Hedged Equity

INVESTMENT STRATEGY

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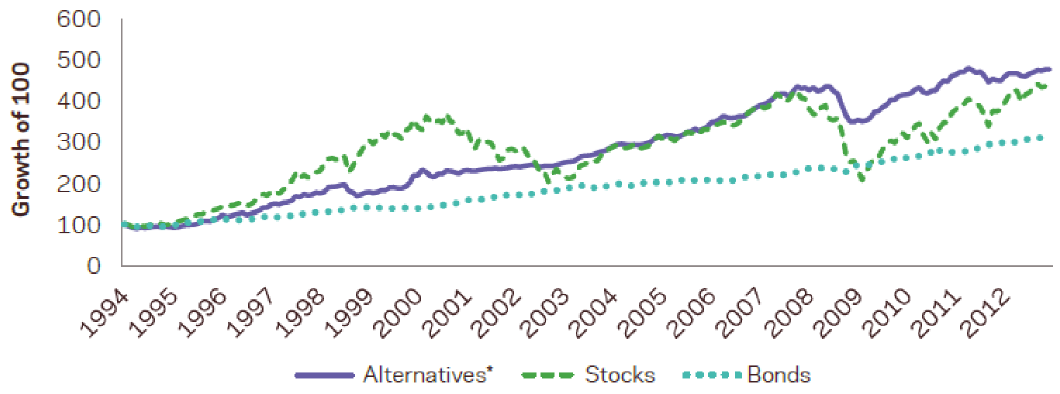
"Hedged Equity" (also known as "Long/Short Equity") is a classic alternative investment strategy that uses both long and short positions within a fund by buying undervalued stocks and selling short overvalued stocks. This strategy has historically generated higher risk-adjusted returns with lower volatility than equity markets, as seen in the graph and chart below.

Comparison of Growth:
Alternatives, Stocks and Bonds (Jan. 1994–Dec. 2012)

Alternatives Have Been Less Sensitive to Large Stock-and Bond-Market Returns



*Past performance does not guarantee future performance. Alternatives are represented by the Dow Jones Credit Suisse Hedge Fund Index; stocks are represented by the S&P 500 Index, and bonds by the Barclays U.S. Aggregate Bond Index. Sources: Datastream, Dow Jones Credit Suisse, AQR. Source: Adapted with permission from AQR Capital Management, LLC, Investor Guide Style Premia Alternative Strategy.

History

The first Hedged Equity fund was created in 1949 by Alfred Winslow Jones. Jones' goal was to hedge investors from downside market swings by shorting certain stocks he expected to perform relatively poorly. He explained, "The logic of the idea was very clear… You can buy more good stocks without taking as much risk as someone who merely buys." By utilizing this strategy, Jones was able to reap returns in both rising and falling markets and he further amplified his returns through the use of leverage. After Jones' early success, this strategy emerged as the bread and butter of the hedge fund investing community, yet has carried with it the negatives of hedge fund investing: high expenses, illiquidity, and limited transparency.

Correlation between Asset Class and U.S. Large Cap Equities

Asset Class	U.S. Large Cap Equities
U.S. Large Cap Equities	—
U.S. Small Cap Equities	0.77
Int'l Large Cap Equities	0.81
Emerging Market Equities	0.72
Taxable Bonds	(0.01)
International Bonds	(0.03)
Diversified Alternatives	0.54
Managed Futures	(0.08)
Hedged Equities	**0.74**
MLPs	0.36
Commodities	0.31
REITs	0.51

Source: LPL Research, FactSet, Morningstar, Standard & Poor's, Russell, MSCI, Barclays 05/14/15

Continued on reverse side

Today

In recent years, these same strategies have grown in popularity through the use of liquid mutual funds, which enable investors to access them with lower expenses, greater transparency, and daily liquidity. The "Growth of $100" chart demonstrates the attractive risk-adjusted returns that the strategy has delivered as a whole, as well as the hedging benefits illustrated by its lower volatility and a max drawdown that was less than half that of the MSCI World Equity Index.

There is little uniformity in approach among Hedged Equity managers. Their objectives can range from those seeking conservative, bond-like returns to those using leverage to pursue highly volatile returns. Their philosophies can also differ as some managers seek to generate returns through superior stock selection while others adhere to a more passive, evidence-based investment approach. Due to this wide spectrum of strategies and risk/return objectives, it's of critical importance to exercise careful due diligence when selecting and monitoring a Hedged Equity manager.

Comparison between MSCI World Equity Index and Long-Short Equity Index

Jan. 1995–Dec. 2015	Annualized Returns	Annualized Volatility	Sharpe Ratio	Max Drawdown
MSCI World	7%	15%	0.27	-54%
Long-Short Equity Index	10%	9%	0.75	-22%

Source: AQR, MSCI and Credit Suisse

Conclusion

Due to this wide spectrum of strategies and risk/return objectives, it's of critical importance to exercise careful due diligence when selecting and monitoring a Hedged Equity manager. Hedged Equity has been shown in the past to provide attractive risk-adjusted returns while being less volatile than traditional equity investing. With the rise in liquid Hedged Equity mutual funds, we believe there is a compelling case to use them as part of your investment strategy.