



DYNAMIC BETA  
— A BI DIVISION —

# Hedge Funds and Liquid Alternatives

Hype vs. Reality

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THE FACTOR REPLICATION COMPOSITE IS HYPOTHETICAL AND THESE TRADING ADVISORS HAVE NOT TRADED TOGETHER IN THE MANNER SHOWN IN THE COMPOSITE DURING THIS PERIOD. HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY MULTI-ADVISOR MANAGED ACCOUNT OR POOL WILL OR IS LIKELY TO ACHIEVE A COMPOSITE PERFORMANCE RECORD SIMILAR TO THAT SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD AND THE ACTUAL RECORD SUBSEQUENTLY ACHIEVED.

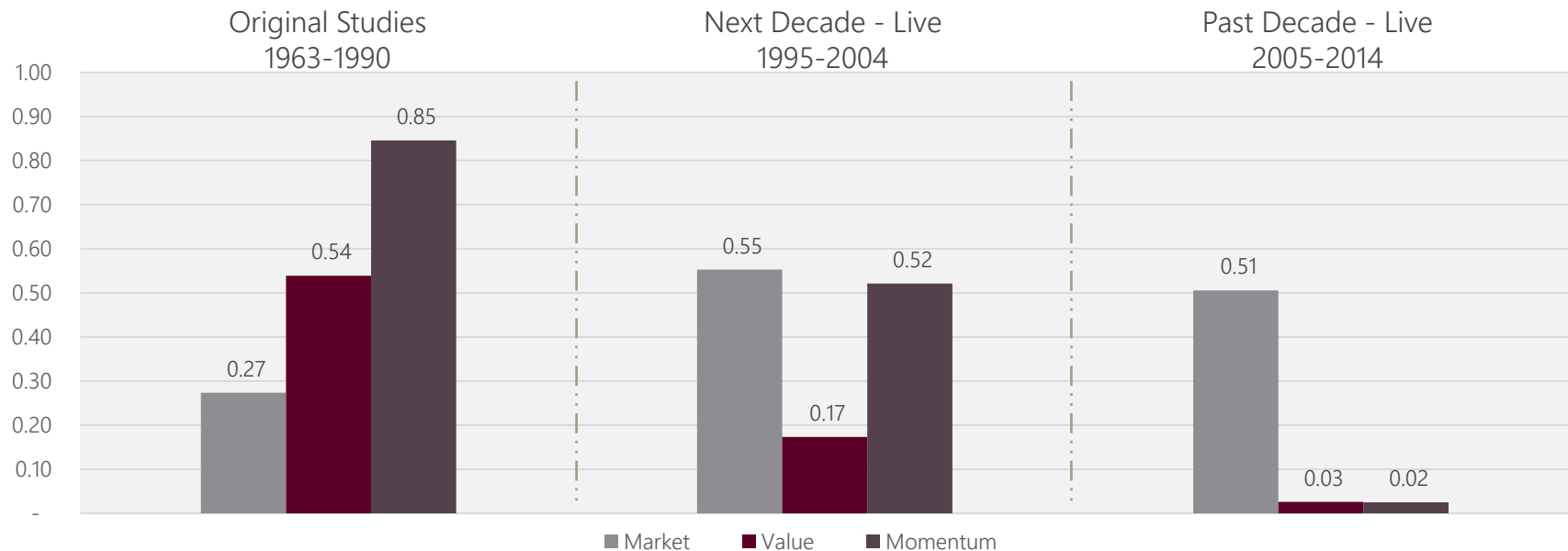
ONE OF THE LIMITATIONS OF A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD IS THAT DECISIONS RELATING TO THE SELECTION OF TRADING ADVISORS AND THE ALLOCATION OF ASSETS AMONG THOSE TRADING ADVISORS WERE MADE WITH THE BENEFIT OF HINDSIGHT BASED UPON THE HISTORICAL RATES OF RETURN OF THE SELECTED TRADING ADVISORS. ANOTHER INHERENT LIMITATION ON THESE RESULTS IS THAT THE ALLOCATION DECISIONS REFLECTED IN THE PERFORMANCE RECORD WERE NOT MADE UNDER ACTUAL MARKET CONDITIONS AND, THEREFORE, CANNOT COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FURTHERMORE, THE COMPOSITE PERFORMANCE RECORD MAY BE DISTORTED BECAUSE THE ALLOCATION OF ASSETS CHANGES FROM TIME TO TIME AND THESE ADJUSTMENTS ARE NOT REFLECTED IN THE COMPOSITE.

THESE RESULTS ARE BASED ON SIMULATED OR HYPOTHETICAL PERFORMANCE RESULTS THAT HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE THE RESULTS SHOWN IN AN ACTUAL PERFORMANCE RECORD, THESE RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, BECAUSE THESE TRADES HAVE NOT ACTUALLY BEEN EXECUTED, THESE RESULTS MAY HAVE UNDER-OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED OR HYPOTHETICAL TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THESE BEING SHOWN.

# Smart Beta

Do Smart Beta strategies outperform the market over time?

## Sharpe Ratio of Smart Beta Factors



### Issues:

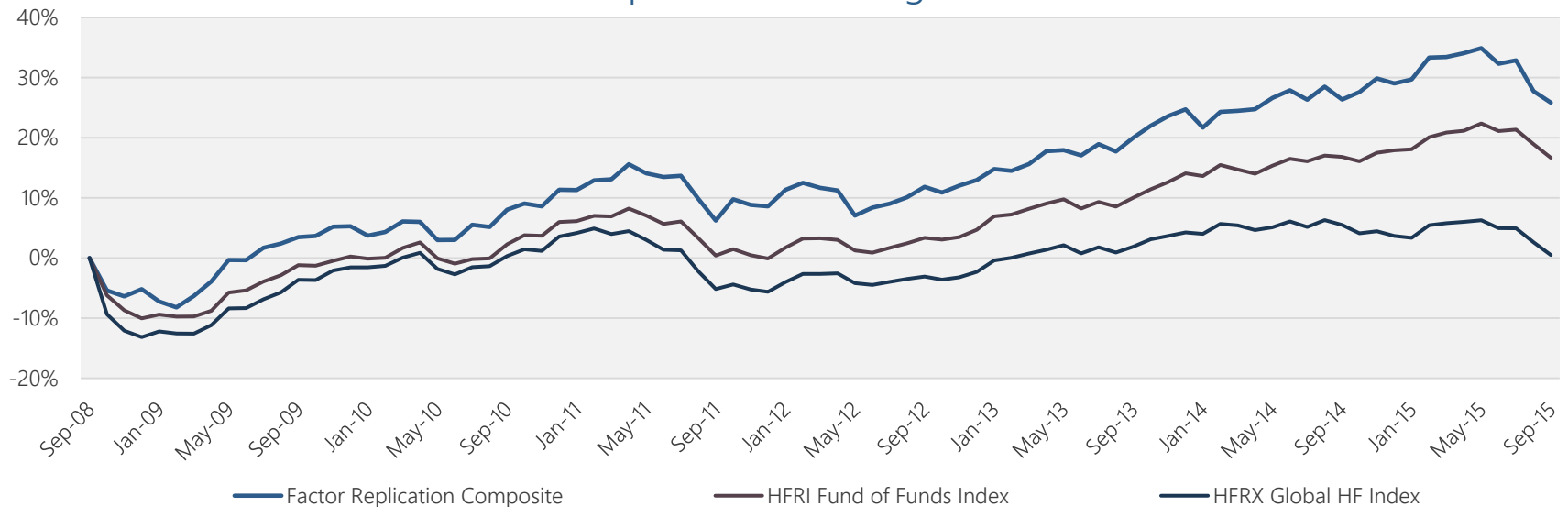
- Bias to publish only good results.
- Market/economic foundations do change.
- Different definitions of "value", etc.
- Compression of returns/strategy arbitrage.

Source: Data for the Value, Momentum and Market factors were pulled from Kenneth French's [website](#) at Dartmouth University.

# Factor Replication

Can factor-based (top down) replication deliver comparable returns to hedge funds?

## Factor Replication vs. Hedge Fund Indices



\*The Factor Replication Composite is a hypothetical composite, please see disclosure page.

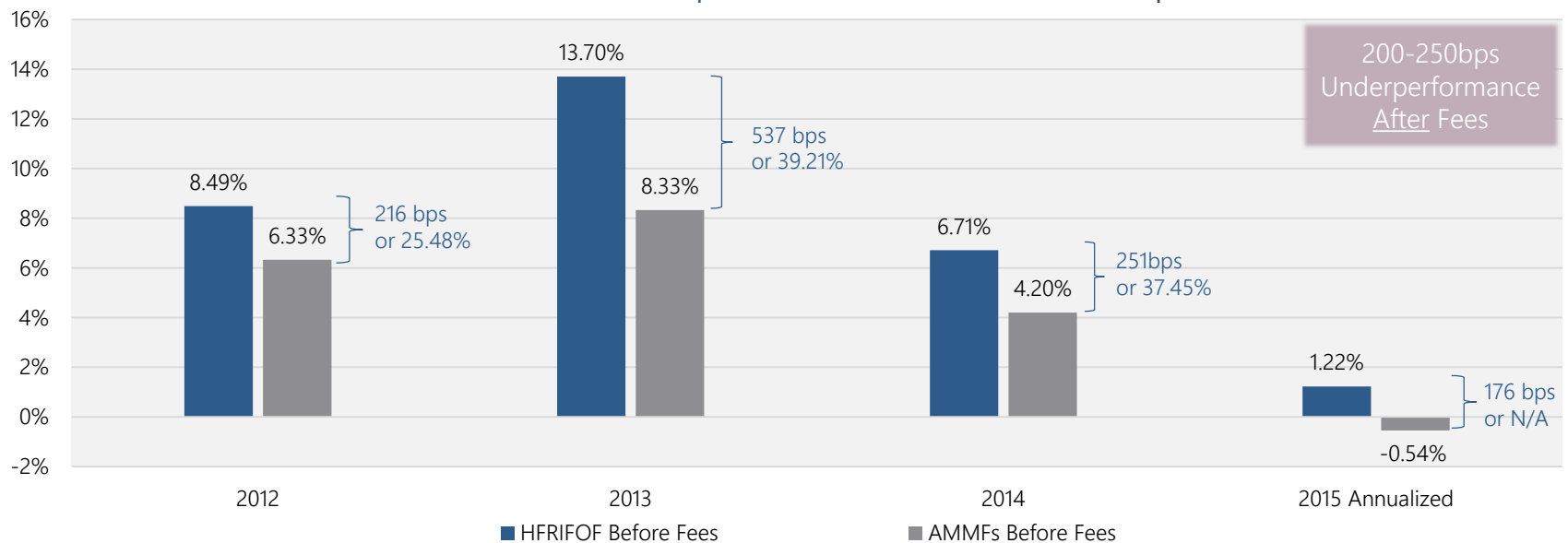
## Issues:

- Hedge fund indices have underperformed vs. 2007 expectations.
- Equity correlations are high (akin to most hedge fund portfolios).
- Different models produce different results.
- Issues with hedge fund index data (e.g. strategy bias).

# Alternative Multi-Manager Funds

What happens when unconstrained hedge fund managers are subject to mutual fund constraints on liquidity, leverage and shorting?

HFRIFOF vs AMMFs | Pre-fee Performance Comparison



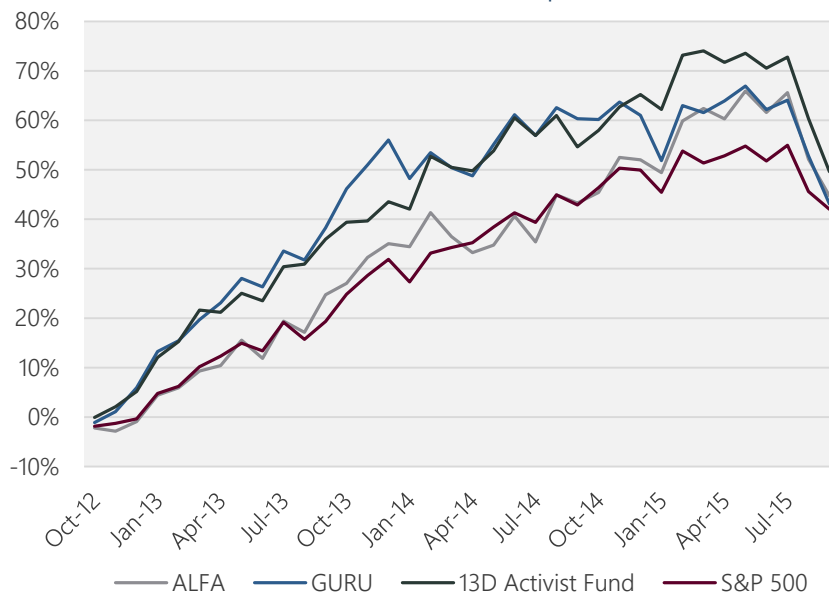
## Issues:

- Overpromising on returns?
- Liquidity very valuable but hard to price.
- Too expensive versus traditional?
- Short track records.

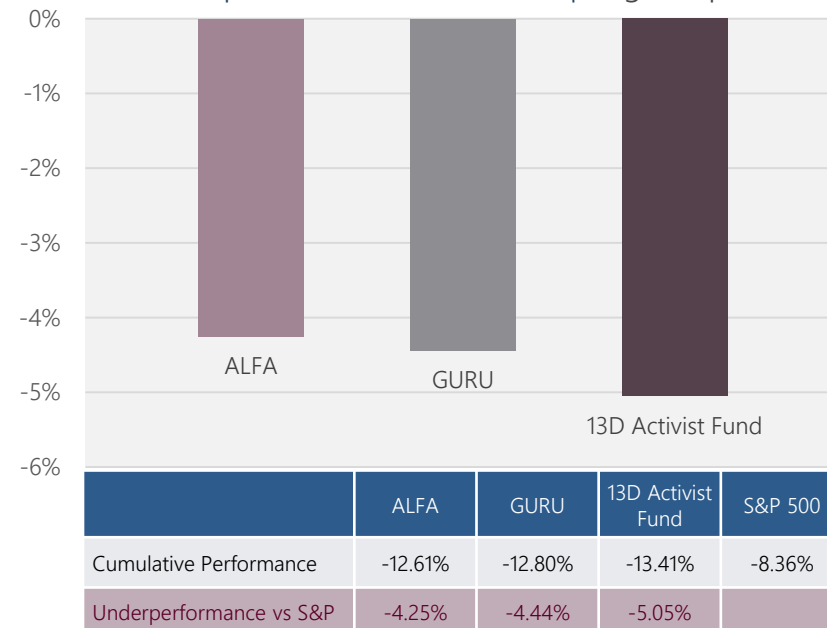
# 13F/13D Portfolios

Are 13F/13D portfolios a viable way to get hedge fund stock selection alpha at lower cost?

Performance vs S&P 500 | Past 3 Years



Underperformance vs S&P 500 | Aug – Sep 2015



	ALFA	GURU	13D Activist Fund	S&P 500
Cumulative Performance	-12.61%	-12.80%	-13.41%	-8.36%
Underperformance vs S&P	-4.25%	-4.44%	-5.05%	

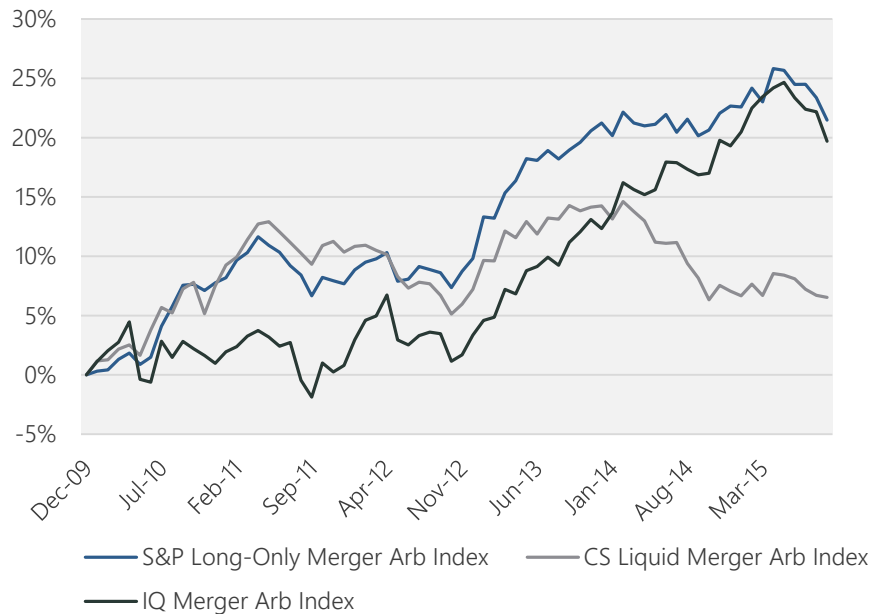
## Issues:

- Different portfolios produce different results.
- Position crowding is a real issue.
- Only designated "13F Securities".
- Short track records (except, perhaps, GS VIP).

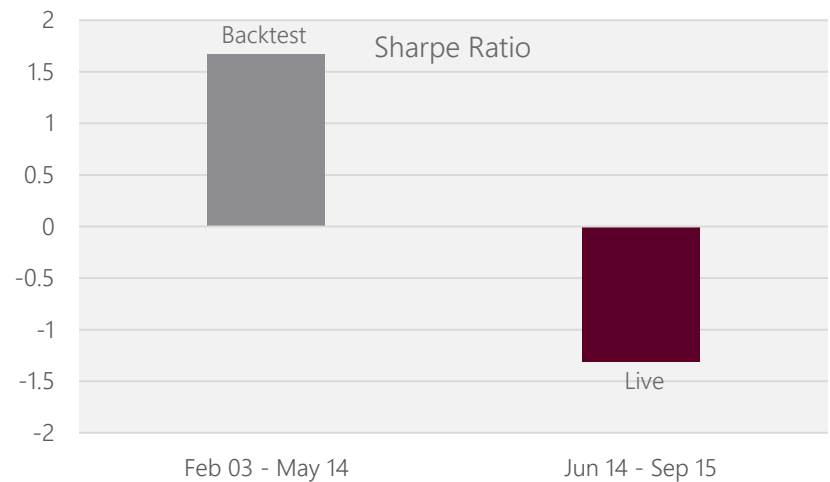
# Alternative Risk Premia

Can models efficiently capture hedge fund trading strategy returns?

Wide Dispersion of Results ("Simple" Merger Arbitrage)



Unrealistic Index Returns | Replication ETF/Index



## Issues:

- Similar models produce **very** different results.
- Live vs. pro forma performance.
- Is this what hedge funds actually do today?
- Implementation can be very problematic (e.g. OTC swaps)

# Definitions

- 13D Activist Fund (DDDIX) reflects the performance of common stocks of U.S. companies of any market capitalization that are the targets of shareholder activism.
- AlphaClone Alternative Alpha ETF (ALFA) is an exchange-traded fund incorporated in the USA. The Fund seeks to track the performance of the AlphaClone Hedge Fund Long/Short Index. The ETF tracks the ALPHA Clone Index, which began publishing live returns in April 2012.
- AMMFs: The AMMF performance presented here is that of an equally weighted basket of 32 Alternative Multi-Manager Mutual Funds. The performance in any given year reflects the equal weighted performance of funds with full performance records for that year.
- CS Liquid Merger Arb Index attempts to gain broad exposure to the merger arbitrage strategy by using a quantitative methodology to invest in long and short equity positions in companies involved in announced merger deals.
- Data for the Value, Momentum and Market factors were pulled from Kenneth French's website at Dartmouth University.
- Global X GuruTM Index ETF (GURU) is designed to track the performance of the Solactive Guru Index, which reflects the performance of the top equity holdings of a select group of hedge funds based on the quarterly regulatory filings reported to the SEC.
- GS VIP Index reflects the performance of a basket of equities most commonly held by hedge funds.
- HFRI Fund of Funds Index is designed to reflect the performance of the fund of hedge funds universe.
- HFRX Global HF Index is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage.
- IQ ARB Merger Arbitrage Index employs a systematic investment process designed to identify opportunities in companies involved in announced mergers, acquisitions and other buyout-related transactions
- Morgan Stanley Multi-Strategy Alternative Index (Bloomberg ticker MSUSLALT) data begins on 1/1/2003. Given the start date, it is possible that the Index was launched sometime in 2013 with roughly ten years of backfilled data. Unfortunately, there is no requirement to differentiate between backfilled and live results. The index combines multiple quantitative rules-based strategies with the objective of generating returns with a low correlation to traditional asset classes.
- S&P Long-Only Merger Arb Index seeks to model a risk arbitrage strategy that exploits commonly observed price changes associated with mergers.
- Some of the information presented in this brochure includes information that has been obtained from third-party sources. Performance information was obtained from Bloomberg for the indices and exchange traded funds identified above.
- Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks and is designed to reflect the performance of large domestic companies across all major industries. Index performance utilized is total return and reflects interest, capital gains, dividends and distributions.
- The Factor Replication Composite reflects the equally weighted performance of: i) Merrill Lynch Factor Model Index; ii) Natixis ASG Global Alternatives Fund; iii) Goldman Sachs Absolute Return Tracker Index.
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## GLOSSARY OF TERMS

- Compound Annual Growth Rate (CAGR) measures the annual growth of an investment over multiple time periods
- Sharpe Ratio measures risk-adjusted investment performance by expressing return per unit of risk.

## Sources

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