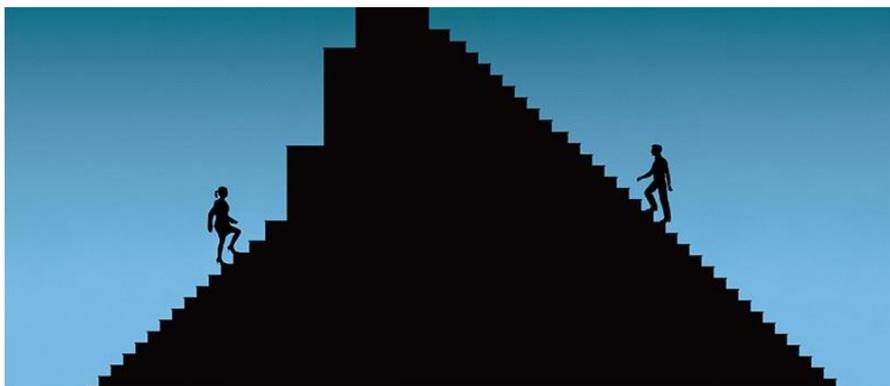


## The Bastardization of Pari-Passu



**Pari-Passu** is an important concept, particularly when utilizing a hedge fund manager as a sub-adviser to a mutual fund. As a refresher, it is a Latin phrase that means “side by side; on equal footing.” It generally describes an investment approach where two or more portfolios are managed in the same way, without any display of preference.

Published on July 26<sup>th</sup>, 2018 in Barron’s, the article “Be Wary of Mutual Funds Run by Hedge-Fund Managers”<sup>1</sup> precisely highlights the potential pitfalls when managers fail to follow the principles of Pari-Passu. The premise of the piece is that hedge fund managers who also sub-advise mutual funds are not giving their best effort to the mutual fund and are thus providing the mutual fund with lower quality ideas. In other words, that they are not managing their portfolios Pari-Passu, despite telling investors that they were doing so from the start. We cannot argue with the findings for the most part on this topic, and frankly, it is the basis on which we formed Balter Liquid Alternatives (BLA) as we sought to create solutions and correct flaws that have persisted in the liquid alternative mutual fund industry.

This is a perfect example of how the overused buzzword/term “Pari-Passu” has more recently been distorted, and for the lack of a better word, completely bastardized. It’s a shell of what it once was, and we get the feeling that no one really knows what it is supposed to mean anymore. There will always be a few that will ruin it for the rest of us. We’re proud that we’ve always stuck to our guns in that we’re obsessed with ensuring Pari-Passu. We came from the industry, so we like to think that we are rather meticulous about how we structure our offerings. We simply don’t compromise here.

### Why do we like to require a Pari-Passu approach?

- So that our multi-manager mutual funds receive the hedge fund manager’s best thinking, rather than a watered-down product, particularly in the short portfolio. Many sub-advisers substitute ETFs and market indices for individual shorts within their mutual fund portfolio. We believe this can lead to ineffective hedges and short exposure incapable of producing alpha.
- Sub-advisers may be tempted to put their potentially higher returning investment opportunities into portfolios with higher compensation structures.

### How do we ensure the sanctity of Pari-Passu and that managers adhere to their mandate?

- We put in place agreements with our multi-manager funds to ensure the Pari-Passu mandate.

<sup>1</sup> Alpert, Bill. (2018, July 26). Be Wary of Mutual Funds Run by Hedge-Fund Managers. Barron’s. Retrieved from <https://www.barrons.com/articles/be-wary-of-mutual-funds-run-by-hedge-fund-managers-1532611193>

- Prior to onboarding a new manager in our multi-manager mutual funds, a sub-adviser is required to sign an agreement ensuring the pari-passu mandate is followed.
- We also regularly monitor each vehicle’s (LP vs. MF) results.

**Once a sub-adviser joins our platform, our in-house operations team:**

- Reconciles monthly performance attribution between each sub-adviser’s allocated mutual fund portfolio and that of their hedge fund.
- Verifies the portfolio holdings are the same for both the sub-adviser’s allocated hedge fund and mutual fund portfolio to confirm we are getting the same ideas.

We’ve put together a nice little “Cliff Notes” table version below that we believe concisely describes our internal procedures to ensure that Pari-Passu principles are being followed:

<b>The BLA Method for Ensuring Pari-Passu Within Our Multi-Manager Funds:</b>	
<b>Prior to Fund Launch</b>	Ensure strategy fits '40 Act constraints.
	Execute agreements requiring sub-advisers manage their allocated mutual fund portfolio Pari-Passu with their respective hedge fund.
<b>During Engagement as Sub-Advisor</b>	Portfolio monitoring and risk assessment.
	Review and reconciliation of attribution.
	Portfolio holdings review and reconciliation.
	Monitor for performance discrepancies between a sub-adviser’s hedge fund and its allocated portfolio of the mutual fund; discuss and determine source of discrepancy.

**The bottom line?** We see no point in having a brand name hedge fund manager sub-advising a mutual fund portfolio in which they are not giving their best ideas to. In our opinion this is a disastrous recipe for lackluster returns, which is what many are observing in the market today. Our intention is to offer genuine hedge strategies in a mutual fund wrapper. We reject the idea that alternative mutual funds need to be “hedge fund lite.” What we believe distinguishes us most at Balter Liquid Alternatives is that we will adhere to this strict philosophy when we believe many of our peers do not.

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