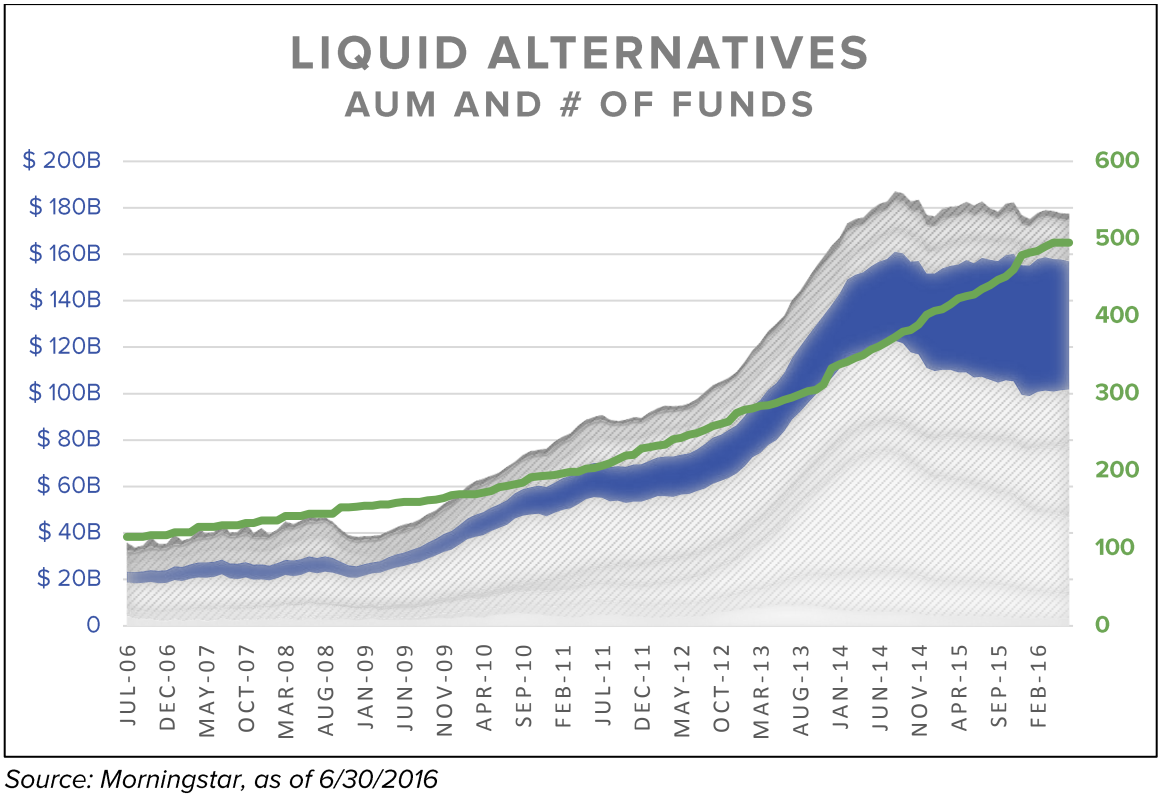
THE RISE (AND RUSE) OF MULTIALTERNATIVE MUTUAL FUNDS

Over the last 10 years, the liquid alternative space has grown five-fold from approximately $36B in June, 2006 to around $180B as of June, 2016. There was good reason for that growth: Many investors have been distrusting of the equity markets because of the significant pain they felt, first in the tech wreck, then during the financial crisis in 2008.

Because many alternative strategies fared better than equity markets or offered non-correlated return streams, investors rushed into these "liquid alt" funds… and product providers tried to keep up with investor demand. The chart below depicts AUM in the various liquid alt categories alongside a green line representing the number of funds in the liquid alt space (source: Morningstar).

Multialternative mutual fund assets have grown by 275% over the last five years

Morningstar Alternative Categories: July 2006 – June 2016



Source: Morningstar, as of 6/30/2016

The blue shaded area above represents Morningstar's "Multialternative" category: While it is the largest category today, it is probably fair to characterize it as misunderstood, misallocated and bereft of any desirable return stream… so why has it grown in assets so quickly?

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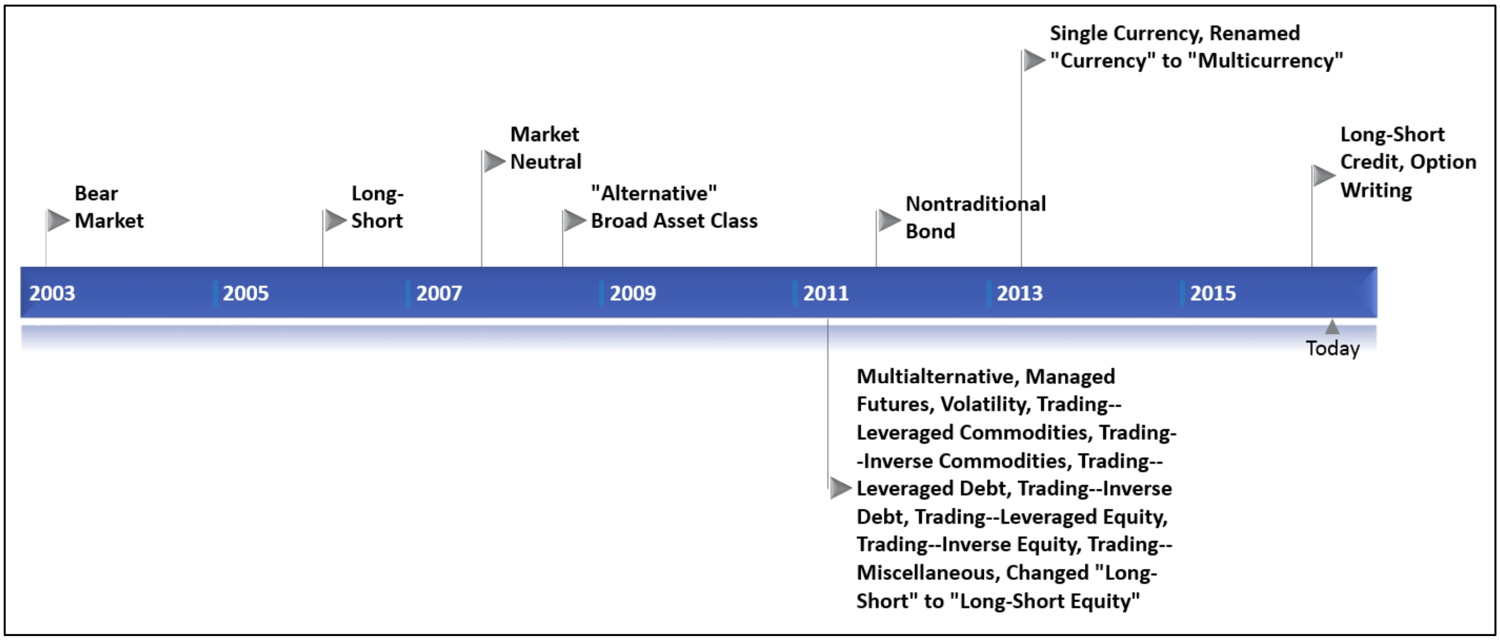
| DINING AT THE ALTS BUFFET

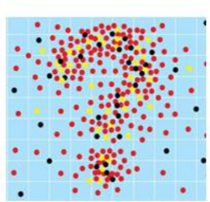
The growth in the Multialternative category is somewhat logical on the surface: Investment advisors want alternative mutual funds to provide diversification away from stocks and bonds but *navigating the liquid alternatives space is fraught with challenges*... A ballooning buffet of à la carte single-strategy choices has rendered the multi-strategy solution more appetizing than creating your own plate from the cluster of cuisine, the potpourri of provisions, the rookery of cookery. We've put together a timeline of the Morningstar universe to show how the menu items have been shuffled and rebranded throughout the years:

A Brief History of the Morningstar Alternative Category Creation



Source: Morningstar

Now if investors weren't paying attention carefully to the space they might be left wondering what belongs on their plate. As we see it, there are four major challenges in allocating to alternative strategies:



Dispersion

Education

Regulation

Time

We wrote about dispersion earlier this year (see AlphaCore Insights – Dispersion in Alternative Strategies and 2Q 2016 AlphaCore Quarterly Commentary)—in essence, the mis-categorization of funds has led to misallocation from investors because "top

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performers" and "bottom performers" might just be pitted against the wrong peer group. As a result, it takes significant time to learn about the individual managers and re-categorize the universe. If that wasn't enough, regulators are making investors' lives more challenging by introducing regulation that in our opinion has historically been backwards-looking rather than forward-thinking.

At AlphaCore, we have created our own internal categories to try and mitigate dispersion. We believe stronger categories makes for more effective quantitative analysis.

It's no wonder multialternative funds have burgeoned and bubbled these past five years! Investors have been pushed that way by our industry... "just leave it to the experts." But in our opinion the "experts" have not been delivering.

| FOR BETA OR FOR WORSE

To borrow yet another tasty cliché, there are three veritable strikes against the multialternative category:

1) High correlation to stocks
2) Low levels of volatility
3) One size fits all

Most multialternative funds provide *significant amounts of* stock market exposure—exactly the exposure investors buying them were hoping to mitigate. Here are 12 of the largest multialternative funds that have track records of 3 years or longer, representing over 50% of all assets in the multi-alternative category. The chart below shows their correlation to the S&P (the bottom row):

Correlation Matrix, Multialternative Funds

If a fund has a correlation to the S&P of over 0.7 and equity markets crumble, all an investor gets with a lower beta is a slower train wreck.

Correlation Matrix

Time Period: 7/1/2013 to 6/30/2016

		1	2	3	4	5	6	7	8	9	10	11	12	13
1	Multialts Fund 1	1.00												
2	Multialts Fund 2	0.59	1.00											
3	Multialts Fund 3	0.20	0.28	1.00										
4	Multialts Fund 4	0.55	0.83	0.18	1.00									
5	Multialts Fund 5	0.74	0.76	0.30	0.84	1.00								
6	Multialts Fund 6	0.53	0.56	-0.02	0.65	0.64	1.00							
7	Multialts Fund 7	0.60	0.78	0.04	0.88	0.82	0.72	1.00						
8	Multialts Fund 8	0.64	0.69	0.19	0.68	0.66	0.32	0.53	1.00					
9	Multialts Fund 9	0.55	0.70	-0.18	0.82	0.64	0.69	0.83	0.53	1.00				
10	Multialts Fund 10	0.57	0.99	0.24	0.85	0.76	0.58	0.80	0.69	0.75	1.00			
11	Multialts Fund 11	0.53	0.77	-0.07	0.94	0.80	0.71	0.91	0.59	0.86	0.79	1.00		
12	Multialts Fund 12	0.41	0.69	-0.04	0.87	0.72	0.68	0.88	0.51	0.80	0.72	0.91	1.00	
13	S&P 500 TR USD	0.49	0.70	-0.06	0.81	0.67	0.65	0.86	0.54	0.83	0.74	0.84	0.94	1.00

Source: AlphaCore Capital, Morningstar, as of 6/30/2016

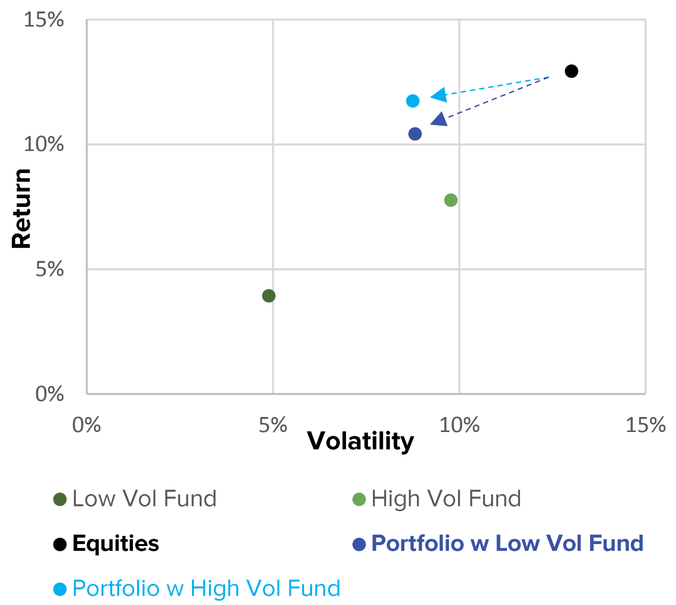
Save one colorful fund, the **largest funds with three year-track records have an average correlation to the S&P 500 of over 0.70**—hardly anything deserving of an alternative gold medal.

A fund with a low level of volatility does not help a portfolio if the portfolio has stuff in it that contains high volatility (i.e. stocks). Low volatility is, in this author's opinion, the biggest ruse of them all! Low volatility does one thing: It reduces beta. But it does not reduce correlation, which means if a fund has a correlation to the S&P of over 0.7 and equity markets crumble, all an investor gets with a lower beta is a slower train wreck.

| DRAWING BACK THE CURTAIN

Here is a hypothetical illustrative example of two funds, both with the same correlation to the S&P 500 (-0.23). One fund ("Low Vol Fund") has a volatility of slightly less than 5; the other ("High Vol Fund") is a 2x version with the exact same return stream and twice the volatility. The Low Vol Fund has a slightly higher Sharpe ratio due to compounding. When we allocate 30% of either fund to a hypothetical equities portfolio... voila! Perhaps counterintuitively, ***the portfolio with the High Vol Fund has a lower volatility than the portfolio with the Low Vol Fund***... with higher returns to boot.

Hypothetical Example: Adding a Liquid Alts Fund to an Equities Portfolio



Investment	Return	Volatility	Sharpe
Low Vol Fund	3.93%	4.89%	0.81
High Vol Fund	7.76%	9.77%	0.79
Equities	12.93%	13.02%	0.99
Portfolio w Low Vol Fund	**10.42%**	**8.81%**	**1.18**
Portfolio w High Vol Fund	**11.74%**	**8.75%**	**1.34**

For illustrative purpose only. The results are not reflective of actual investment results. There is no guarantee of future performance. Source: AlphaCore Capital, Bloomberg, as of 6/30/2016.

The portfolio with the High Vol Fund actually experiences lower volatility than its peer, higher returns and a higher Sharpe ratio. Can't argue with mathematics: "Low vol" isn't necessarily better.

Finally, the one-size-fits-all approach many of these product providers encourage by offering multi-strategy funds misses the mark in a major way: Just like the equity allocation for a conservative investor will likely look different from the equity allocation of an aggressive investor, so should the alternatives allocation differ for aggressive and conservative investors. We believe this approach to alternatives allocation will soon become best practice and are **pleased to offer multiple multi-strategy alternative solutions for our investors designed to complement the rest of their portfolio.**

Simply put, the alts strategies should talk to the rest of the portfolio.

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*A higher volatility "alts" fund can potentially decrease a portfolio's volatility **more than** a lower volatility "alts" fund, if those alts funds have low enough correlation to the rest of the portfolio.*

| THREE STRIKES = YOU'RE OUT

While the multialternative category might currently be the largest category in terms of assets, it has also experienced some very difficult fund turnover so far this year. 19 out of the 31 liquid alternative fund closures this year have been in the multialternative category[1]... we aren't surprised by this fund turnover at all—investors and product providers alike are still trying to figure out what kinds of strategies will serve investors best.

| A BETTER WAY: WHO IS ALPHACORE?

AlphaCore is one of the first firms to help advisors incorporate diversified liquid alternatives tailor-made to their traditional stock and bond allocations.

We believe an effective alternatives allocation can be built using single strategy funds rather than multi-strategy alternative funds... and the end result can be a lowly-correlated diversified pool of managers with enough volatility to counteract the equity and fixed income volatility present in many investors' portfolios.

Having watched the alternatives landscape evolve, we have seen what works and what doesn't. We offer sub advisory services specializing in alternative strategies and provide:

- Customized alternative strategy portfolios matched to your clients' risk profiles
- Full transparency via managed account solutions
- Research, education and commentary centered on the liquid alternatives universe
- Trusted source for unbiased allocations to best-of-breed managers of alternative strategies
- Ongoing monitoring, rebalancing, and strategic allocation decisions

We can be reached at info@alphacorecap.com.

[1] Source: Investment News, "Liquid Alt Imposters Fall to the Wayside", July 25, 2016

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