New Frontiers:
Due Diligence Implications for Liquid Alternatives

James J. Tavares, AIF®
Vice President, Retirement Strategies
Natixis Global Asset Management

Natixis Overview

Active Investment Advisors® Index-based Solutions [1]

Expertise: Index-based solutions
Founded: 2002
Headquarters: Oakland, CA
AUM: $571 M/€417 M

GATEWAY Investment Advisers, LLC

Expertise: Hedged equity strategies
Founded: 1977
Headquarters: Cincinnati, OH
AUM: $12.8 B/€9.3 B

PRIVATE EQUITY DIVISION [2]

Expertise: Private equity
Founded: 2014
AUM: $7.0 B/€5.1 B

AEW

Expertise: Real estate investments
Founded: 1981
Headquarters: Boston, MA
AUM: $18.5 B/€13.5 B

Harris Associates L.P.

Expertise: Value investments
Founded: 1976
Headquarters: Chicago, IL
AUM: $133.3 B/€97.4 B

REICH & TANG

Expertise: Money market mutual funds, FDIC deposit programs & cash management services
Founded: 1970
Headquarters: New York, NY
AUM: $16.7 B/€12.2 B

AlphaSimplex

Expertise: Alternative investment strategies
Founded: 1999
Headquarters: Cambridge, MA
AUM: $4.9 B/€3.6 B

Loomis | Sayles

Expertise: Actively managed, research-driven equity and fixed-income portfolios
Founded: 1926
Headquarters: Boston, MA
AUM: $216.6 B/€158.2 B

SEEYOND investing beyond beta [3]

Expertise: Active management
Founded: 2012
Headquarters: Paris, France

AURORA Investment Management

Expertise: Alternative investment management
Founded: 1988
Headquarters: Chicago, IL.
AUM: $9.1 B/€6.6 B

MPA | Managed Portfolio Advisors® [1]

Expertise: Overlay management
Founded: 2005
Headquarters: Oakland, CA
AUM: $13.8 B/€10.1 B

SNYDER Capital Management, L.P.

Expertise: U.S. small, small/mid-cap and concentrated all-cap value investments
Founded: 1984
Headquarters: San Francisco, CA
AUM: $2.3 B/€1.7 B

Capital Growth Management

Expertise: Concentrated equity portfolios
Founded: 1990
Headquarters: Boston, MA
AUM: $3.8 B/€2.8 B

McDonnell Investment Management, LLC

Expertise: Fixed-income specialist managing taxable & tax-exempt bond portfolios
Founded: 2001 – leadership since 1987
Headquarters: Oak Brook, IL
AUM: $12.0 B/€8.7 B

Vaughan Nelson Investment Management

Expertise: U.S. equity investments
Founded: 1970
Headquarters: Houston, TX
AUM: $9.8 B/€7.2 B

[1] Division of NGAM Advisors, L.P.
[2] Comprising six distinct private equity companies. Not all offerings available in all jurisdictions.
[3] Operated in the U.S. through Natixis Asset Management U.S., LLC.

Excellence across asset classes

NATIXIS GLOBAL ASSET MANAGEMENT **#1**

In ***Barron's/Lipper Fund Family*** Ranking

Category Ranking

#1 U.S. Equity

#2 World Equity

#2 Mixed Asset

#1 Taxable Bond

Barron's/Lipper 2013 one-year ranking is based on 64 qualifying U.S. fund companies. Award recipient must have at least three funds in Lipper's general U.S.-stock category (including at least one world and one mixed-asset/balanced), two taxable bond and one tax-exempt bond fund. Natixis was not ranked for the 5- and 10- year periods. Past performance is no guarantee of future results. For more details visit ngam.natixis.com/TopFundFamily2013.

Agenda

- Natixis Overview
- Durable Portfolio Construction®
- The Case for Alternatives
- Due Diligence Implications
- Adoption within Defined Contribution
- Q&A

Durable Portfolio Construction®

5 Principles of Durable Portfolio Construction

- **Put Risk First**
  - Risk as an input, not a byproduct
- **Enhance Diversification**
  - Consider a wider range of global opportunities
- **Implement Alternatives**
  - Utilizing a broader set of portfolio tools

More tools in your toolbox

- **Smarter Use of Traditional Assets**
  - Efficient ways to capitalize on the potential of stocks & bonds
- **Consistency of Process**
  - Systematic implementation of portfolios and business practices

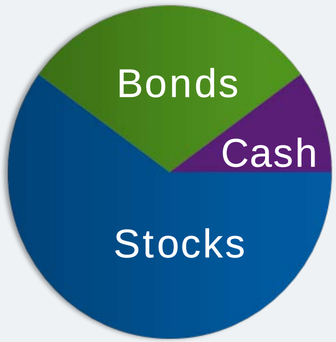
NGAM Liquid Alternatives

Fund	Category / Strategy	AUM* ($millions)
Gateway Fund	**Long / Short Equity** *Hedged equity, low volatility option strategy*	$8,152
Gateway International Fund	**Long / Short Equity** *Hedged equity, low volatility option strategy*	$20
ASG Global Alternatives Fund	**Multi-Alternative** *Hedge fund consensus model*	$2,869
ASG Managed Futures Fund	**Managed Futures** *Multi-horizon trend following*	$1,168
ASG Tactical U.S. Markets Fund	**Long / Short Equity** *Equity/cash tactical allocation strategy*	$48
Aurora Horizons Fund	**Multi-Alternative** *Multi-manager alternatives strategy*	$197
Loomis Sayles Strategic Alpha Fund	**Non-Traditional Bond** *Long/short opportunistic bond strategy*	$1,257
Seeyond Multi-Asset Allocation Fund	**Multi-Alternative** *Dynamic GAA with volatility as an asset*	$49

* As of 8/15/14

NATIXIS GLOBAL ASSOCIATES

The investment case for alternatives



Stocks: **Structural volatility**
Bonds: **Interest rate risk**
Cash: **Yields approx. 0 %**

Alts?

A good alternative strategy should offer...

- Potentially **attractive levels** of return
- **Moderate** levels of risk

Better risk-adjusted returns

- Historically **lower correlation** to other assets
- Exposure to **new** or **different** sources of return

More efficient portfolios

Alternatives may be key to building more durable portfolios

Alternative investments involve unique risks that may be different from those associated with traditional investments, including illiquidity and the potential for amplified losses or gains. Investors should fully understand the risks associated with any investment prior to investing.

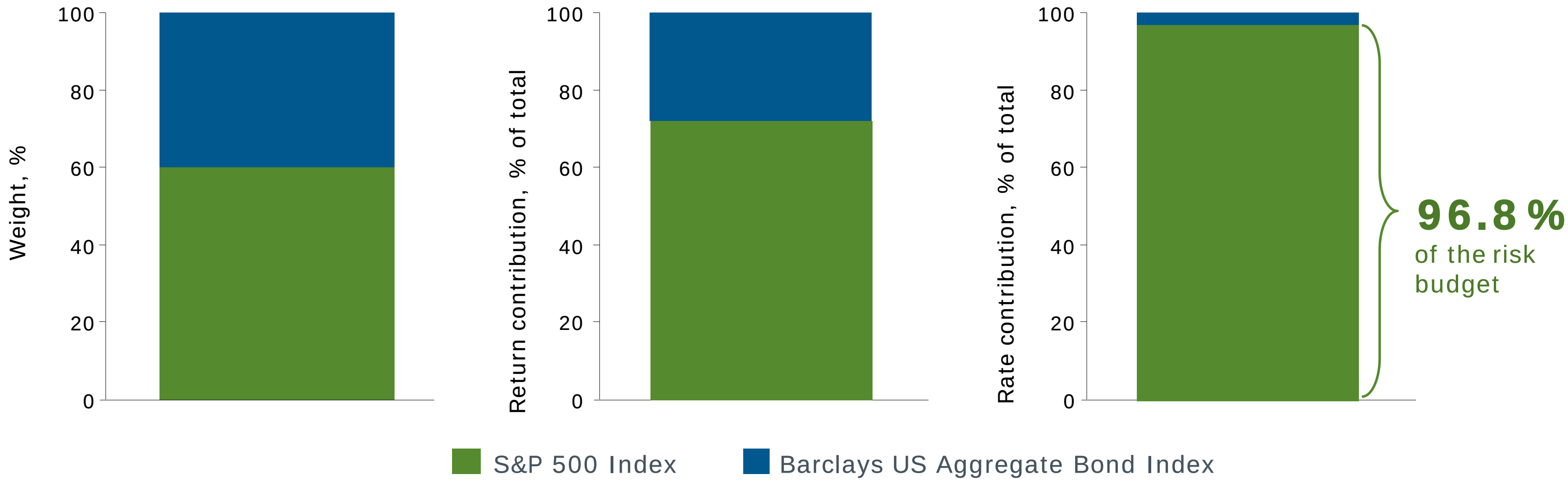
Stocks: The dominant source of portfolio risk

For Illustrative Purposes Only

Traditional allocation
Weights fixed

Contribution to portfolio return
Jan 1994 – Dec 2013

Contribution to portfolio risk (%)
Jan 1994 – Dec 2013



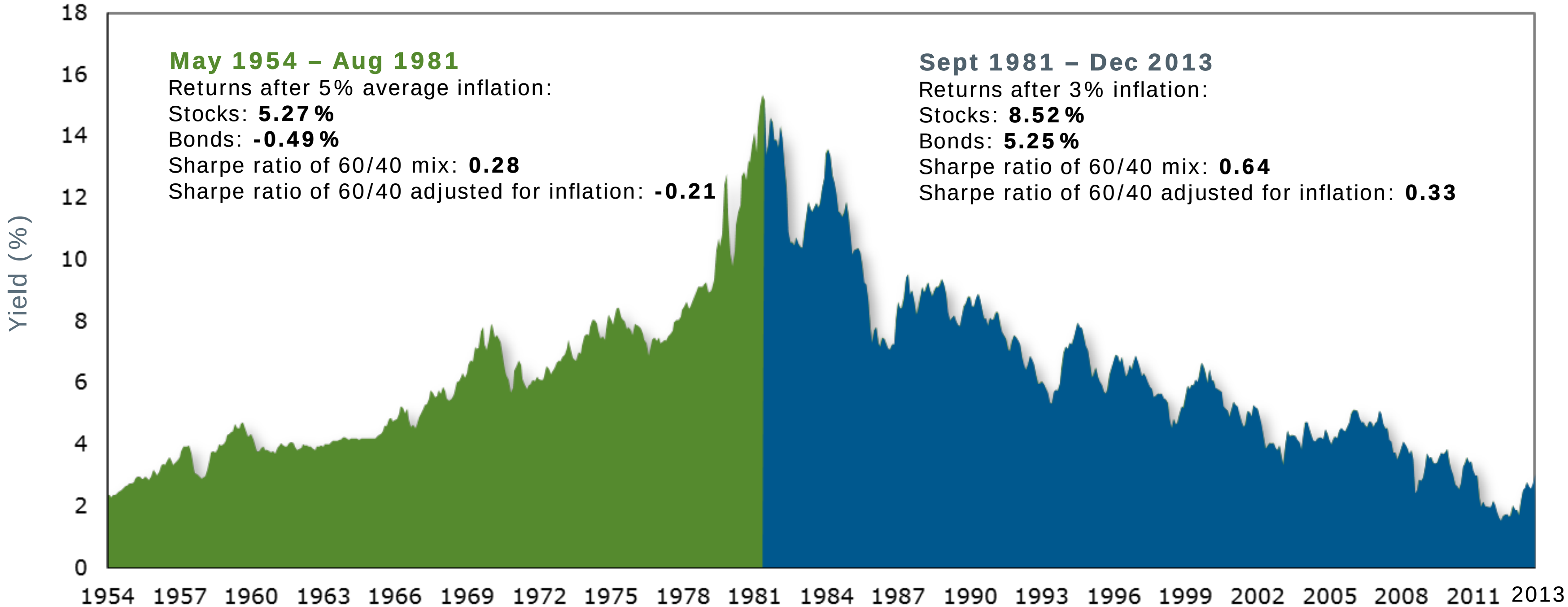
	Portfolio weight %	Ann Return % as of 12/31/13	Ann Risk (vol) % as of 12/31/13
60/40% Portfolio	-	8.1	9.3
S&P 500® Index	60	71.8	96.8
BC Aggregate Bond	40	28.2	3.2

Past performance is no guarantee of future results. Performance reflects the reinvestment of capital gains and dividends, if any. Indices are unmanaged and do not incur fees. It is not possible to invest in an index. Source: MPI Stylus

NATIXIS GLOBAL ASSET MANAGEMENT

A headwind coming for traditional assets?

Historical yield of 10-year U.S. Treasury*



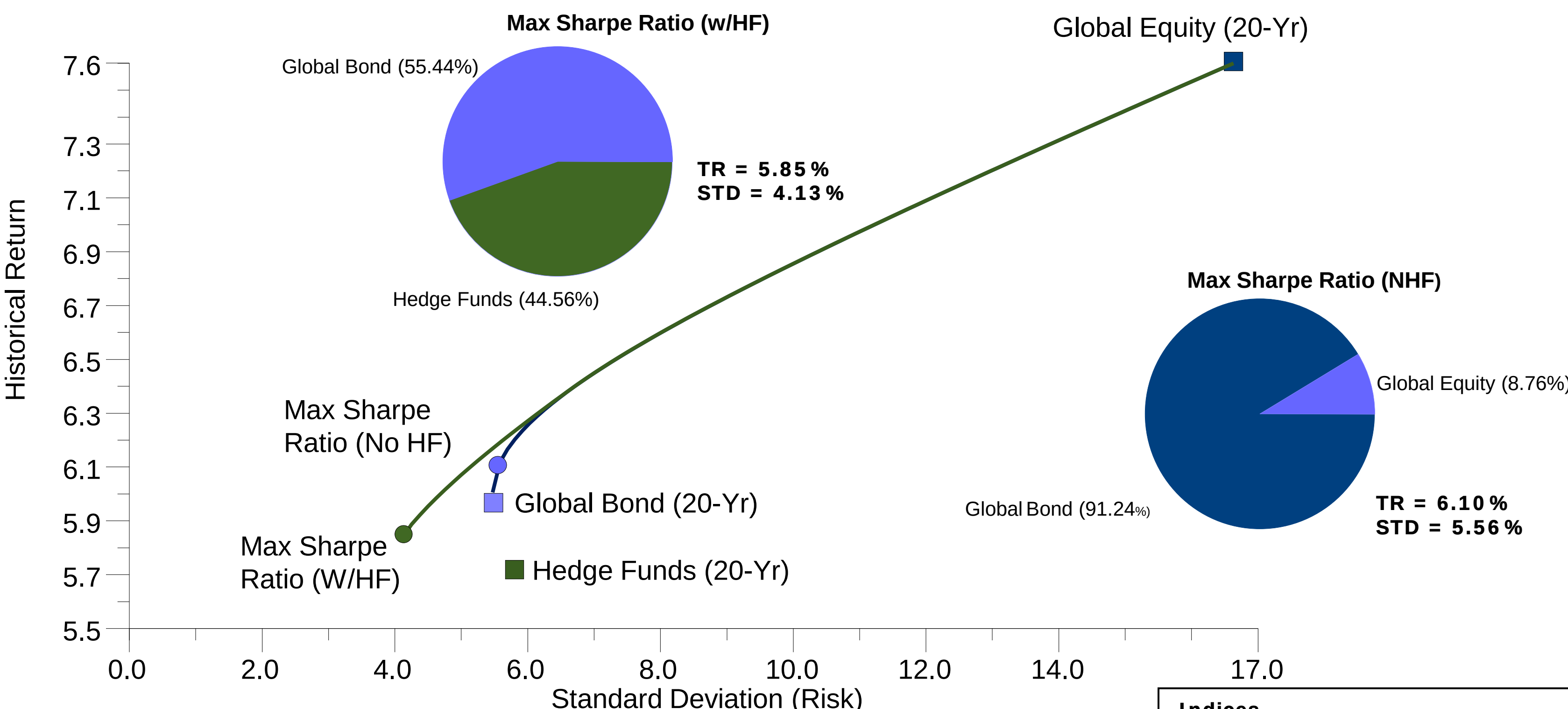
Declining interest rate environment over the past 30 years has helped bolster stocks and bonds. A reversal of interest rate trend may have a negative impact on traditional assets.

*U.S. Treasury Yield serves as a proxy for interest rate movements.

Past performance is no guarantee of future results. Returns reflect reinvestment of capital gains and dividends, if any. Indices are unmanaged and do not incur fees. It is not possible to invest in an index. Stocks are represented by the S&P 500® Index. Bonds are represented by the Ibbotson U.S. Intermediate-Term Government Bond Index. Source: Federal Reserve Bank of St. Louis; Bloomberg L.P.; Natixis Global Asset Management Investment Strategies Group.

The Asset Allocation Case for Alternatives

Optimization including Hedge Funds 20 years ago may have skipped equities altogether



Data from July 1994 – June 2014. T-Bill rate for Sharpe Ratio = 2.85%
Source: Morningstar Encorr; ISG.

Indices
Global Equity = MSCI All Country World
Global Bond = Barclays Global Aggregate
Hedge Fund = HFRI Fund of Funds

NATIXIS GLOBAL ASSET MANAGEMENT

What qualifies as an "alternative"?

- Alternatives: A term of questionable merit

- What isn't an "alternative"?
  - Long-only investments in stocks, bond, and cash?
  - What is an alternative? - Everything else???

- Alternative Strategies: Common traits
  - Unique asset class exposure such as currency & commodity?
  - Use of shorting or hedging?
  - Use of derivatives?
  - Greater or less than full market exposure?
  - Narrow or niche focus?
  - Broader investment flexibility; "go anywhere"?
  - Leverage?
  - Arbitrage?
  - Illiquidity?

- Hedge Funds
  - The term "hedge fund" refers to a legal structure, typically a privately offered investment (i.e., LLC or LP), ***not*** a strategy or asset class

Regulatory Focus

- Due to their complexity, alternative investments require a deeper understanding
- Strong demand for alternatives comes with additional responsibilities
  - ICI, "The Differences Between Mutual Funds and Hedge Funds", April 2007
  - SEC actions
    - SEC Investor Bulletin on Hedge Funds, February 2013
    - SEC Sweep Examination of Alternative Mutual Funds, Fall 2014
  - FINRA Investor Alerts
    - "Fund of Hedge Funds – Higher Costs and Risks for Higher Potential Returns", October 2008
    - "Alternative Funds Are Not Your Typical Mutual Funds", June 2013

Key Areas of Concern

- *Complexity and the use of derivatives*
- *Risk & volatility*
- *Leverage*
- *Fees, expenses, & cost*
- *Liquidity*
- *Regulatory oversight*
- *Taxation*

Risk – The Disconnect

	5 Years ending 6/30/14				
Morningstar Category	**Volatility (STD)**	**Volatility as a % of S&P 500**	**Beta vs. S&P 500**	**Max Drawdown**	**Correlation vs. S&P 500**
Long/Short Equity	9.38%	70%	0.55	-13.22%	0.77
Multi-Currency	7.17%	54%	0.29	-10.95%	0.53
Multi-Alternative	6.65%	50%	0.34	-10.84	0.67
Managed Futures	7.41%	55%	0.05	-16.02%	0.13
Market Neutral	4.16%	31%	0.09	-8.14%	0.27
Commodities Broad Basket	15.28%	114%	0.75	-28.75%	0.65
S&P 500	**13.40%**	**100%**	**1.00**	**-16.26%**	**1.00**

Source: Morningstar, ISG

*Excluding commodities, most alternative categories exhibit **LESS RISK** than the broad equity market in both individual (STD, beta, and drawdown) and portfolio (correlation) terms.*

Past performance is no guarantee of future results.

Leverage

- **How does leverage impact the risk & return characteristics of the strategy?**

- **Sources of leverage**
  - Borrowed funds (e.g., Line of Credit) => Who are you borrowing from?
  - Derivatives: Notional exposures > Net assets
  - Short exposure (see next slide)
  - The *source of leverage has significant impact* on operations, risk exposures, return profile, cost, etc.
  - What is the best way to *measure and monitor* the risks & exposures associated with leverage?

- **Use of leverage**
  - Gaining exposure: Potential for upside participation
  - Hedging exposure: Potential to reduce downside/losses
  - Systematic or opportunistic?

NATIXIS GLOBAL ASSOCIATES

Derivatives

- **Common derivatives**
  - Futures contracts
  - Forward contracts
  - Options (calls & puts, index-based or on individual securities)
  - Credit Default Swaps (CDS & CDX)
  - Interest rate swaps and/or swaptions
- **Derivatives can be used to …**
  - Mitigate exposure (hedging)
  - Increase exposure
  - Create a more complete expression of research effort
  - Create arbitrage opportunity (exploit basis risk, mispricing)
  - Increase liquidity (Many derivative contracts are far more liquid than their underlying reference asset).
- **Exchange-traded or over-the-counter**
  - Over-the-counter: Explicit counterparty risk, customizable, may be less liquid
  - Exchange-Traded: Limited counterparty risk (the exchange is the counterparty), standardized terms, may be more liquid
- **How do you measure & monitor risk?**
  - Notional exposure => Implications for leverage?
  - Gain/Loss (net assets)
  - Other (VaR, beta, delta, vega, etc.)

Derivatives are like fire.
Helpful when used appropriately, dangerous when used incorrectly.

- **Operational Issues**
  - Does the fund have enough liquid assets to cover its derivative obligations?
  - Collateral & asset segregation
  - Taxes and compliance? e.g., Commodity SIVs/SPVs/blocker funds

Measuring Risk

Fund A	Assets	Exposure
S&P Stocks (basket)	$500,000	$500,000
S&P 500 Futures	-- (G/L)	$500,000
Cash	$500,000	--
Total	**$1,000,000**	**$1,000,000**
% Equity	**50%**	**100%**

Fund A (up 10%)	Assets	Exposure
S&P Stocks (basket)	$550,000	$550,000
S&P 500 Futures	$50,000 (G/L)	$550,000
Cash	$500,000	--
Total	**$1,100,000**	**$1,100,000**
% Equity	**55%**	**100%**

For illustrative purposes only

- **Unlike traditional, long-only exposure, asset values may be a misleading guide to risk**
- **Notional contract or derivative exposure may be more accurate**
- **Not all notional exposures are equal**
  - Which is more risky? 200% exposure to Eurodollar Futures or 20% exposure to Natural Gas futures?
  - Hint: Annualized volatility of Eurodollars = 0.5%; Natural Gas = 28.6% (Bloomberg as of 6/30/14)
- **Other risk measures**
  - Beta for equity
  - Duration for bonds
  - Delta for options
  - Vega for volatility

NATIXIS GLOBAL ASSOCIATES

Shorting

- **Definition(s)**
  - Borrowing a security to sell it, betting on its price falling (to replace later at a lower cost)
  - Owning a derivative that profits from falling prices (long CDS/CDX, long put options, etc.)

- **What is the purpose of the short positions?**
  - Generate return (betting on losses)
  - Mitigate losses elsewhere in the portfolio (hedging)
  - Both

- **Is your short exposure "physical securities" (borrowed "cash securities") or "synthetic" exposure (i.e., derivative)**
  - Shorting stocks and bonds: Typically requires a prime broker/tri-party arrangement => added expense
  - Short position thru derivatives: No borrowing, no prime broker, no additional expense
    - Cross-hedges are imperfect => "basis risk"

- **Caveat: Unlike long positions, where the maximum loss is 100%, short positions can incur unlimited losses**
  - Understand borrowing costs
  - Liquidity => "short squeeze"

- **Manager Expertise & Experience**
  - Shorting is a unique skill; not simply doing the opposite of your long positions
  - A sell is not the same as a short position: Some of the parts, acquisition synergies, etc.

The Two Deadliest Words: "Absolute Return"

How do you measure investment success?

Relative Return: A strategy whose success is measured *relative* to a broad market benchmark

Absolute Return: A strategy whose success is measured in *absolute* terms (independent of any broad market benchmark)

Did you make or lose money?

Absolute Return: A strategy that rarely loses money (returns <0%)

Be careful:
The term **absolute return** can be confusing, misleading, and poorly defines expectations.

No strategy makes money in every market.

Benchmarking

- **Losing your anchor: Determining appropriate benchmarks can make alternative due diligence more difficult**
- **Some of the Morningstar categories have a broad range of strategies within them (e.g., Multi-alternative) => Some strategies within categories are not apples-to-apples**
- **Many alternative or hedge fund benchmarks are not investible**
  - **They do not provide a true measure of opportunity cost**
  - **They average constituent returns masking true volatility**
- **While improving, benchmarks and products within the liquid alternative space tend to have shorter history => Less data? => Validity and statistical strength of conclusions?**

5 Most Common Benchmarks per Morningstar Categories

Long/Short Equity	Multi-currency	Multi-alternative	Market Neutral	Managed Futures	Nontraditional Bond	Commodities Broad Basket
S&P 500	S&P 500	S&P 500	BofAML US Treasury Bill - 3 Month	BofAML US Treasury Bill - 3 Month	BofAML USD LIBOR - 3 Mon	Bloomberg Commodity
Russell 3000	Citi Treasury Bill - 3 Month	HFRX Global Hedge Fund	S&P 500	S&P 500	BofAML US Treasury Bill - 3 Month	S&P 500
HFRX Equity Hedge	JPM GBI Global - 3 Month	Barclays US Aggregate Bond	Citi Treasury Bill - 3 Month	Barclay BTOP 50 Index	BBA Libor: 3 Month	S&P GSCI
IQ Hedge Long/ Short Beta Index	Citi Treasury Bill - 1 Month	BofAML US Treasury Bill - 3 Month	BBA Libor - 3 Month	DJ UBS Commodity Index	Barclays US Aggregate Bond	Reuters/ Jefferies CRB
MSCI EAFE	JPM ELMI+ TR	Citi Treasury Bill - 3 Month	Barclays US Treasury Bill : 1-3 Month	Aspen Managed Futures Beta Index	Citi Treasury Bill - 3 Month	CEMP Commodity Volatility Weighted

Source: Morningstar, ISG

Absolute Return

Portfolio Objective

- Can you articulate the product's value proposition?
  - Potential to **increase returns**?
  - Potential to **reduce risk**?
    - What kind of risk: Volatility or Downside?
  - Potential to **enhance diversification**?
    - Lower correlation? (quantitative diversification)
    - New source or alpha or beta? (qualitative diversification)

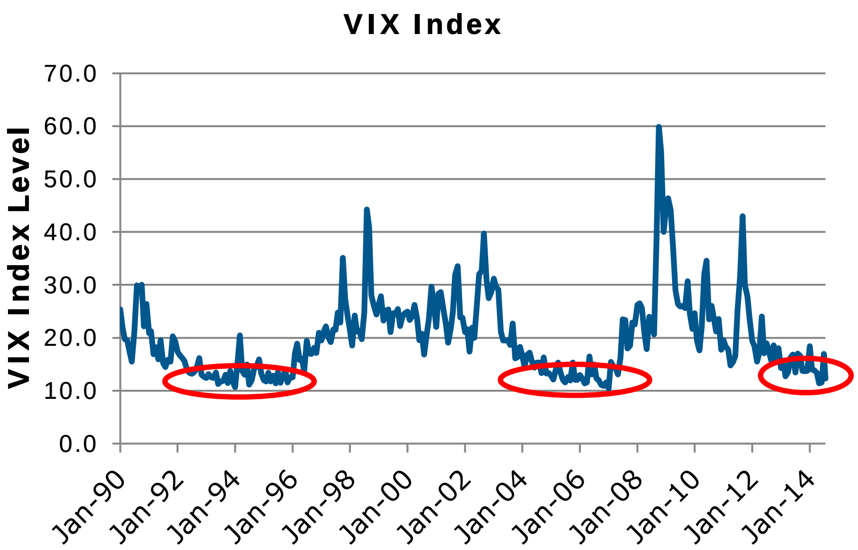
- Can you measure and monitor this for success?

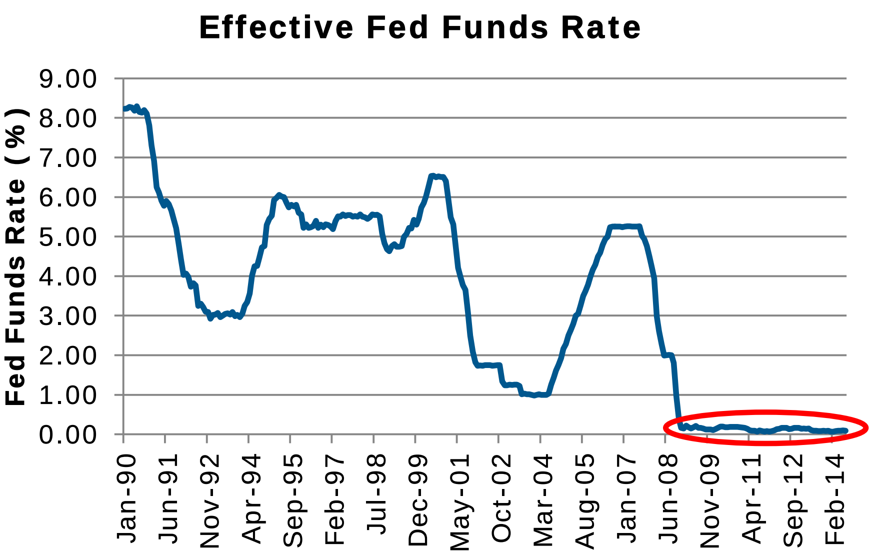
- Can you (or your client) stick with this during periods of market stress or underperformance?
  - Moving the goalposts

The role of volatility & interest rates

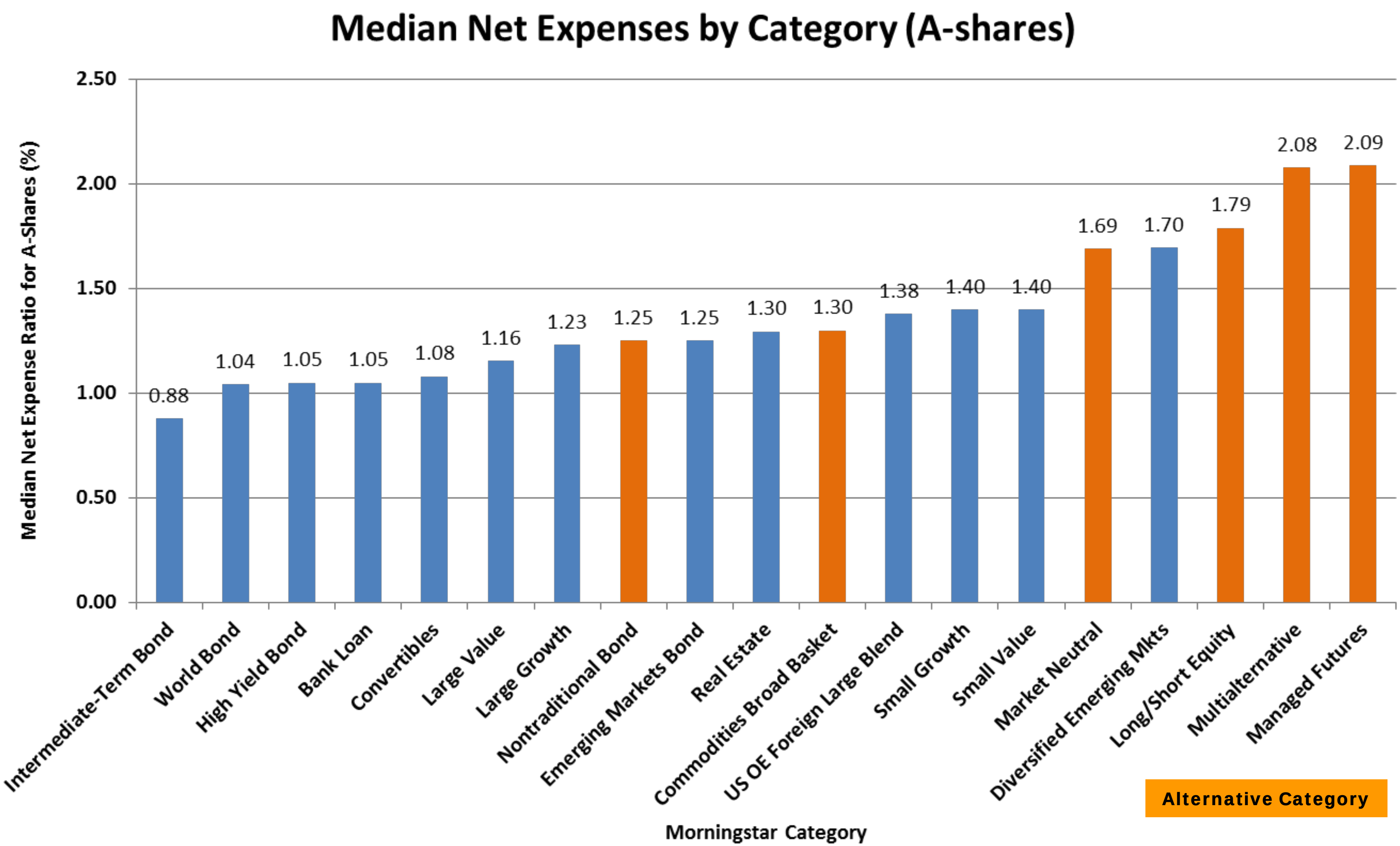
- Many alternatives utilize arbitrage, hedging, or cross-security analysis, their performance can be affected by …
  - Volatility
  - Correlation
  - Cross-sectional volatility
- The greater the dispersion, the more opportunity to add value

- Many alternatives utilize derivatives that are held against cash…
  - both collateral and excess margin), and …
  - the rate that can be earned on cash and short term securities creates a base return level
- Because cash yields almost nothing today, that "base rate" is low / non-existent





How expensive are the funds?



Expenses

- **Alternative strategies are generally considered expensive, but within categories or styles, there can be a wide variation**

- **Cost can be driven up by…**
  - Using sub-advisors
  - Prime brokerage expense
  - Short dividend expense (payment of dividends on borrowed shares)
  - Acquired fees (typically underlying ETF fees)

- **In spite of higher expenses, alternatives can be used to drive risk adjusted expense efficiencies**
  - Historically, both fixed income strategies and alternative strategies have higher Sharpe Ratios (risk-adjusted returns) than equities
  - Coming headwinds for fixed income?

Growth of '40 Act Alternatives

	Length of Track Record (oldest share class)				
AUM*	**< 1 Year**	**1-3 Years**	**3-5 Years**	**5-10 Years**	**>10 Years**
<$50 million	79 funds	59 funds	31 funds	23 funds	7 funds
$50 - $100 million	6 funds	21 funds	17 funds	12 funds	6 funds
$100 - $250 million	14 funds	19 funds	17 funds	16 funds	10 funds
$250 - $500 million	7 funds	6 funds	16 funds	13 funds	5 funds
$500 - $1,000 million	0 funds	15 funds	8 funds	10 funds	7 funds
> $1,000 million	1 fund	15 funds	17 funds	17 funds	15 funds

*7 Morningstar Categories: Equity Long/Short, Market Neutral, Multi-Alternatives, Multi-Currency, Managed Futures, Non-Traditional Bond, and Commodity Broad Basket
Source: Morningstar, ISG

There are 67 fund with over a 5-year history and greater than $250 million in AUM.

NATIXIS GLOBAL ASSET MANAGEMENT

Adoption within DC Plans

Objection	Answer
Too risky	• Many alternative strategies have proven to be far less risky than long-only equity, the dominant DC asset • Low correlation may reduce overall portfolio risk • Derivatives are inherently no more or less risky than their reference asset
Too confusing	• Sponsors and participants should focus on the portfolio role of the strategy • What it does?, not How does it do it? • What unique aspect does it bring to the DC plan line-up?
Too expensive	• Expense structures vary widely by underlying strategy, type of strategy, and scale • Some categories are no more expensive than other widely used categories • Immature market => Fee pressure is coming …
Illiquid	• ‘40 Act alternatives have all the same liquidity constraints and coverage test as traditional mutual funds
Unproven/Short Track Record	• There are today lots of alternative mutual funds with significant assets and long track-records

Questions?

Disclosure

Diversification through the use of alternative investment strategies may result in a profit or a loss and can underperform during periods of strong market performance.

Alternative investments involve unique risks that may be different than those associated with traditional investments, including illiquidity and the potential for amplified losses or gains. Investors should fully understand the risks associated with any investment prior to investing.

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