The Burgeoning Alternative Investment Funds Market

A Staple for Every Fund Family?
November 2013

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PREFACE

Since the concurrent credit and market crises took a bite out of investors in late 2008, professionals and novices alike have been searching for asset classes that are *uncorrelated* to traditional fixed income, equity securities, and 'the market' in general. Demand has spawned many more so-called "multi-asset" and "alternative asset (class)" funds which seek to reduce volatility by investing in a wide variety of securities and asset classes not always commonly held by open-end mutual funds. Yet, the definition of "alternative investment" is arguably divergent at this juncture and the term can be used loosely, similar to the way "hedge fund" is indiscriminately tossed around.

This newest open-end fund product type can be generically categorized as a less-affluent man's hedge fund - without the supposed liquidity risk - but also without the presumed upside potential. Yet, this view is overly simplistic. Frankly, nailing down a widely accepted definition of an alternative investment is apparently proving to be no easy task. Today, the most widely recognized types of alternative investment funds (AIFs) are referred to as "absolute return," "market-neutral," "global macro," "long/short" (or "130/30"), and "managed futures." Given the unique investment objectives of AIFs and the appearance of their typical holdings, it may not be clear to many readers whether to define them by their strategy or by their (reported) holdings.

These types of funds clearly add complexity to plain vanilla investment company portfolios, seek increased diversification benefits, may possess an indifference to market benchmark comparisons, and are designed as a complement to traditional portfolios of funds. So, one might define an AIF as one which provides diversification and reduces risk through low market correlation in conjunction with "buy-and-hold long-only" types of funds. At this juncture, many AIFs are not generally intended to be a stand-alone holding or be a "one-stop shop" fund, but some have leanings that direction. It is fair to say that this view precludes underlying annuity funds which, because of their insurance wrappers and income and/or principal preservation guarantees, are essentially designed as stand-alone vehicles and have been using more absolute return or buffered volatility strategies for years.

It is important to note that based on most AIFs volatility buffering techniques, investors may give up a significant portion of market upside if singularly held. Very broadly and semantically speaking, an alternative fund will generally focus on holding less traditional asset classes/securities such as REITs, commodity-based investments, ETFs, currency-based contracts, hedge funds, and potentially a wide range of derivative contracts for active or hedging purposes. Shorting and leverage, to the extent allowable under the '40 Act, are common.

In KFS's view, these funds should facilitate diligent research, a deeper understanding of the markets, and exemplary disclosure(s) for the benefit of Trustees/Directors, Advisors, intermediaries and investors alike. Perhaps most important, investors are likely not very adept at knowing how to use AIFs at this early stage of their development having only emerged in any meaningful way in 2007. Some level of investor confusion is undoubtedly widespread.

The obvious question for Boards of Trustees/Directors: What do I need to know about these types of funds and should *my* fund family offer one or more AIFs to our current or prospective investors?

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[Several of the viewpoints and insights reflected in this paper benefited from in-depth conversations with Mr. Andrew Clark, Head of Alternative Investment Funds Research at Lipper Inc. Andrew is the author of several textbooks on investing and portfolio construction. KFS would like to recognize Mr. Clark's invaluable contribution to this paper and very much appreciates his input and expertise.]

EXECUTIVE SUMMARY

Fund Trustees/Directors and other readers are urged to take away and/or seriously consider the following points contemplated by this white paper:

- Demand for uncorrelated asset classes (and thus funds) has been demonstrated by the institutional and retail marketplaces
- The AIF market continues to grow at a healthy pace as new offerings and new product strategies have been prevalent in 2013
- Thus, many Boards may be asked to approve new AIFs in the near future, if they haven't already
- Due to liquidity constraints, retail versions of true AIFs cannot fully exploit mispricing in the illiquid securities markets and thus, their returns will likely be diluted

- With generally more absolute return aspirations, AIFs may not rightfully embrace traditional market return comparisons
- Boards may be asked by their advisor to contemplate whether they wish to not follow the SEC's desire for open-end AIFs to cap their hedge fund investments at 10%
- Most AIFs should be considered as a complement to a core fund portfolio of more traditional long-only holdings
- Benchmarking an AIF may rightfully involve more due diligence than simply following a Morningstar or Lipper investment objective category - uncovering the most directly comparable peers is the goal
- Many types of (retail) AIFs have not yet been tested under the stressful market conditions witnessed during the contagion of 2008/9
- Asset class correlations can shift, so investment models must be flexible
- Boards are advised to address many core issues prior to approving the introduction of an AIF such as product line fit, goals of a fund, expertise inside the advisor, portfolio manager discretion vs. stable allocation, hedge fund exposure, and a plan to educate the marketplace
- Perhaps most important, Trustees should seek out as much information as they are able to ensure they are fully informed about an AIF; approval and oversight should be based on verification and not simply trust- or faith-based
- Despite desire on a the part of a fund advisor, all Boards overseeing differing sized complexes are ill-advised to categorically approve any and all introductions of AIFs without significant research and probing

BACKGROUND/CURRENT INVESTOR ATTITUDES

The popularity of AIFs was spawned by the credit crises and market contagion that defined the period in late 2008 and into 2009. Many asset classes' values followed one another down a steep slope to unprecedented (depressed) price levels, correlated far higher than most anticipated, and left many investors with few alternatives as to where to park their money. Many fled to cash, close equivalents or short-term government securities. The "flight to safety" spoke to the perspective that investors felt no asset class was without carnage and hunkering down, clinging to (supposed) ultra low-risk holdings, was prudent. Fixed income with modest duration was a target for some, but many felt reluctant to venture beyond "risk-free" assets. Credit was extremely tight, significant monies sat on the sidelines, and the economy stagnated.

The core problem with the 2008/9 market meltdown was the high correlation amongst many global securities, reducing the ability for investors to diversify their holdings asset classes, amongst regions, capitalizations and developed/developing nations. In a worst-case scenario, many supposedly uncorrelated investments moved in lockstep downward. Mandated by their investment charters and stated policies, most open-end funds had no choice by to stay primarily "fully invested" through the market correction and dutifully followed prices to new lows. Retail investors were noticeably disenchanted with this reality.

Yet, during this same period, many hedge funds (private, lightly regulated and less-constrained investment pools) were free to invest in proportions, asset types, and derivatives that - if used judiciously - afforded them a buffer to the markets' downswing. A few select hedge funds were widely publicized as preventing capital losses through the correction and some even garnering returns that were only expected during healthy economic times. The tales of Ms. Hedge Fund hero only taunted the average investor who did not have the financial wherewithal to qualify for entry into these affluent funds. While the SEC has since upped their requirement for hedge fund registrations and disclosures, potentially stifling restrictions are not (yet?) in place. Enter retail AIFs.

While some AIFs did emerge prior to the 2008/9 market correction, their overall performance record as a group has been disappointing. The more recent offerings are a reaction to new-found conservatism as a result of painful capital losses and the inability for older investors to sustain repeat losses and recover financially. After the market shock subsided, demand was clear as investors seemed to clamor for funds with stated objectives such as "stable, modest returns through all market conditions", "downside risk protection", "volatility lower than that of the overall market", "wide diversification to smooth overall price movements" and "seeks to preserve capital". The stated objectives were simple enough, but the techniques that many times had to be enlisted to achieve these nirvana-like goals were anything but simple for even the highly trained and experienced. Put another way, true alternative investment funds are hardly plain vanilla instruments.

The design of a retail AIF had to account for '40 Act restrictions that did not shackle hedge fund managers. The level of a fund security holdings' liquidity, i.e., the extent to which an asset may be sold if and when desired, is restricted under the '40 Act and substantially disallows public AIFs funds to truly behave like hedge funds offered to "qualified investors" since they must be conscious of the proportion of illiquid securities they hold. The cap for so-called "144A securities" is currently 15% of the portfolio, a restriction not required of hedge funds. Thus, the open-end fund business coined the term "liquid alts" to refer to funds that *may* be offered within the confines of the '40 Act, hold nontraditional asset classes, and offer non-affluent investors a way to achieve (presumed) diversification benefits.

The required liquidity considerations of open-end AIFs exposes the fact that large exploitation of mispricing in the illiquid securities markets <u>cannot</u> be undertaken by retail liquid alt funds and dilutes their ability to mimic the strategies and returns of their hedge fund brethren. [Yet, open-end funds can be advantaged under severe periods of widespread illiquidity!] It is also worthy to note that hedge funds frequently require of their investors agreement that they will be "locked out" of the ability to redeem for periods of time (frequently at the outset), allowing managers to not have to hold cash to buy back shares and put all cash to work.

DEFINITION of ALTERNATIVE INVESTMENT FUND

Perhaps the trickiest part of commencing a discussion about AIFs is trying to pin down actual definitions and then, explaining them to investors! While the title seems obvious, what types of investments are truly viewed as 'alternative' and thus, which ones are 'traditional'? KFS is not convinced that the marketplace is fully cohesive on these definitional points, so investor communication verbiage, word choice, and AIF's potential role in investors' portfolios must be crystal clear.

Let us start with the assumption that any non-equity, non-bond, and non-money market funds and strategies that are generally not "long-only" (shorting used routinely) are considered alternative. This leaves the door wide open for many, many strategies that go way beyond typical names such as

Large-cap Growth Equity, Small-Cap Value, A-Rated Bond, and High Yield Opportunities. Investments may include the following security types and lesser-known strategy genres: currencies, commodities, non-traded real estate, non-public, private placements, special purpose acquisition, inflation-linked, restricted, trust-preferred, all types of mortgage securities, equipment trust certificates, zeros, PIK bonds, ETFs, structured notes, equity participation notes, distressed, equity-linked notes, inverse floaters, credit-linked, loan participation, hedge funds, acquisition arbitrage, other arbitrage strategies, and (of course) a wide range of other derivative contracts. Even for the most sophisticated market participants, these are all complicated instruments with limited trading, market data, and less-predictable value and price fluctuations. Yet, when used judiciously and in conjunction with one another, these strategies and vehicles may offer desired diversification and exposures not achieved by traditional equity and bond offerings. Perhaps most worthy of note, AIFs many times do not relentlessly pursue or attempt to simply mimic a chosen market benchmark (in spite of SEC N1-A disclosure regulations). They do not by design and are purposefully not incented to do so.

At the risk of oversimplifying the AIF world, here are ***some* strategies** employed by hedge funds (in very simple terms) that could be considered akin to what AIFs are essentially trying to emulate and achieve, under much more restrictive conditions:

Absolute return - A total return of x% is sought regardless of market movements and under all market conditions and generally expressed in terms of a price index

Market neutral - Return is sought through taking both long and short positions, potentially in multiple markets, and in varying stocks generally in an effort to mitigate dependence on wider market movements; other more esoteric techniques may be utilized to buffer large market swings

Unconstrained global macro - Economic theories are used to guide investments in stocks, bonds, and derivatives world-wide based on trade deficits/surpluses, country relations, currency movements, political developments, interest rate parity and the like

Long/Short - Both long and short positions are assumed (many times in the same stock) in addition to related derivative security stances to lessen reliance on market movements; managers are conscious of, and manage to, an appropriate market index, seeking to flatten spikes

Managed futures - *Future contracts are used in conjunction with, and focused on, specific traditional long-only investments to hedge risk and add diversification

* *An exchange-traded contract that allows a seller/buyer to sell/buy an asset at a fixed price and to be settled at a later date*

And, to a lesser extent, these strategies:

Distressed securities - Equity or fixed income investments are made in companies which are considered to be financially very unstable and are questionable as a going concern; multiple markets for the distressed companies' securities may be involved

Commodity or currency - Positions are taken in commodity- or currency-linked securities based on fundamental economic research, currency market data, foreign exchange prices, and government actions, amongst other factors

Event-driven - Opportunistic security positions are taken at the outset or in the wake of a structural corporate change such as a spin-off, merger, acquisition etc.

Market timing - Broad asset class investments are made based on projections of short-term movements in perceived, directional security prices and relative asset class values

Convertible arbitrage - Positions in convertible securities are assumed in several markets simultaneously seeking to capitalize on either disparate prices amongst trading venues or mispriced assets based on underlying conversion assumptions between markets

Some industry observers also support categories such as "**bear market/inverse results**", "**managed volatility**", "**credit focus**", "**trading strategies**", simply "**leveraged**" (one might interpret this several ways), and "**buy-write**" (presumably option-generating income funds) classifications. KFS feels comfortable prognosticating that all the aforementioned 'flavors' will not exist as the AIF business matures, strategies are tested long-term, and categories are refined.

Perhaps obvious, AIFs may also seek to attain their investment objective(s) by investment directly in several underlying hedge funds which have one or several of the above investment strategies. This approach may be due to the cost-effective nature of direct investment or lack of expertise to truly 'play' in the markets in which investment exposure is desired. Worthy of note is the SEC's recent pronouncement that they do not expect AIFs to invest more than 10% of their assets in underlying hedge funds due to liquidity concerns and difficulty in measuring liquidity of an underlying vehicle. Several legal opinions indicate that the SEC's desire is not grounded in a comment letter, Rule or constitutes official guidance. So, perhaps it is appropriate to call it a "strong urging." Based on and considering Board counsel's opinion, some Trustees may wish to allow their advisor to exceed this 10% cap on hedge fund investments. This may be prudent only if Boards understand the liquidity risks, the hedge funds' strategies in great detail, and the finer points of Rule 144A.

A fundamental question that can arise from an assessment of the above strategies and as interested parties try to agree on a definition of an AIF: should they be classified by their portfolio holdings, e.g., all-cap value, high yield, micro-cap growth etc., or their strategy? In other words, can the holdings 'tell the story' or must one look deeply into techniques and the objective being pursued to determine the true genre? Since an AIF's *point-in-time* holdings may appear very similar to more traditional offerings (with shorting employed, in many cases) one could make the case that strategy is more appropriate and indicative of behavior inside a portfolio. Yet, while investment objectives can be virtually identical, underlying strategies may be dramatically different.

And, if AIFs or so-called "liquid alts" are truly being designed for the open-end fund investor world as targeted diversifiers and not necessarily as stand-alone holdings, are they not essentially an asset class in and of themselves? In the spirit of modern portfolio theory, is an investment aimed at providing low return correlation and a better overall fund portfolio risk/return trade-off not an asset class? Therefore, hedge funds - with all their differing strategies - could morph into an asset class for open-end fund investment purposes - ? This stance makes sense if AIFs are being used to mitigate market risks inherent in a specific fund strategy for a presumably more advantageous risk/return profile. But, it is not clear to KFS if every fund complex designs its AIFs with this targeted risk mitigation or 'fund matching' use in mind. Some may be envisioned and sold as 'core' funds.

This raises the issue of open-end AIF fund classification and benchmarking.

CLASSIFYING/BENCHMARKING AIFs

Professionals in the open-end fund business can hardly have a discussion about an innovative, new fund genre without discussing how they will be classified by independent observers and rating agencies and thus, how they will undoubtedly be benchmarked. Comparative costs and returns are core to the business. Yet, are there enough direct comparables at this juncture to provide broad context and indications of success or failure? Interest and fund registrations have only been building for a short time and the permutations are numerous making comparisons problematic in many cases. Directly comparable funds - if available - must frequently be sought out by using more stringent holdings and/or stated objective criteria and sub-dividing an existing fund tracker category.

Essentially including the most common types of AIFs, e.g., market-neutral, absolute return etc., the following sample investment objectives have emerged which tend to enlist many less traditional security types and esoteric techniques:

- Modest (absolute) yearly return %
- Target index + % return
- Cited interest rate + a return spread
- Inflation rate/CPI + % return
- Market downside (principal) protection
- Target duration
- Portfolio (fund) volatility benchmark
- Volatility target lower than that of a chosen market index

... and many other variations on these themes.

The proliferation of many different views on the appropriate way to achieve risk abatement or return smoothing clearly complicates the peer selection process. Therefore, not seeking to oversimplify the exercise (!), KFS suggests that fund advisors, observers, analysts, and Board of Trustees/Directors consider the following criteria to uncover appropriate peers and thus, benchmarks:

1. The full, detailed, stated objective in the statutory prospectus
2. Market benchmarks (perhaps several or blended) that may be used as relative performance indicators of some sort
3. Portfolio holdings and their consistent themes
4. The sheer number of securities and techniques that *may* be utilized

5. Use of derivative contracts and frequency
6. Stability of allocations amongst many types of asset classes
7. The extent to which hedging techniques, e.g., shorting, derivatives, currency etc., are likely to be used and can be clearly discerned
8. Any disclosure(s) that indicates what actions are likely to be taken under 'traumatic' market conditions

Perhaps it goes without saying that if one utilizes each of these criterion strictly, no peers emerge as no two funds are perfectly identical! The goal is to assemble a "most comparable" list and business judgment is required. As AIFs penetrate the marketplace, objectives and strategies are fine-tuned, and investors warm up to certain strategies, peer selection will likely be easier. In the meantime, Boards may be well-advised to understand that comparisons are less than perfect and look to their funds' advisor as well as outside experts to assist in the performance and expense peer selection process.

Perhaps also obvious is that the performance benchmarking exercise for AIFs is not a simplistic exercise. Multiple benchmarks either blended or used separately (to assess unique asset class results) are likely appropriate, but may depend on an AIF's objective. Standard market benchmarks may apply to certain segments/asset allocations of an AIF, but not others. Ultimate portfolio manager flexibility to significantly shift asset class allocations over time may complicate the benchmarking process for some AIFs. Bottom line: custom (or multiple) benchmarks should arguably be entertained.

With regard to shareholder reporting, an advisor cannot avoid the reporting requirement to include a widely-recognized securities market index in SEC filings and other communications with investors. Given the limited utility of standard benchmarks, reporting additional more applicable, *supplemental* benchmarks is advised. While the SEC may take pause at what some complexes feel are applicable bogeys for reporting purposes, KFS understands that they are willing to listen to a sponsor's rationale and generally approve supplemental (more applicable) benchmarks.

Finally, Boards need understand that the process of classifying and thus benchmarking AIFs will undoubtedly change over time. Categories will emerge and die. Definitions will shift. Benchmarks may no longer apply as alternative asset classes are added or dropped. New strategies may precipitate the lack of true market peers. Therefore, a Board's expectations and oversight processes must also be flexible. The evolution of the AIF business segment will unavoidably spur questions such as: 1) when and how often should a benchmark change (if at all)? 2) how applicable are performance histories in the benchmarking process? 3) does a fund continue to fit the existing categories? 4) when should a Board buy into the notion of "we are truly unique" and potentially discount all performance comparisons? These are clearly not easy questions and require Trustee probing, advisor-led education, business judgment, and ultimate buy-in.

BOARD ASSESSMENT and OVERSIGHT OF AIFs

The construction, introduction, portfolio management, oversight and marketing of AIFs present many challenges for Boards not generally present in more straightforward investment company offerings. The first core question is arguably: should an advisor offer this type of fund to its clients or shareholder base? Simply because competitive complexes are offering a specific type of fund does not necessitate that everyone can or should do so. High-level expertise must be possessed or outsourced. Compliance must be rigorous. And, implicit demand as an integral part of a product line must be warranted and demonstrated. These factors may not appropriately fall into place for all sponsors. AIF products falling into the "me too" category can sometimes be insufficiently conceptualized, garner meager assets and be a drag on advisor financial wherewithal.

Given the wide leeway that can be fundamental to an AIF's strategies and hopeful success, KFS would propose that there are several core issues that should be either volunteered by a fund advisor and/or teased out by Trustees in order for Boards to satisfy themselves that an AIF or suite of AIFs is truly in everyone's joint interests. Those questions and associated issues include, but may not be limited to:

Product Management

- Has demand for AIFs been communicated and/or validated?
- How do the AIFs fit into the product line?
- Are investment objectives clear and do they resonate with the marketplace?
- Are they intended to be stand-alone or complementary products?
- Have the chosen service providers demonstrated sufficient expertise to handle the challenges of an AIF?
- Given the limited availability of some AIF genres (as benchmarks), how was pricing determined?
- What are the track records of identical or very similar offerings, if any?
- Retail and institutional offerings? If so, how do they differ?

Portfolio Management

- Are the goals sought and methods employed by the investment staff clear?
- Are the investment personnel comfortable and savvy with the investment techniques proposed to be available for portfolio construction?
- What are their experience levels and does one have proof of management ability?
- What are the market liquidity risks?
- What is the fund's benchmark? How was it determined? If multiple, why?
- How have the investment techniques employed and the specific strategies allegedly being used been validated?
- Are the compensation models of any underlying hedge funds palatable to the manager and in line with public fund regulations?
- If part of the management function is essentially outsourced, what does the Board know about the manager, past experience, their staff's abilities, compliance capacity, risk mitigation techniques and the like?
- What is the Board oversight plan of any sub-advisors?
- Does the portfolio manager compensation structure include a similar benchmark to that which is expressed to shareholders?
- Do the securities that can be used match those enlisted by competitive funds? If not, might the unavailable securities be vital to competitive success?

- Are the asset class allocations likely to be stable over time or at the *discretion* of the portfolio management team?
- How do the investment management philosophies change during times of market trauma, if at all, i.e., customize with the catalyst/event(s) or maintain positions?

Compliance

- In what ways has the advisor's compliance program been enhanced to prepare for what is likely more rigorous oversight and monitoring?
- What new compliance issues regarding valuation, trading, diversification, leverage etc. necessarily arise when managing an AIF?
- What challenges do the compliance staff foresee as AIF launches reach fruition?
- Is compliance staffing a potential issue?

Marketing

- What is the overall marketing plan for the AIFs?
- How will they be explained and rationalized to the investing public? Are they in plain English or filled with industry jargon?
- How will the AIFs be differentiated in the marketplace?
- From what angles and sources will investor education be implemented?
- How might the advisor characterize the distribution channel and intermediary support behind the AIFs?

While many of these questions apply to non-AIF offerings, the answers are clearly more complicated when applied to AIFs and should bear close examination by Boards. Trustees should be skeptical of advisors who are highly focused on capturing what they envision as "the latest big thing for investors" with tauntingly healthy flows vs. a well thought-out strategy and visions of a long-term staple in their suite of fund products. The perspective, level of opportunism, and time window matter.

In summary, perhaps the most important points KFS can make to Boards of Trustees is that they must validate that an advisor is capable of managing a complex investment company, understand the processes that are employed and have verified that documentation matches advisor actions. This is not simply a trust- or faith-base model. Deep due diligence and verification must occur to reach an irrefutable state of full information and the ability to apply business judgment adequately. As is always the case, Trustees are well-advised to heavily lean on Board counsel for perspectives, advice, and inescapable action items.

Lastly and eluded to by this discussion, Boards must feel they have received adequate education (from the funds' advisor or otherwise) in the AIF space to enable highly informed opinions and well-founded decisions on the above subjects.

EMBRACING AIFs LONG-TERM

The sad reality for fans of the most prevalent AIF objective categories early on is that their collective track records are mixed, at best. Success at attracting and keeping assets has not met sponsors' hopes and performance has not met market expectations. Many early AIF market entrants have not been met with the desired enthusiasm and results have not consistently mimicked the stated objectives. Well-heeled investors seeking the latest and most innovative portfolio diversifier can be impatient, unforgiving and fickle.

That is not to say that the more seasoned sponsors of AIFs cannot generate renewed enthusiasm over time with fine tuning, more compelling marketing campaigns, longer performance histories, and enhanced investment techniques. While some marginal sponsors not fully committed to AIFs long-term will undoubtedly fall off the grid, new entrants will come to market with new ideas and creative iterations. Providing they survived possible investor disenchantment and likely outflows, the early entrants should have a leg up on the AIF space neophytes. Experience investing in lesser-known asset classes over time is clearly invaluable to smooth returns over time and providing a palatable investor experience. Is that not the draw of AIFs? In other words, severing the tails from the total return distribution curve over time can only be demonstrated by those with time in the market.

Perhaps a bit surprising, less-than-compelling results have not dissuaded more sponsors from entering the AIF space with suites of different strategies. 2013 has been witness to <u>many</u> new offerings. This speaks to the theory that sponsors and investors alike buy into the notion that AIFs make sense to raise alternative market exposures, elevate diversification, and provide a buffer to traditional assets classes' potential price corrections. This belief, of course, relies on the premise that asset prices cannot all move in a southerly direction simultaneously. A sizable proportion of many investors' monies desire a home that is not considered risk-free. Rather than sit on the sidelines, 'big money' will find investments that are appropriate for the conditions and allow for the potential for growth. Yet, recent market studies have shown that asset class price correlations (or lack thereof) are not always stable - an asset class that was once a diversifier may no longer be effective. Shifting levels of asset class diversification necessitate a flexible investment model.

A core and concerning issue today is the fact that we have not been through an economic/market period akin to the "Great Recession" (2008/9) that would test the true resilience of the newly offered AIFs. Those few AIFs in existence in 2008 did not generally fare as expected (and may have soured investor attitudes to the chagrin of subsequent sponsors) and newer offerings have not been tested under severed market duress. However, it is fair to say that legislative and regulatory actions since the market contagion have significantly mitigated the chances of a repeat scenario ... at least we hope that is the case!?

In line with the apparent zeal for AIFs, this author believes that some portfolio dedication to AIFs makes ultimate sense for most investors long-term and as part of a well-diversified financial plan. Most investors should <u>not</u> cling to the notion that a traditional 'long' portfolio with stocks, bonds, and cash equivalents will provide the desired risk/return profile when a portfolio can have a broader asset class reach and the potential for less-volatile growth - albeit likely buffered - with AIFs. I make this statement with the qualifier that investors must be <u>fully informed</u> of the limitations of AIF investments, their possible pitfalls, their intended uses, and their somewhat limited role in a portfolio.

CONCLUDING REMARKS

Referring back to this white paper's sub-title: Are AIFs destined to, or should they, be a staple in every fund family? Yes and no. Fund families with the resources to manage the investing and compliance complexities of AIFs should arguably consider entering the space. This advice would preclude some complexes. In addition to portfolio management and market information resource issues, success in the AIF market must include a comprehensive plan for how and under what conditions AIFs should be utilized and clearly relayed to prospective investors in plain English. With any new investment genre, well thought-out, comprehensive education is vital for setting expectations and thus what is referred to a 'asset stickiness.' Not all complexes may be suited to the rigors of AIFs or embrace, to the extent necessary, the resources required to fully support an AIF offering. Boards must arguably determine the level of advisor commitment and likely longevity.

KFS feels compelled to conclude this discussion with a few comments about the moniker currently, but regrettably, carried by AIFs: alternative investments. Personally, we feel that the name is inadequate, misleading, and less than investor-friendly. [This view is akin to this author's dislike of the term "hedge fund" to label many divergent strategies.] What are the investments alternative to? The name seems to indicate that most mainstream investors are very similar with alternative investors daring to not be another pitiful sheep following the herd. And, if AIFs are complementary from an investment perspective, then they're not truly alternative, but supplemental.

Based on the definition of alternative investments embraced and/or put forth by many professionals in the funds business, it may seem more reasonable to some business participants to consider the following *alternative* (!) labels for AIFs (or some preferred combination of the below):

- ✓ Complementary asset class funds
- ✓ Strategic multi-asset funds
- ✓ Non-traditional asset funds
- ✓ Uncorrelated asset class funds
- ✓ Niche asset funds

Something to think about as the term AIF has not yet been pinned down.

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