

# GOTHAM FUNDS

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LONG/SHORT VALUE INVESTING

## GOTHAM INDEX PLUS (GINDX)

The best long-term investment strategy for most people must meet two simple requirements:

1. The strategy must make sense; and
2. Investors must be able to stick with it.

Unfortunately, finding such a strategy is much harder than people think. According to Morningstar<sup>1</sup>, the top performing mutual fund for the decade 2000-2009 earned more than 18 percent annually while the market was down close to 1 percent per year over that same 10 year period. Yet the average investor in this top performing fund managed to *lose* 11 percent per year on a dollar-weighted basis over those ten years.

How? Pretty much after every period in which the fund did well, investors piled in. After every period in which the fund did poorly, investors ran for the exits. So the average investor managed to lose money in the best-performing fund simply by buying and selling the fund at just the wrong times! Most professional allocators follow the same pattern as individuals. They pull money out after the market or a manager does poorly. They put money in only after the market is already up or a manager has outperformed.

In a recent column in the *Wall Street Journal*<sup>2</sup>, author Jonathan Clements suggests that, based on research he conducted through Morningstar, index investors far surpass the results for active-fund investors on a dollar-weighted basis. This isn't because index fund investors are necessarily smarter; it's because "when you buy an index fund, your only worry is the market's performance. But when you buy an active fund, you have to worry about both the market's direction *and (emphasis added)* your fund's performance relative to the market." Having to make these two challenging decisions, rather than just one, makes active-fund investors "more likely to buy and sell at the wrong time."

So here's the problem. For those investors who still want to "beat the market," the active managers they choose must do something different than the market. But, in the vast majority of cases, the returns for long-term top performing managers zig and zag quite differently from market benchmarks. In other words, even if investors find an active strategy that makes sense

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<sup>1</sup> Morningstar study quoted in the *Wall Street Journal*, December 31, 2009, "Best Stock Fund of the Decade."

<sup>2</sup> Clements, Jonathan. "Are Index-Fund Investors Smarter?" *The Wall Street Journal* 28 Mar. 2015: B7-B8. Print.

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over the long-term, they may not be able to stick with it during the inevitable periods of underperformance.

### **WHAT IS THE SOLUTION?**

For equity investors that are seeking to more closely track an index, *Gotham Index Plus (GINDX)* was constructed with both an index component and an actively managed long/short component. The fund will generally maintain an exposure of 190% long by 90% short, comprised of an investment that seeks to closely track the S&P 500 and an investment in an actively managed long/short overlay.<sup>3</sup>

Here's how it works:

For each \$100 invested in *Gotham Index Plus*, we start with \$100 of U.S. stocks that seeks to track the S&P 500 Index. Next, we select long and short positions (primarily from the largest 500-700 U.S. companies) that we believe are the cheapest and most expensive, respectively, relative to our assessment of value. Finally, we net positions that appear in both the index portion and the actively managed long/short overlay, with the result being a portfolio with an overall exposure of approximately \$190 long and \$90 short.

### **TWO BENEFITS:**

#### **1) Tracking the Market**

First, investors in *Gotham Index Plus* should receive the benefits of owning a \$100 investment that tracks the underlying index.

#### **2) Adding Active Management**

Second, *Gotham Index Plus* adds another element to the index component to achieve an overall exposure of approximately \$190 long and \$90 short. In this part of the portfolio, Gotham will generally invest in roughly 150 U.S. large cap stocks that we believe are selling at the biggest discount to our assessment of value. We will also sell short roughly 150 U.S. large cap stocks that we believe are selling most expensively relative to our assessment of value.

Generally, the cheaper a company appears to us, the larger the allocation it will receive in this part of our portfolio. On the short side, the more expensive a company appears relative to our assessment of value, the larger the short allocation it generally receives. As with all of our long/short funds, we manage the risks in this part of the portfolio by requiring substantial portfolio diversification, limiting sector concentration and maintaining overall gross and net

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<sup>3</sup> Exposures are targeted exposures, are estimated and subject to change.

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exposures within carefully defined ranges. In addition, this portion of the portfolio is tax managed.

### **COMBINING THE BENEFITS OF AN INDEX WITH FUNDAMENTAL ANALYSIS**

In summary, we seek to achieve returns from two main sources for every \$100 invested in GINDX. The first potential source of returns is from an investment that seeks to closely track the S&P 500 Index. The second potential source of returns is the “spread” between how much an additional investment in our favorite large cap stocks returns versus the returns of our short selections. Hopefully, if we invest effectively, our long selections will outperform the stocks that we have sold short and this will add to the returns we achieve from the index tracking portion of our strategy.

*Gotham Index Plus* is designed to hopefully mitigate both overall risk and underperformance risk. Of course, we expect the index portion of the portfolio to closely track underlying index returns. We also believe that our long/short spread returns will be largely uncorrelated with the market’s returns in many market environments.

In fact, since most of our shorts are high priced (based on our assessment of value), with many eating through cash or achieving poor returns on capital, we hope and expect that our long/short spreads will actually be even more robust during poor market periods. This, we believe, will significantly help our spreads and add to overall returns in down markets, thus helping to counteract our exposure to the index exactly when we may need it most.<sup>4</sup>

So, if the best investment strategy is truly one that not only makes sense but also one that investors can stick with, *Gotham Index Plus* may provide a combination of attributes that will help many investors achieve long-term investment success.

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<sup>4</sup> As opposed to running two separate strategies, for example, placing \$100 into an index strategy and then placing another \$100 into a separate market neutral fund that runs \$90 long and \$90 short, GINDX may actually have an advantage by putting both together. First, owning two separate funds would require an investment of \$200, not the \$100 invested in GINDX to achieve gross exposure of 280% (190% long/90% short). Second, because our spreads may often be negatively correlated with the market, as the value of the index exposure rises when the market rises, our long/short overlay will be based on the new higher equity amount (this would not be the case if the strategies were run separately). This may be a good time to have additional protection as markets are often more vulnerable after big market run-ups.

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## **Important Information**

*Mutual fund investing involves risks, including possible loss of principal. The fund will short securities. Short sales theoretically involve unlimited loss potential since the market price of securities sold short may continuously increase. The fund will also use leverage to make additional investments which could result in greater losses than if the fund were not leveraged. An investor should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. The prospectus contains this and other information about the fund. A copy of the prospectus is available at [www.GothamFunds.com](http://www.GothamFunds.com) or by calling 877-974-6852. The prospectus must be read carefully before investing.*

This document contains certain information that constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "expect," "hope," "intend," "believe," and/or comparable terminology. No assurance, representation, or warranty is made that any of Gotham's expectations, views, objectives, and/or goals will be achieved.

Exposures are targeted exposures, are estimated and subject to change.

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