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**Reflections on the Wall Street Journal’s Article: *Defense! Five Mutual Funds for Bad—and Good—Times*, written by Tom Lauricella, July 3, 2011**

The article is a timely and important focus on funds that “provide competitive returns when times are good but that don't take the kinds of risks that give back those gains and more in a market rout.” Put another way, the focus is on funds that offer some degree of asymmetry of returns – better upside participation than downside participation.

The article is focused on mutual funds that have at least a five year track record, so the Virtus Premium AlphaSector Fund (ticker VAPAX) that tracks F-Squared’s AlphaSector™ Premium Index, was not eligible for inclusion. However, the Index that the fund tracks has a 10 year track record, so it is interesting to compare its record to that of the five funds highlighted as well as the benchmark S&P 500 TR Index and the average large cap equity mutual fund.

The article summarizes the key data as shown below. (Note that we identified a typo for the five year return of the S&P 500, where the annualized return should be 2.96% rather than 2.00%.)

<b>Front Line</b>				
Mutual funds that beat the market during the last big downturn.				
Name (Ticker)	10/9/2007 – 3/9/2009	Year-to-date return	One-year return	Five-year return*
Gateway (GATEX)	-20.18%	1.86%	9.17%	2.49%
BlackRock Global Allocation (MDLOX)	-21.99	2.01	14.95	7.19
FPA Crescent (FPACX)	-20.25	3.73	16.78	6.52
First Eagle Global (SGENX)	-25.75	3.00	19.67	8.00
Vanguard Wellington (VWELX)	-26.78	3.77	16.48	5.96
Standard & Poor’s 500-stock index	-42.95	4.09	23.08	2.00
Actively managed large-cap funds	-42.47	3.59	22.78	2.89

Note: Returns through 6/28/11 \*annualized  
Source: Morningstar

The comparative performance returns for the AlphaSector Premium Index, sourced through Morningstar, would be as follows:

<b><u>Bear Mkt (10/07 – 3/09)*</u></b>	<b><u>YTD</u></b>	<b><u>1 Year</u></b>	<b><u>5 Year*</u></b>
-0.62%	5.14%	28.31%	16.02%

\*Annualized

In order to make the comparison between mutual funds and the AlphaSector Premium Index more accurate (as an Index, the latter does not reflect fees or transaction costs), the performance information is repeated assuming a 2.0% annual fee and expense charge.

<b><u>Bear Mkt (10/07 – 3/09)*</u></b>	<b><u>YTD</u></b>	<b><u>1 Year</u></b>	<b><u>5 Year*</u></b>
-3.45%	4.14%	26.31%	14.02%

\*Annualized

Even after the theoretical fee adjustment, the AlphaSector Premium Index outperformed the benchmark S&P 500 index, the large cap mutual fund peer group, and *every single highlighted mutual fund, for every single time period.*

Since the theme of the article is funds with asymmetry of returns, an alternative means of measuring asymmetry is useful for more depth of understanding. This approach compares the Up Capture Ratio (UCR)<sup>1</sup> during the bull market (April 2009 – June 2011) and the Down Capture Ratio (DCR)<sup>2</sup> during the bear market (October 2007 – March 2009). The results are as shown below (UCR/DCR explain what percentage of the up/down market, represented by the benchmark return, was captured by the manager; the objective for the UCR is to be as high as possible and the DCR to be as low as possible):

<u>Fund</u>	<u>Up Capture Ratio</u>	<u>Down Capture Ratio</u>	<u>Spread UCR – DCR</u>
Gateway	37.2%	47.6%	-10.4%
Blackrock Global Alloc	64.3%	52.6%	11.7%
FPA Crescent	63.0%	49.0%	14.1%
First Eagle Global	81.2%	59.1%	22.1%
Vanguard Wellington	69.0%	60.2%	8.8%
<i>Average Large Cap MF</i>	<i>100.1%</i>	<i>102.3%</i>	<i>-2.2%</i>
<b>AlphaSector Premium Index</b>	<b>93.4%</b>	<b>15.4%</b>	<b>78.0%</b>

As can be seen, for all of the mutual funds highlighted in the article, the DCR is 60% or less, perfectly explaining why this group of funds so meaningfully outperformed the market in the bear market period.

Additionally, for the majority of the highlighted funds, the positive spread between the UCR and the DCR (a positive spread is a demonstration of asymmetry of returns, and is desired) is materially larger than the mutual fund peer group, and helps explain why they were able to offer better upside participation after the bear market, while still providing downside protection. The one exception to the positive spread calculation is the Gateway fund which uses an option buy-write strategy for its downside protection, and appears to suffer one of the traditional critiques of this approach which is reduced upside participation.

Further review shows why the average large cap mutual fund fares so poorly in this comparison, with a negative spread between the UCR and the DCR, and a DCR over 100%.

The final observation of this data focuses on the AlphaSector Premium Index. As mentioned earlier, the index, even adjusted for a theoretical management fee and transaction fee, still outperforms every highlighted fund for every time period. A very simple explanation for this outperformance can be seen in the UCR and DCR data.

The vastly superior DCR explains the powerful downside protection delivered during the bear market cycle. When the DCR is coupled with a modestly stronger UCR versus the highlighted fund group, it translates to a spread between the two that is fully 8 times as large as the average of the highlighted funds. This explains the outperformance in the remainder of the evaluated time periods.

In summary, asymmetry of returns provides a powerful approach to providing investors with a return profile that is increasingly in demand – reasonable participation in the bull markets, and superior protection in the bear markets.

Considering that some of the highlighted mutual funds from the article are also some of the best selling mutual funds in the industry, it would appear that investors are “voting with their feet” when it comes to the desirability of this approach.

Further, the Virtus Premium AlphaSector Fund, which tracks the AlphaSector Premium Index, is the best selling mutual fund among all actively managed Large Cap Blend funds, as tracked by both Morningstar and Strategic Insight, so investors are clearly finding even newer mutual funds with a tangible asymmetry of returns profile.

*The following is the explanation for UCR and DCR as provided by Morningstar:*

<sup>1</sup>Upside Capture Ratio is a measure of the manager’s performance in periods when the benchmark has positive returns. In essence, it tells you what percentage of the up market, represented by the benchmark return, was captured by the manager.

<sup>2</sup>Downside Capture Ratio is a measure of the manager’s performance in periods when the benchmark has negative returns. In essence, it tells you what percentage of the down market, represented by the benchmark return, was captured by the manager.

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