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Nontraditional Bond Funds Aren't All Bad

By Amey Stone

So-called unconstrained bond funds have taken it on the chin lately, most notably Bill Gross' **Janus Unconstrained Bond** (JUCAX), which has lost 3.17% in the past month. It is one of the worst performers in Morningstar's nontraditional bond fund category, which is down 1% in that time. The category is down 1.53% in the past year.

Critics have pointed out that unconstrained bond funds are too complex and vulnerable to the fund manager making the wrong bet at the wrong time — like thinking the Federal Reserve would raise interest rates earlier this year.

But not all funds in that category have suffered equally, a new report from **Markov Processes International**, a quantitative analytics firm, points out. In fact, there is a wider range of returns among this group than in typical fund categories. The MPI authors note:

> The difference in annualized return between the average of the top 5 and average of the bottom 5 nontraditional bond funds is relatively high, 9.15% in the last two years, compared to intermediate-term bond funds, which showed an annualized difference of 6.36% over the period. Such a relatively wide range is not surprising in a diverse category lacking a common benchmark and is indicative of the care required when conducting manager research in the nontraditional universe.

The report doesn't name names, but a look at Morningstar shows top one-year performers include **Semper MBS Total Return Investor (SEMPX) up 5.38% in the past year**, **Arrow Alternative Solutions** (ASFFX), up 4.68%, and **Columbia Mortgage Opportunities** (CLMAX), up 4.67%.

That's not to say these funds are a buy. Arrow, for example, has long-term returns well below average. And it's clear from the names that funds in this group that an emphasis on mortgage-backed securities was an advantage. None of the top funds in this category use the word "unconstrained" in their name.

MPI's quantitative research shows that securities selection and market timing are key determinants of performance. For example, funds that shorted Treasuries were hard hit:

> The short interest rate exposure amongst the bottom 5 funds is greater than double that displayed by the top 5. 10-year Treasury futures have returned 4.46% annually over the past two years (and nearly 1% in August through 8/21/15 alone). This cost the bottom 5 funds significantly.

In contrast, funds that used leverage to invest in credit sensitive securities like bank loans and high yield bonds did the best:

> We see that the winning funds displayed effective leverage (exhibited by short cash exposure) from the beginning of the examined period into Q1 2014, allowing leveraged long exposure, particularly in credit segments, including bank loans and short duration high yield.

These results may not be that surprising on the face of it, but investors who dig into the report will find a lot more detail on what the best and worst performing nontraditional bond funds were up to in the past two years.

Semper MBS Total Return Fund Performance

Total Returns	3 Months	1 Year	Since Inception (07/13)	Operating Expenses
Institutional Class (SEMMX)	0.99%	5.96%	10.76%	Gross: 0.90%
Investor Class (SEMPX)	1.03%	5.72%	10.53%	Gross: 1.13%

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 855-736-7799. Periods longer than 1 year are annualized.

CONTACT INFORMATION

Thomas Mandel, CFA
Senior Managing Director
212-612-9102
Tmandel@sempercap.com

Semper Capital Management
52 Vanderbilt Ave, Suite 401
New York, NY 10017
www.sempercap.com

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Mutual fund investing involves risk. Principal loss is possible. The Fund invests in debt securities: As interest rates rise, the value of debt securities decrease; whereas prepayment risk tends to occur during periods of declining interest rates. This risk is usually greater for longer-term debt securities. Investments in Mortgage-Backed and Asset Backed Securities include additional risks that investors should be aware of such as credit risk, interest rate risk, prepayment risk, real estate market risk, possible illiquidity and default, as well as increased susceptibility to adverse economic developments. The Fund regularly makes short sales of securities, which involves the risk that losses to those securities may exceed the original amount invested by the Fund. The Fund may invest in securities that are less liquid which can be difficult to sell. The Fund may use certain types of investment derivatives such as futures, forwards, and swaps. Derivatives involve risks different from, and in certain cases, greater than the risks presented by more traditional investments. The Fund may use leverage which may exaggerate the effect of any increase or decrease in the value of portfolio securities. The Fund may invest in TBA securities which involve interest rate and investment exposure risks. The Fund may invest in When-Issued securities which may involve less favorable prices for securities, when delivered, and failure to deliver securities could cause loss to the Fund.

The Semper MBS Total Return Fund is distributed by Quasar Distributors, LLC
The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 212-612-9065 or visiting www.semperfunds.com. Read it carefully before investing.

Intermediate-Term Bond – defined by Morningstar: Intermediate-term bond portfolios invest primarily in corporate and other investment-grade U.S. fixed-income issues and typically have durations of 3.5 to 6.0 years. These portfolios are less sensitive to interest rates, and therefore less volatile, than portfolios that have longer durations.

Nontraditional Bond – defined by Morningstar: The Nontraditional Bond category contains funds that pursue strategies divergent in one or more ways from conventional practice in the broader bond-fund universe. Many funds in this group describe themselves as "absolute return" portfolios, which seek to avoid losses and produce returns uncorrelated with the overall bond market; they employ a variety of methods to achieve those aims. Another large subset are self-described "unconstrained" portfolios that have more flexibility to invest tactically across a wide swath of individual sectors, including high-yield and foreign debt, and typically with very large allocations. Funds in the latter group typically have broad freedom to manage interest-rate sensitivity, but attempt to tactically manage those exposures in order to minimize volatility. The category is also home to a subset of portfolios that attempt to minimize volatility by maintaining short or ultra-short duration portfolios, but explicitly court significant credit and foreign bond market risk in order to generate high returns. Funds within this category often will use credit default swaps and other fixed income derivatives to a significant level within their portfolios.

CONTACT INFORMATION

Thomas Mandel, CFA
Senior Managing Director
212-612-9129
Tmandel@sempercap.com

Semper Capital Management
52 Vanderbilt Ave, Suite 401
New York, NY 10017
www.sempercap.com