Investment Guidance on Alternative Investment Mutual Funds

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What are Alternative Mutual Funds?

Generally, alternative investment mutual funds or liquid alternative mutual funds are described as open-end registered investment companies that seek to achieve their objectives through investments in non-traditional investments or asset classes. Alternative mutual funds encompass a wide range of investments with each containing its own set of systematic and unsystematic risks. As their name implies, alternative mutual funds seek to accomplish various investment objectives through non-traditional investments and trading strategies. Alternative mutual funds can invest in asset classes such as global real estate, commodities and leveraged loans. They may also invest in start-up companies and unlisted securities that offer exposure beyond traditional stocks, bonds and cash.

Some alternative funds also implement more complex trading strategies, hedging and leveraging positions through derivatives, short selling and "opportunistic" strategies that change with market conditions as various opportunities present themselves. Some funds employ a ‘single strategy’ offering full exposure to one investment type, for example currencies or distressed bonds, market-neutral or "absolute return" strategies using long and short positions in stocks to generate returns. Other mutual funds may employ a ‘multi-strategy’ approach, combining market-neutral strategies and various arbitrage strategies. Still others are structured as a mutual fund of hedge funds with higher fees and expenses.

The primary objectives of these funds can be quite different. Some attempt to generate above-market returns and others attempt to help investors better manage risk with strategies designed to smooth out volatility or offer greater diversification.

Alternative Mutual Funds are not Hedge Funds

Although the strategies and investments used in alternative mutual funds may be similar to hedge funds, the two should *not* be confused. Alternative mutual funds are regulated under the Investment Company Act of 1940, which limits their operations in ways that do not apply to unregistered hedge funds. These protections include:

- limits on illiquid investments;
- limits on leveraging;
- diversification requirements, including limits on how much may be invested in any one issuer;
- daily pricing and redeemability of fund shares;
- investment advisers to mutual funds are not permitted to charge a performance fee (typically referred to as a “2/20 fee”, equaling 2 percent of the fund's assets, plus 20 percent of gains).

Alternative Funds have Unique Risks

Like any investment, alternative mutual funds have their pros and cons. Before you invest in an alternative fund, here are some points to keep in mind:

- **Investment Structure**
  Be advised that an alternative ‘fund of funds’ structure may offer greater diversification than a single-strategy or even multi-strategy alternative fund. At the same time, this greater diversification may lead

to reduced returns or less transparency. There may also be an inability to re-allocate or adapt in a way that is beneficial to the overall performance of a particular fund of funds.

- **Strategy Risk Factors**
  In addition to the usual market and investment specific risks a typical mutual fund has, alternative mutual funds can carry unique risks. For example, market-neutral funds tend to have significant portfolio turnover risk that can result in higher costs. Similarly, a distressed bond fund is likely to have significant credit risk.

- **Investment Objectives**
  Alternative mutual funds have a wide range of investment goals. Be sure to understand your selected fund’s objectives. One fund might be designed to capitalize on management expertise in a specific area, for example, distressed companies. Another might seek to provide what the fund's managers believe to be more complete diversification through exposure to commodities, currencies and other alternative investments.

- **Operating Expenses**
  Alternative mutual funds can be pricey relative to their traditional managed fund peers. It is common for alternative mutual funds to have annual operating expenses well above industry averages for traditional equity funds.

- **Fund Manager**
  Learn as much as you can about the fund manager, such as how long he or she has managed the fund and any additional fund management or professional experience. A fund manager’s professional background can be found using FINRA BrokerCheck®, which is accessible at: http://www.finra.org/Investors/ToolsCalculators/BrokerCheck.

- **Performance History**
  Some alternative funds may have limited performance histories, so it may not be predictable as to how they will react or perform in a down market. They may underperform broad indexes such as the S&P 500—particularly after considering expenses and like all investments, performance will fluctuate.

In conclusion, Financial Advisors and their clients should take caution and weigh all of the unique risks associated with an investment in alternative mutual funds. If it is determined that certain strategies are suitable, take care to use them in a prudent manner and within a properly diversified asset allocation strategy. If you have any questions regarding Alternative Mutual Funds, please contact your Oppenheimer Financial Advisor.

Investing in securities is speculative and entails risk. There can be no assurance that the investment objectives will be achieved or that an investment strategy will be successful. Investors must carefully consider an investment company's investment objectives, risks, charges and expenses of the investment before investing. This and other information, including a description of the different share classes and their different fee structures, are contained in a fund's prospectus. You may obtain a prospectus from your Oppenheimer Financial Advisor. Please read the prospectus carefully before investing.

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