Rinehart Wealth Management
Greater Trust

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The Hybrid Solution: Our Answer to Alternative Investments

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Alternative Investments are a critical component of a well-positioned, highly-diversified portfolio. Despite the mystique surrounding Alternative Investments, these investment strategies are simply assets that fall out of the traditional Asset Allocation Model; often, Alternative Assets are a subset of an existing asset class.[1] As a part of our Asset Allocation, we at Rinehart Wealth Management classify these Alternative Investments as Hybrids because their expected performance is independent of the performance of traditional asset classes, such as stocks and bonds. Our Hybrid Solution includes Alternative Investment strategies such as Asset Allocation, Real Estate/REITs, Hedge Fund Strategies, Utilities/Alternative Fixed Income/Preferred Stock, and Hard Assets.

We believe superior investment performance can be achieved by mitigating volatility and accurately diversifying a portfolio's sources of risk, not just diversification across traditional asset classes. **The main reason for investing in alternative assets is to improve risk-adjusted performance by adding uncorrelated, or less correlated, assets to a traditional portfolio.**

When Traditional Diversification Fails

Given the significant losses experienced during the "Great Recession" of 2008, many prognosticated the failure of Modern Portfolio Theory and the breakdown of diversification. Despite the perception of a well-diversified portfolio of fixed income and equity as stable, portfolios exhibited extreme volatility. During the financial crisis of 2008, traditional diversification did not necessarily result in downside protection as the global economic crisis caused correlations to spike, which drove asset prices down concurrently. The only traditional asset class that provided diversification was the US Treasury.

The impact of economic globalization has practically eliminated the diversification benefit of investing in International Equities, as correlations have risen dramatically. During the "Great Recession," the correlation between Domestic Equities and International Equities rose to 0.91, suggesting there was virtually no diversification benefit from an allocation to International Equities. This convergence of correlations does not mean diversification does not work; it simply means we need to broaden our definition of diversification. Our Hybrid Solution is designed to add additional diversification to portfolios with the goal of mitigating portfolio volatility, improving risk-adjusted returns, and providing downside protection during a crisis.

Tables I & II provide an outline of the correlations during the most recent periods of economic distress.

Table I: The Bursting of the Technology Bubble (2000-2002)

	LC Stocks	MC Stocks	SC Stocks	Int'l Stocks	EM Stocks	Corp. FI	Treas. FI	HY FI
LC Stocks	1.00							
MC Stocks	0.89	1.00						
SC Stocks	0.80	0.93	1.00					
Int'l Stocks	0.84	0.89	0.82	1.00				
EM Stocks	0.82	0.85	0.81	0.77	1.00			
Corp. FI	-0.16	-0.11	-0.04	-0.09	0.00	1.00		
Treas. FI	-0.61	-0.56	-0.46	-0.47	-0.47	0.75	1.00	
HY FI	0.56	0.64	0.64	0.51	0.75	0.38	-0.18	1.00

[1] *CAIA Level I: An Introduction to Core Topics in Alternative Investments*, The CAIA Association. John Wiley & Sons, Inc.

Table II: The "Great Recession" (2008-2009)

	LC Stocks	MC Stocks	SC Stocks	Int'l Stocks	EM Stocks	Corp. FI	Treas. FI	HY FI
LC Stocks	1.00							
MC Stocks	0.97	1.00						
SC Stocks	0.95	0.94	1.00					
Int'l Stocks	0.91	0.93	0.83	1.00				
EM Stocks	0.79	0.87	0.72	0.94	1.00			
Corp. FI	0.53	0.56	0.44	0.70	0.64	1.00		
Treas. FI	-0.01	-0.08	0.01	0.12	-0.05	0.51	1.00	
HY FI	0.72	0.81	0.68	0.73	0.78	0.60	-0.24	1.00

Extremely High Correlations Across All Equities

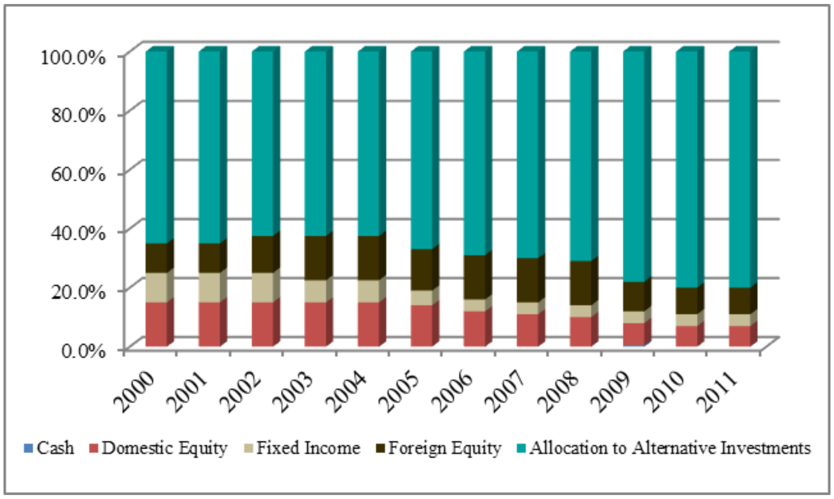
Geographic Exposure Provided Little Diversification Benefit

Source: "Open Your Eyes to Alternatives," BlackRock; Informa Investment Solutions

History of Hybrids

Large institutional money has migrated toward Alternatives, and now, with our Hybrid Solution, smaller investors are able to benefit from the additional diversification and risk management that these large institutions have enjoyed for years. For example, Chart I shows that roughly 80% of the Yale Endowment is allocated to Alternative Investments. Currently, there are numerous strategies available in a mutual fund vehicle, which reduces or removes many of the traditional impediments to investing in alternative assets, such as restrictive lock-up periods, the lack of a transparency, the K-1 tax reporting structure, high fees, and exclusionary minimum investment requirements.

Chart I: Institutional Exposure to Alternative Investments



Source: The Yale Endowment Reports, 2000-2011, http://www.yale.edu/investments/

The Hybrid Solution

Within our Hybrid Solution are Asset Allocation, Hedge Fund Strategies, Utilities, Preferred Stock, Alternative Fixed Income, Real Estate, and Hard Assets. Below is an overview of each asset class.

Table III:

Asset Type	Description
Asset Allocation	A portfolio management strategy that makes tactical allocation decisions across multiple asset classes
Hedge Fund Strategies	Mutual funds that replicate hedge fund strategies utilizing traditional asset classes in non-traditional ways, normally by utilizing derivatives. Examples of such strategies include: Merger Arbitrage, Long/Short, Hedged Equity/Fixed Income, Event-Driven Arbitrage, Global Macro, and Relative Value
Utilities	The equities of Utility Companies
Preferred Stock	Unique equity instrument with attributes of Fixed Income, as well as Equity
Alternative Fixed Income	Emerging Market Debt, High-Yield, Distressed Debt, Credit Arbitrage
Real Estate	Real Estate Investment Trusts (REITs) and outright land and/or property ownership
Hard Assets	Materials, precious metals, commodities, and hard currency

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Performance Expectations

It is possible that over a full market cycle successful hedge fund strategies can outperform bonds and equities. Our expectation in using the Hybrid Solution is not to beat the S&P 500 Index each year but buffer volatility while providing capital appreciation independent of fixed income and equity with lower interest rate sensitivity.

Below is a table featuring the performance of many popular indices. The HFRX Global Hedge Fund Index is a widely-used index for the performance of the hedge fund universe. This index is fraught with problems, such as survivorship and backfill biases[i]; however, given the lack of available indices, it is one of the most popular. Despite lagging the S&P 500 recently, the HFRX Global Hedge Fund Index was down less than the S&P 500 in all but one of the corrections referenced.

Table IV: Performance of Popular Indices

				Great	Corrections		
	6-Mo	**1-Yr**	**5-Yr**	**Recession**	**2010**	**2011**	**2012**
HFRX Global Hedge Fund	0.6%	-6.7%	-17.4%	-24.3%	-2.2%	-8.5%	-2.3%
S&P GSCI Commodities Index	-11.0%	-15.1%	-24.9%	-53.0%	-13.0%	-14.5%	-15.1%
FTSE NAREIT All REITs	15.3%	9.3%	-1.4%	-61.7%	-2.9%	-5.1%	-4.1%
Barclays US Aggr. Bond Index	3.0%	6.6%	38.5%	5.6%	4.8%	5.0%	2.1%
S&P 500	5.7%	4.6%	-3.3%	-49.6%	-10.9%	-7.1%	-8.9%

Source: FactSet Research Systems, Inc. – Rinehart Wealth Management. The timeframe used for the "Great Recession" is Nov. 1st, 2007 – Feb. 28th, 2009. The timeframes used for each respective Market Correction are as follows: May 1st – August 31st, 2010; May 1st – Oct. 31st, 2011; and March 31st – June 4th, 2012.

The funds shown below in Table V are a sample of the funds we utilize or have used in the past in our Hybrid Solution. All of these funds provided downside protection during the "Great Recession" and were actually up during the most recent two correction periods. This suggests there is an ability not only to protect on the downside, but also to outperform the HFRX Global Hedge Fund Index by doing proper due diligence and selecting funds that can add alpha. Our proprietary due diligence template used when conducting fund research, liquidity requirements, and dialogue with the portfolio managers is what differentiates our Hybrid Solution.

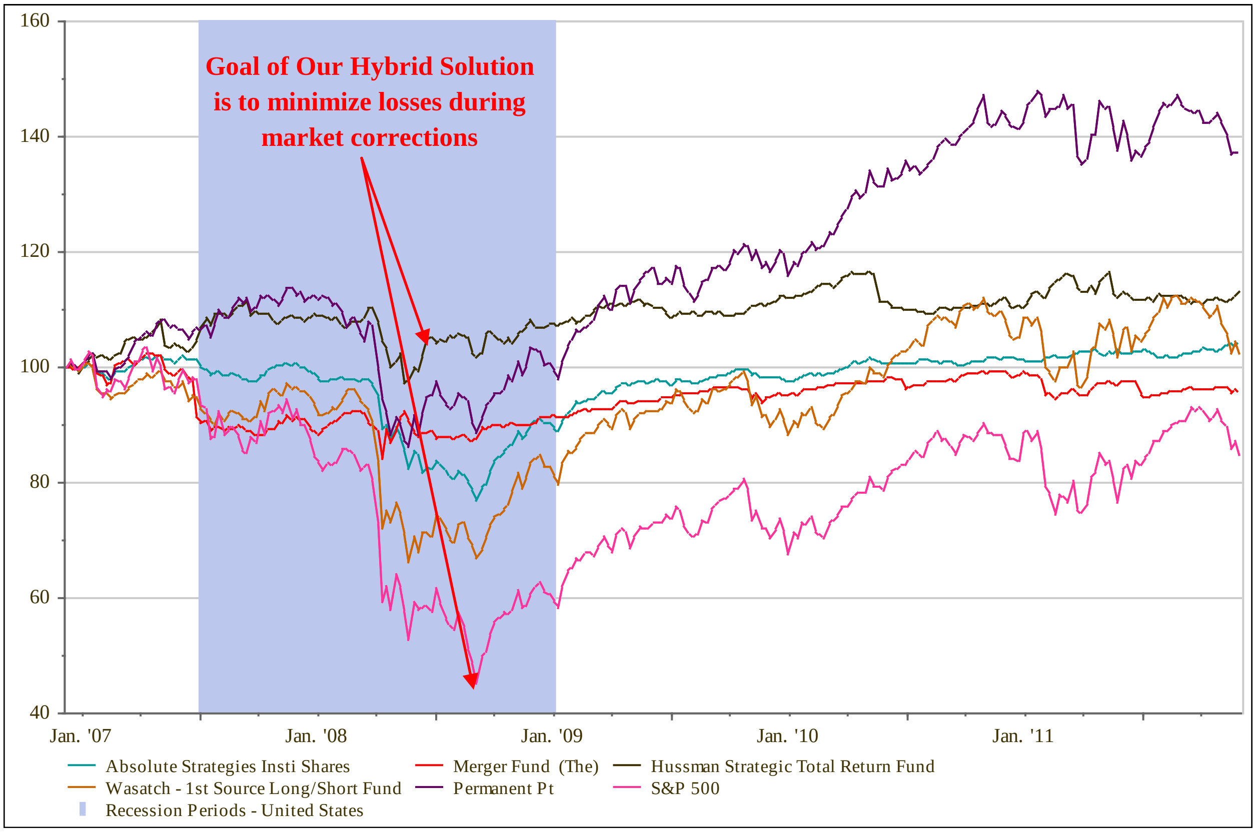
Table V: Performance of Sample Funds

				Great	Corrections		
	6-Mo	**1-Yr**	**5-Yr**	**Recession**	**2010**	**2011**	**2012**
Absolute Strategies Fund	1.8%	2.7%	11.3%	-18.1%	-1.0%	1.8%	1.3%
Merger Fund	1.1%	-0.1%	9.3%	-5.9%	0.6%	-2.3%	-0.8%
Hussman Strategic Total Return Fund	0.6%	4.7%	37.6%	5.6%	5.4%	3.6%	2.0%
Wasatch Long/Short Fund	-2.8%	-2.4%	11.2%	-24.8%	-9.4%	-5.6%	-8.5%
Permanent Portfolio	-1.2%	-1.3%	42.8%	-14.1%	0.2%	-2.1%	-5.4%
S&P 500	5.7%	4.6%	-3.3%	-47.8%	-10.9%	-7.1%	-6.2%

Source: FactSet Research Systems, Inc. – Rinehart Wealth Management. The timeframe used for the "Great Recession" is Nov. 1st, 2007 – Feb. 28th, 2009. The timeframes used for each respective Market Correction are as follows: May 1st – August 31st, 2010; May 1st – Oct. 31st, 2011; and March 31st – June 4th, 2012.

Chart II graphically shows the outperformance of some of the strategies in our Hybrid Solution. By reducing the drawdown experienced in late 2008 and early 2009, these funds have been able to differentiate themselves from the S&P 500 and provide the additional diversification and necessary risk mitigation we seek for portfolios with our Hybrid Solution.

Chart II: Performance of Sample Funds



Source: FactSet Research Systems, Inc. – Rinehart Wealth Management

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[i] **Survivorship Bias** – Arises when constructing a hedge fund index today based on hedge fund managers that have survived the time period…this creates an upward bias to the performance of a hedge fund index because, presumably, the remaining hedge funds survived as a result of their superior performance.

Backfill Bias – Occurs because once a hedge fund manager begins to report his performance to a database provider, the provider backfills the hedge fund manager's historical performance into the database. Again, because it is more likely that a hedge fund manager will begin reporting his performance after a period of good performance, this bias pushes the historical performance of managers upward.

Source: CAIA Level I: An Introduction to Core Topics in Alternative Investments, the CAIA Association. John Wiley & Sons, Inc.