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Fees Sap Mutual Funds Seeking Hedge Returns

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Altegris Managed Futures Strategy Fund, a mutual fund that allows less affluent clients to invest with some of the best-known hedge-fund commodities traders, has attracted $707 million since its start less than a year ago.

Investors in the fund lost 6 percent this year, and plummeting gold, silver and oil prices weren't the only reason. The losses also reflect fees of as much as 2 percent of assets paid to the underlying traders in addition to the fund's 2 percent management fee and 5.75 percent in upfront charges. If the fund had made a profit, as much as 35 percent of that would also have gone to the underlying managers.

Investors in U.S. mutual funds, by contrast, paid 0.8 percent in average fees last year, according to data from Morningstar.

"The fees are far higher than for less specialized strategies," said Nadia Papagiannis, an analyst with Chicago- based Morningstar Inc. (MORN) "They're promising the performance of hedge-fund managers, but what we've seen with funds of funds is that the performance is mediocre."

Altegris Managed Futures and three similar products, the MutualHedge Frontier Legends Fund, Princeton Futures Strategy Fund and Grant Park Managed Futures Strategy Fund, have attracted $1.3 billion since the end of 2009, offering access to as many as 20 prominent hedge funds that buy and sell everything from grain to gold to dollars, for as little as $2,500 in initial investment. They also bring another feature of hedge funds: high fees.

Investor Headwinds

Managed futures funds for retail investors have been around since the 1970s, using computer-driven trading models to buy futures contracts. They can bet on the advance or decline in securities including stocks, bonds, currencies and commodities. Some also invest in securities linked to specific events like changes in the weather or interest rates.

An investor in MutualHedge Legends fund, whose six underlying managers charge average fees of 0.64 percent of assets and 24.55 percent of any gain, would have to make 12 percent in the first year to break even given all the fees.

The fund, which also includes a 5.75 percent sales load and a 2 percent management fee, is up 0.7 percent this year, compared with 2 percent, including dividends, for the Standard & Poor’s 500 Index. Since its inception on Dec. 31, 2009, the Denver-based fund has returned 6 percent, not including the sales-load fee, while the S&P 500 has jumped more than 17 percent.

The Princeton fund, which has lost 1.8 percent this year, charges 2.2 percent in annual operating expenses and a 5.75 percent sales load. The Grant Park fund, which is down 1.2 percent since Jan. 1, charges 1.95 percent in annual maintenance fees and a 5.75 percent sales charge. Neither fund discloses how much it pays its underlying managers.

Quant Stars

“Judging the performance of any investment over a six month period is arbitrary,” said Jon Sundt, president and chief executive officer of La Jolla, California-based Altegris Investments Inc. “The real question is how will it perform over time. And with managed futures, they have stood the test of time.”

The S&P 500 rose 1 percent between July 2000 and March 2011, compared with an annual gain of 8.2 percent for managed futures, Altegris said.

Two of the funds invest with David Harding, whose $20 billion Winton Capital Management LLC has returned an average 17 percent a year since 1997, according to an investor, who asked not to be identified because the London-based firm’s returns aren’t public.

Offshore Exemption

Three of the funds use Jaffray Woodriff's $4.6 billion Quantitative Investment Management LLC , based in Charlottesville, Virginia. That fund has gained an average of 13.5 percent since it was founded, according to another investor who also requested not to be identified.

Because the underlying traders bet on rising as well as falling prices, their performance doesn't tend to move in lock- step with stock and bond markets, said Matthew Osborne, co- portfolio manager of the Altegris fund.

In 2008, the worst year for stock performance in seven decades, an Altegris-run futures index that tracks the performance of 40 such managers rose 15.5 percent, Osborne said.

Still, investors may be surprised at how little is left for them after each manager's cut. The U.S. Securities and Exchange Commission requires most mutual funds that invest in other managers to disclose so-called acquired-fund fees and expenses at the front of the offering document. The futures funds are exempt because they invest through off-shore subsidiaries, which don't fall under the SEC's purview, according to Morningstar's Papagiannis.

'Loosened Up'

The four funds note the additional fees under the "Risks" section of their prospectus. In the case of Altegris Managed Futures Strategy, that's on page 16 of the mutual fund's 32-page document.

Chicago-based Grant Park and Denver-based Mount Yale Asset Management LLC, which runs the Princeton Futures fund, don't provide details on the size of the underlying fees.

Representatives of the Altegris, MutualHedge and Grant Park funds said their hands were tied when it came to disclosing fees since SEC policy at the time the funds were created prevented them from listing additional charges in the disclosure tables. A spokesman for the Princeton Futures fund referred questions to JoAnne Strasser, an attorney who has worked for the firm.

Strasser, who specializes in mutual funds for Thompson Hine LLP in Cincinnati, said the SEC has relaxed its policy in recent months and funds are now allowed to list the extra expenses in footnotes. “The SEC has recently loosened up so we may see more disclosure as a result of that,” Strasser said in a telephone interview.

Contradictory Rules

Kevin Callahan, a spokesman for the SEC, declined to comment.

Morningstar lists 13 mutual funds in the managed futures category, only four of which are subject to additional fees because they invest in underlying managers. The others either track indexes or employ in-house managers.

The U.S. Commodity Futures Trading Commission is weighing a proposal to regulate funds that use swaps, derivatives and futures to invest in commodity markets.

The rules proposed in January would require mutual-fund operators to register as a commodity pool if they hold more than 5 percent of a portfolio in commodity futures, options or swaps, or market such investments to the public. They would have to clearly disclose all fees, as well as follow other rules that now apply only to private funds.

Opposition From Funds

Swaps are financial instruments in which two parties exchange the benefits of securities that they own. Futures are agreements to buy or sell assets at a set price and date, and often are bought as a bet on price fluctuations and sold before the delivery date. Options give their buyers the right to buy or sell a security at a set price, without the obligation to do so.

Mutual funds have protested, saying that the proposed change will subject them to two sets of sometimes contradictory rules.

Altegris’ Osborne said he’s in favor of more disclosure and more regulation of managed-futures mutual funds.

“We are in 100 percent support as the SEC and the CFTC seek to harmonize their rules,” Osborne said.

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