

5 T H A N N U A L

Innovative ALTERNATIVE INVESTMENT STRATEGIES

Using Non-Correlated Assets To Diversify and Improve Alpha

Liquid Alternatives: Generating Alpha with ETFs, ETNs and Hedge Fund Mutual Funds

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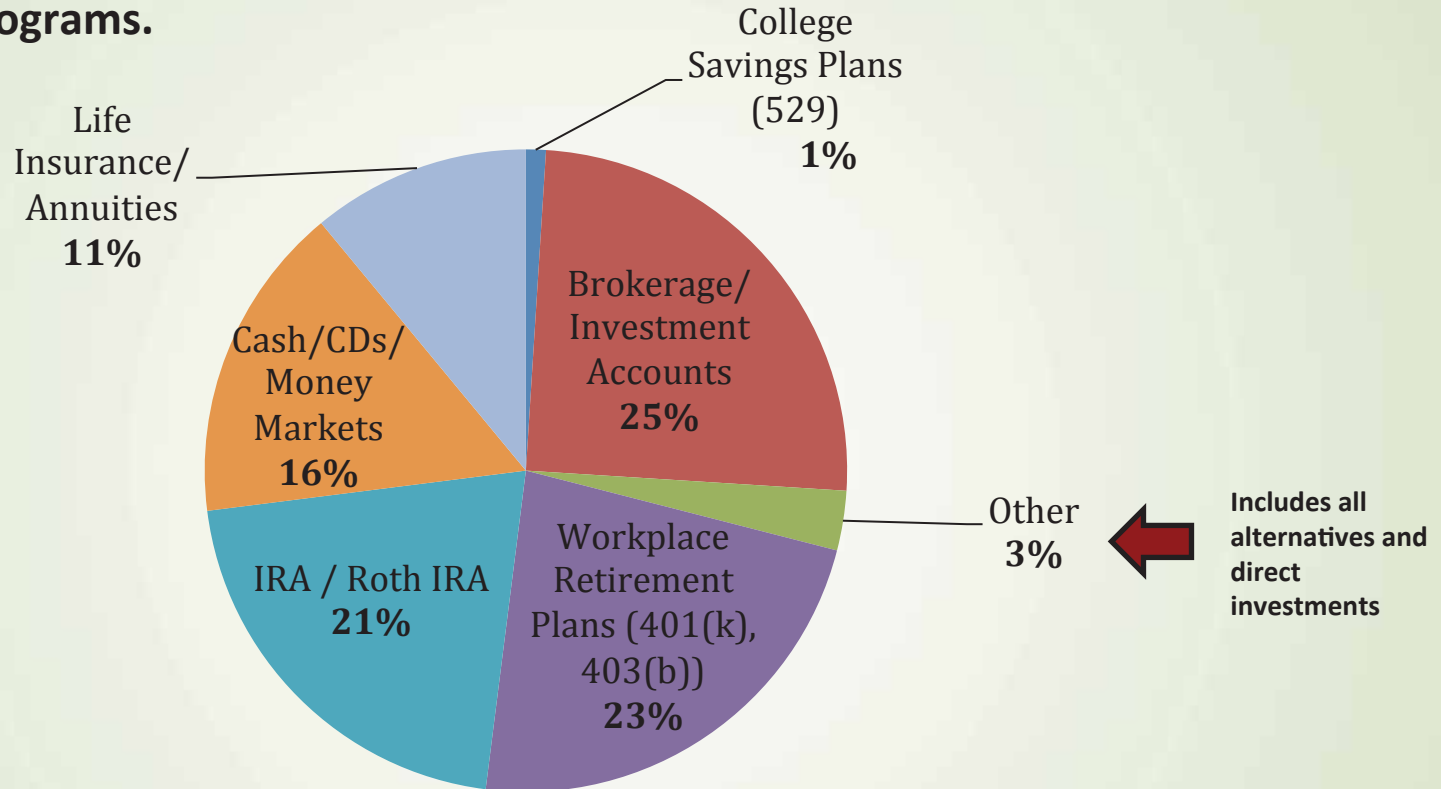
Michael Weil

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In 2012, the Mass Affluent, those Americans able to afford a comfortable retirement, accounted for \$7.5 trillion of investable assets, yet allocated less than 3% to direct investment programs.



Sources: Bank of America Corp., April 2012; The Nielsen Company, 2012; Robert A. Stanger & Co., Inc.; Deloitte



- Nearly three-quarters of the retail U.S. investor market (73%) are not currently wealthy enough to invest in privately offered hedge fund vehicles.*
- This pool of retail investors with less than \$5.0 million in net worth is split into three segments: affluent investors, with \$2.0 million to \$5.0 million of net worth; mass affluent, with \$500,000 to \$2.0 million of net worth and retail, with less than \$500,000 of net worth.*

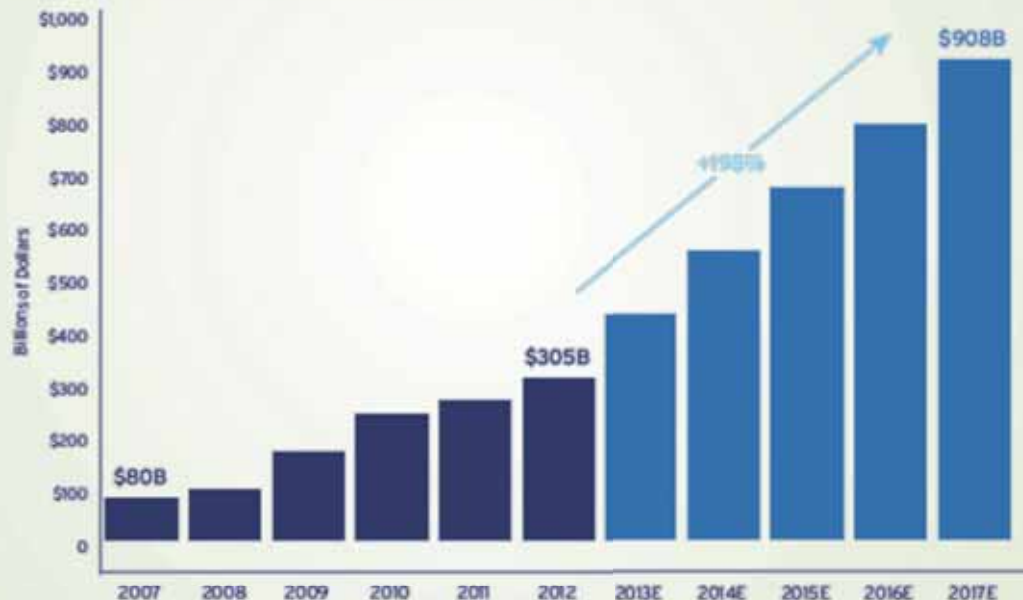
Chart 34: Alternatives Audience Expansion in the U.S.



* Source: Citi, "The Rise of Liquid Alternatives & the Changing Dynamics of Alternative Product Manufacturing and Distribution", May 2013

- Demand for publicly available U.S. alternative retail funds has been surging, allowing assets to more than triple from \$95 billion in 2008 to \$305 billion in 2012. *
- U.S. retail demand for alternative 40 act mutual funds and alternative ETFs will drive assets growth from \$259 billion in 2012 to \$779 billion by 2017. *

Chart 36: Regulated U.S. Alternative 40 Act Mutual Funds & ETFs Forecast on Assets to 2017



Sources: Citi Prime Finance assumptions based on Morningstar, ICL Federal Reserve, Current Populations Survey, Cerulli Associates, Deloitte Center for Financial Services.

* Source: Citi, "The Rise of Liquid Alternatives & the Changing Dynamics of Alternative Product Manufacturing and Distribution", May 2013



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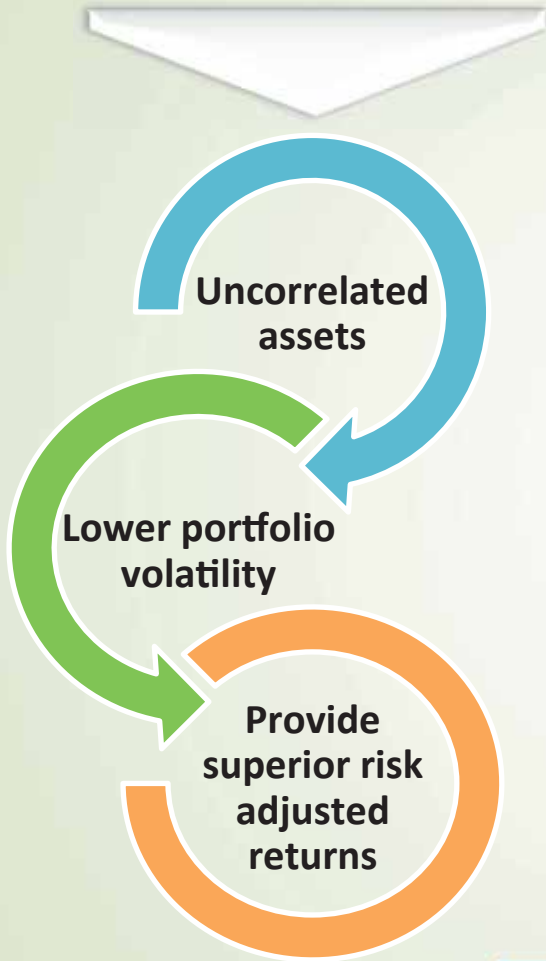
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Liquid Alternatives in a Portfolio

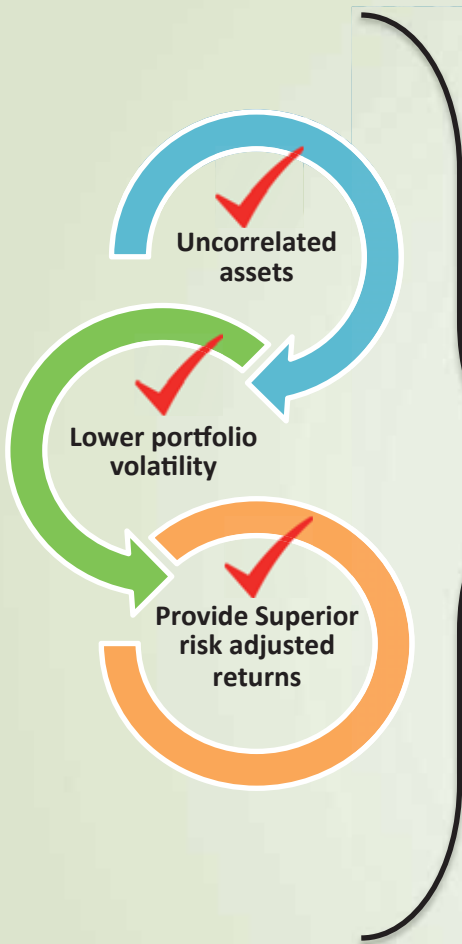


The most liquid of liquid alternatives

Low correlation to equities

Protection against tail risk events

Improves portfolio returns

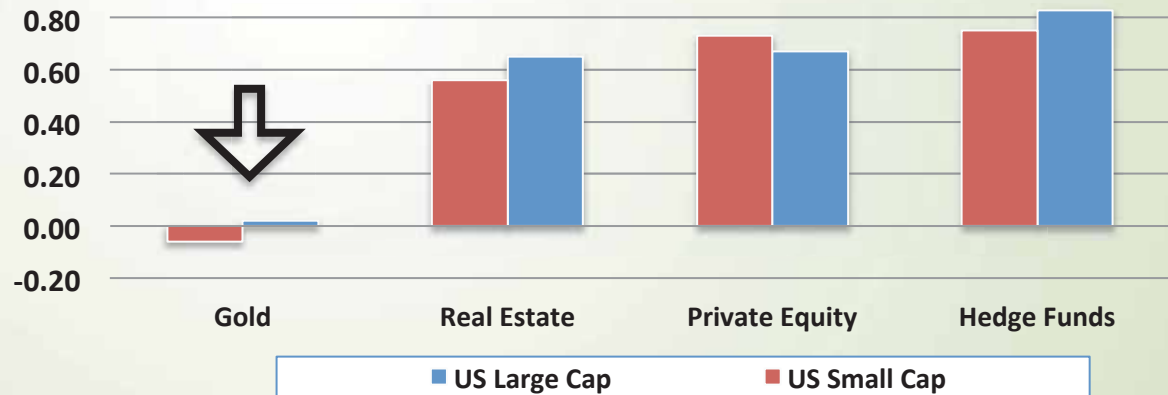


	Portfolio 1	Portfolio 2
Annualized return	7.61%	7.76%
Standard Deviation	11.42%	10.32%
Sharpe Ratio	0.16	0.19

Source: Bloomberg

- **Portfolio 1:**
60% S&P 500 / 40% BAML U.S. Corp & Gov.
- **Portfolio 2:**
55% S&P 500 / 40% BAML U.S. Corp & Gov. / 5% Gold
- These model portfolios spanned 40 years between 1973 –2013 and were rebalanced annually

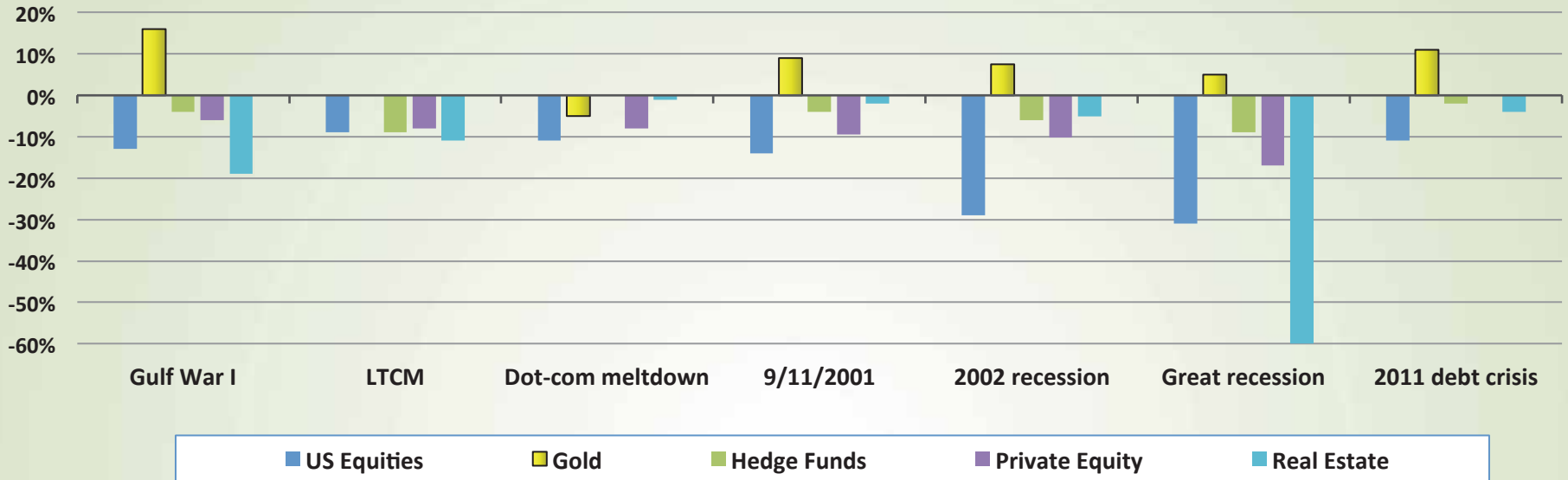
Relative Correlation to Stocks



Source: WGC, Bloomberg



Performance of Gold During Tail-Risk Events



Source: WGC, Bloomberg

Optimal allocation:

- 5-6% in a balanced, medium risk portfolio with a 60-40 equity/bond weighting*
- 4% in a portfolio consisting of other alternatives such as private equity, real estate**

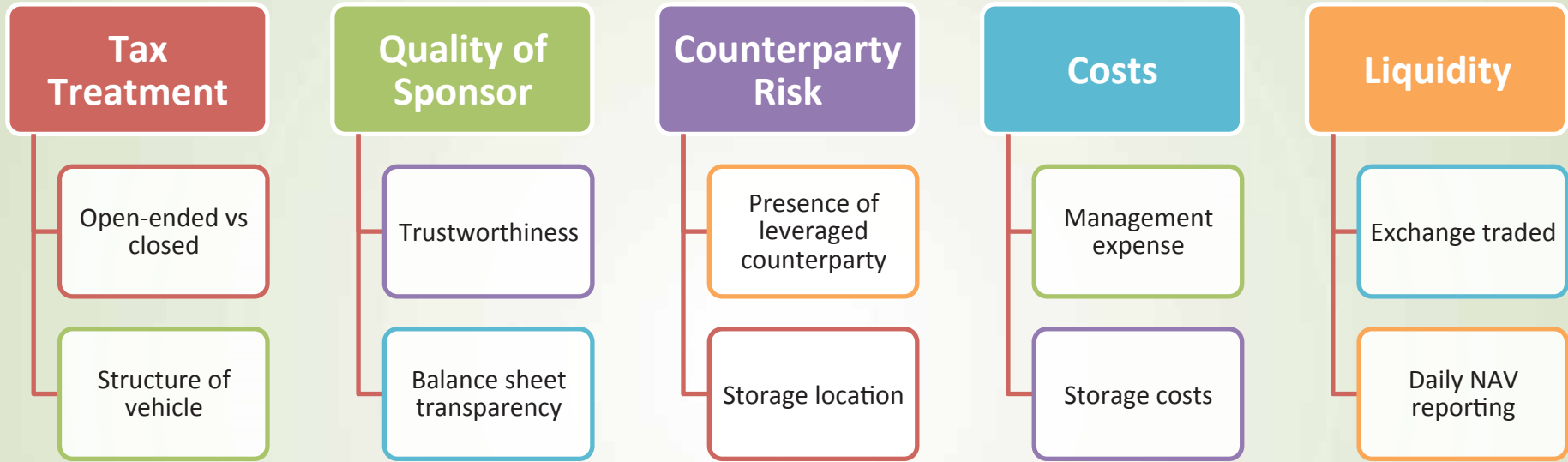
An investor can get exposure through holding bullion, ETVs and futures to name a few.

Exchange traded gold products have been the “go to” vehicles in recent years.



**Source: WGC
 *Source: Michaud and Michaud

Important considerations for exchange-traded bullion investing:



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Cash – Friend or Foe?

Benefits in up market: it keeps returns in check so investors don't get outsized performance expectations.

Benefits in a down market: it doesn't go down and is a source of liquidity to buy depressed stocks.

Bottom line: it really doesn't do anything to improve returns except for providing liquidity.

What are the alternatives?



Options for cash utilization to generate alpha.

Options: Expensive, time constrained.

Futures: Good for making short term market bets.

Hedge Funds: Illiquid, expensive.

ETF's: Mainly passive, too much liquidity & transparency.

Mutual Funds: If active can provide a good hedge.



Why Mutual Funds Rule:

- Daily Liquidity
- Bought and Sold at NAV's
- No time constraint
- Quarterly Transparency

What to Look For:

- Simple structures
- Pragmatic managers
- Clearly delineated risk mitigation parameters
- Hedge fund strategy in an investor friendly package



Optimal Fund for Generating Alpha

Actively managed Short-Only Mutual Fund
Investment Universe is US traded Equities only
Portfolio limited to S&P 500 and similarly sized companies
Diversified with at least 40-60 names and small maximum position sizes
Avoids high short interest names
Has strong risk controls to minimize outsized losses

Sizing Considerations

Start small and build up a position to your comfort level
Excellent discipline is to take cash dividends and invest them in the fund

