When Is a 130/30 Fund Not That? Plenty of Times.(Investment Products)

Ryst, Sonja. "When Is a 130/30 Fund Not That? Plenty of Times.(Investment Products). ." American Banker. 173.147 (July 31, 2008): 13. Academic OneFile. Gale. Northeastern University. 17 Nov. 2008 <http://0-find.galegroup.com.ilsprod.lib.neu.edu/itx/infomark.do?&contentSet=IAC-Documents&type=retrieve&tabID=T003&prodId=AONE&docId=A182017117&source=gale&srcprod=AONE&userGroupName=mlin_b_northest&version=1.0>.

Full Text:

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Many hedge-like mutual funds that have been introduced in the past year with the "130/30" label are not treating that ratio as if it were set in stone.

Morgan Stanley Investment Management, State Street Global Advisors, and Legg Mason Inc. are among the companies that launched such funds last year.The managers invest the money in stocks and get additional funds by taking short positions - borrowing more stocks from another market player.

The term "130/30" refers to the notion of taking a short position of 30%, but that proportion actually varies widely among funds, especially when stock prices are fluctuating.

"I put quotations around the '130/30,' " said Brian Shannahan, the managing director of the U.S. active quantitative equity team at Boston's State Street Global Advisors.

There is not much significance in whether a fund's proportion is at 125/25 or 132/32, because what counts, he said, is how well the managers can pick stocks.

"When you think about it from a client perspective, in the end what they care about is the result," Mr. Shannahan said.

He said that his Large Cap Core Edge Strategy Fund stays close to a 130/30 ratio.

According to State Street Corp.'s Web site, the fund has short positions of up to 30% added to its long portfolio.

"Investors should ask their money managers how they deliver on their promises," said Steve Deutsch, the director of separate accounts at the Chicago investment research firm Morningstar Inc.

The JPMorgan Intrepid Plus Fund had a short position of only 24.91% in May, according to Morningstar. The fund is in the 130/30 category, but its prospectus says its short positions can range from 0% to 50%.

"From an industry standpoint, people generally do a horrific job not only of naming things, but also educating people about the nuances of what a product is," said Ted Dimig, who runs the client portfolio management team for Intrepid funds at JPMorgan Chase & Co. in New York.

The 130/30 strategy caught on because it is the most efficient way to build risk-adjusted return portfolios, but there are many times when an investor would want a different exposure, Mr. Dimig said.

Fund companies should convey clearly to their clients that they need that flexibility in these funds, he said. "This is an important angle."

Goldman Sachs Group Inc.'s GS Structured U.S. Equity Flex Fund reported a short position of 32.59% last month, according to Morningstar.

Its prospectus identifies a short position of 33% as one of "the investment techniques that may (but are not required to) be used by the funds in seeking their investment objectives."

Goldman Sachs did not respond to a request for an interview.

Jasmina Hasanhodzic, a research scientist at the Cambridge, Mass., investment management company Alpha Simplex Group LLC, said it is a natural part of the investment process to have some variation in these proportions.

For example, if an adviser rebalances a fund's portfolio only once a month, shifting market values could easily change the proportion from 130/30 to 125/25, which is not such a big difference in the end, especially in contrast with a 150/50 or 110/10 proportion, she said.

"It's not like ... [the funds] are trying to disguise the level of shorting they're doing," she said.

Mellon Capital Management Corp., a unit of Bank of New York Mellon Corp., told Morningstar that its Dreyfus Premier 130/30 Growth A fund had a short position of 32.88% in May.

Though the fund has 130/30 in its title, its registration statement uses words like "normally" and "approximately" with respect to its short position.

Warren Chiang, a managing director at Mellon Capital Management in San Francisco, said having flexibility built into a fund's prospectus actually makes it easier to deliver solid returns. If market values move the proportion out of whack in a way that an inevitable market correction is likely enough to fix it,

Mr. Chiang and his team at Mellon Capital Management reserve the right not to make an unnecessary short-term trade to remain compliant.

The fact that funds do not have to disclose in real time how much they have sold short in their portfolios makes it tougher to know how closely they are sticking to 130/30 strategies, especially since not all funds disclose their monthly performance figures to Morningstar.

U.S. regulations require them to report their holdings only every three months.

Barry Barbash, the head of the asset management group at Willkie Farr & Gallagher LLP in Washington and a former director of the Securities and Exchange Commission's division of investment management, said that if a 130/30 fund's ratio is temporarily out of sync, it generally is not going to result in a compliance issue.

That would happen only if the fund's investments did not match its objectives for an extended period and there was no disclosure in the prospectus indicating that this could be the case, he said.

Another problem might be having "130/30" in the fund's name, Mr. Barbash said. "If it says 130/30, but the function is something else and nowhere close to 130/30, that's where the SEC would be concerned."

Bill Stone, chief investment strategist for PNC Wealth Management in Philadelphia, said individual investors would be concerned in this case, as well.

His team has a 130/30 fund from an outside company (which he would not identify) managing some assets. Mr. Stone said his firm feels happy with its 130/30 fund experience so far. His company's team took pains to make sure that the fund manager they hired had sufficient experience to sell stocks short, he said.

It is important for 130/30 managers to stick to that proportion, Mr. Stone said. "It's a matter of leverage. At a point, you might have too much magnification of the managers' skill - or lack thereof."

Gale Document Number:A182017117