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Boutique money managers lead way with alternatives

Big firms play catch-up to specialized firms in getting investor attention

By Jason Kephart

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When the average investor looks at the biggest alternatives mutual funds, the fund world's most familiar names probably won't show up.

Unlike traditional asset classes, which tend to be dominated by funds from giant money managers, the new and fast-growing world of funds that invest in alternative strategies has opened opportunities for smaller, less well-known firms. So even though they are not household names, firms like Hussman Funds, AQR Capital Management LLC and Altegris Investments Inc. have been able to gain traction.

Because alternatives funds were largely unknown before the financial crash of 2008, a well-known name doesn't carry the same weight as it would with a traditional asset-class investment, said Chad Carlson, wealth manager at Balasa Dinverno Foltz LLC, which manages about $1.9 billion.

“It's a lot easier for alternatives funds to get on our radar than something like a large-cap-growth fund,” he said, noting that it would take something truly unusual for such a fund to attract attention. While Cogent Research LLC has found that the top 10 mutual fund firms account for about 80% of all fund assets, a recent survey by the firm found that advisers are much more open to new firms when it comes to alternatives.

“We got almost 300 different firm names in response to a question asking which alternatives funds advisers are looking at. It shows that advisers are willing to look for specialty managers with a good investment process when it comes to alternatives,” said Antonio Ferreira, a managing director at Cogent.

Boutique managers hold one advantage over traditional managers in the alternatives area: the ability to attract hedge fund managers looking to add a retail-oriented business.

“A lot of hedge fund managers may be more comfortable with a boutique firm or already have one of their own,” said Mallory Horejs, an alternatives analyst at Morningstar Inc.

Since 2008, hedge fund managers have shown increased interest in adding retail assets, which tend to be more stable than institutional flows, she said.

In alternatives investing, Ms. Horejs said it's especially important for a fund to have managers with extensive alternatives experience running the portfolio because of the complex nature of the strategies used. Shorting, for example, takes different skills than picking stocks to invest in for the long run, she said.

Attracting hedge fund managers to run alternative mutual funds has paid off for some boutique firms, including Absolute Investment Advisers LLC. The firm's Absolute Strategies Fund (ASFAX), where eight of the 10 subadvisers run hedge funds, returned 2.2% for 2011, through Dec. 27, which is more than 4 percentage points better than the average multialternatives fund, according to Morningstar.

A manager's track record is the most important criterion when Steve Dimitriou considers an alternatives fund.

“We're not just looking to compare performance, we want to see how it performs in different market cycles,” said Mr. Dimitriou, a managing partner at Mayflower Advisors LLC. “As the smaller firms develop track records, they're going to get more interesting and perhaps deliver better returns.”

Fund expenses may be a problem for smaller firms, however, as they must be borne by a relatively smaller asset base. While the average alternatives fund charges 1.84%, the $1 billion Altegris Managed Futures Fund (MFTAX), for example, charges 3.84%.

Jon Sundt, president and chief executive of Altegris, said the higher cost reflects the company's recruiting philosophy.

“We would love to find managers that charge less with the same expertise, but if you want talent, you're going to have to pay for it,” he said.

Cost is a concern for Mr. Dimitriou, particularly when it comes to alternatives, because of their defensive nature. He's worried about clients' seeing an expensive fund with a low or negative return in a portfolio when the broad market is going up.

“Managing client expectations is a constant battle,” Mr. Dimitriou said.

Larger firms want in on the action in alternatives funds, which saw $12 billion in inflows and added assets second only to taxable-bond funds last year.

BlackRock Inc. launched its first alternatives retail funds in October, while firms such as Janus Capital Group Inc. and OppenheimerFunds Inc. have made hires to head up their alternatives businesses. “Slowly but surely, a lot of investors are starting to give credence to alternatives as stand-alone options, that's going to lead to a lot of big firms' rolling out more products in 2012,” said Kamal Bhatia, senior vice president and product director for Oppenheimer's alternative-investments and fixed-income teams.

As of Dec. 23, AllianceBernstein LP and American Century Investments had the top-performing market-neutral funds last year, with returns of 7% and 6%, respectively, though neither the AllianceBernstein Market Neutral Strategy U.S. Fund (AMUAX) nor the American Century Equity Market Neutral Fund (ALIAX) managed to crack $75 million in assets.

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