) have made thoughtful changes in the lineup over time, so this fund gets a Positive People rating.

Parent Pillar ● Positive | Gregg Wolper
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 ● Negative | Gregg Wolper
09/01/2016

This fund's Institutional share class had an expense ratio of 0.99% for 2015. On the bright side, that's significantly lower than it was three years ago, when the fund cost 1.15%. One reason for the decline is a fee cap that is in place until at least April 30, 2017. That said, the fund's current expense ratio remains above-average for institutional share classes of foreign large-cap funds. The Investor share class had a 1.23% expense ratio in 2015; while that has also declined meaningfully in recent years, it is also above-average for comparable share classes. Therefore, the fund receives a Negative Price rating.