RiverPark/Gargoyle Hedged Value (RGHVX)

A Mutual Fund Observer 'Star in the Shadows' Fund

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Mutual Fund Observer

Fund name RiverPark/Gargoyle Hedged Value (RGHVX)

Objective and Strategy RiverPark/Gargoyle Hedged Value seeks long-term capital appreciation while exposing investors to less risk than broad stock market indices. The strategy is to hold a diversified portfolio mid- to large-cap value stocks, mostly domestic, and to hedge part of the stock market risk by selling a blend of index call options. In theory, the mix will allow investors to enjoy most of the market's upside while being buffered for a fair chunk of its downside.

Adviser RiverPark Advisors, LLC. RiverPark was formed in 2009 by former executives of Baron Asset Management. The firm is privately owned, with 84% of the company being owned by its employees. They advise, directly or through the selection of sub-advisers, the seven RiverPark funds.

Managers Joshua B. Parker and Alan Salzbank. Messrs. Parker and Salzbank are the Managing Partners of Gargoyle Investment Advisor, LLC. They were the architects of the combined strategy and managed the hedge fund which became RiverPark/Gargoyle and also oversee about a half billion in separate accounts. Mr. Parker, a securities lawyer by training is also an internationally competitive bridge player (Gates, Buffett, Parker…) and there's some reason to believe that the habits of mind that make for successful bridge play also makes for successful options trading. They both have over 30 years of experience and all of the investment folks who support them at Gargoyle have at least 20 years of experience in the industry.

Management's Stake in the Fund As of January 2014, the managers had $5 million invested in the strategy (including $500,000 in this fund). Gargoyle Partners and employees have over $10 million invested in the strategy. Morty Schaja, RiverPark's cofounder and CEO, has over $1 million invested in each of RiverPark's funds.

Opening date The strategy was originally embodied in a hedge fund which launched December 31, 1999. The hedge fund converted to a mutual fund on April 30, 2012.

Minimum investment $1000. There's also an institutional share class (RGHIX) with a $1 million minimum and 1.16% expense ratio.

Expense ratio 1.44% on assets of $44.5 million, as of February, 2014.

Comments The Gargoyle fund has two components. The fund combines an unleveraged long portfolio and a 50% short portfolio, for a steady market exposure of 50%. The portfolio rebalances between those strategies monthly, but monitors and trades its options portfolio "in real time" throughout the month.

The long portfolio is 80-120 stocks, and stock selection is algorithmic. They screen the 1000 largest US stocks on four valuation criteria (price to book, earnings, cash flow and sales) and then assign a "J score" to each stock based on how its current valuation compares with (1) its historic valuation and (2) its industry peers' valuation. They then buy the hundred most undervalued stocks, but maintain sector weightings that are close to the S&P 500's.

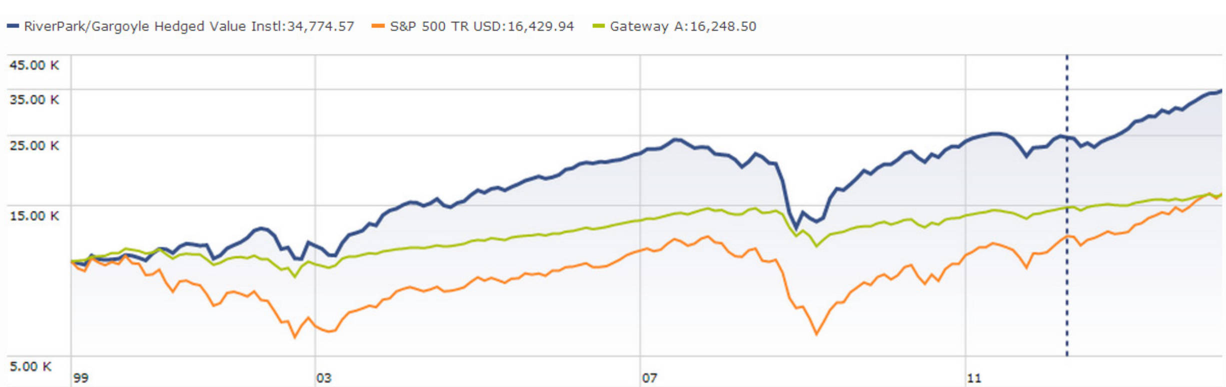
The options portfolio is composed of short index call options. At base, they're selling insurance policies to nervous investors. Those policies pay an average premium of 2% per month and rise in value as the market falls. That 2% is a long-term average, during the market panic in the fall of 2008, their options were generating 8% per month in premiums.

Why index calls? Two reasons: (1) they are systematically mispriced, and so they typically generate more profit than they theoretically should. Apparently anxious investors are not as price-sensitive as they should be. In particular, these options are overpriced by about 35 basis points per month 88% of the time. For sellers such as Gargoyle, that means something like a 35 bps potential advantage. Moreover, (2) selling calls on their individual stocks—that is, betting that the stocks in their long portfolio will fall—would reduce returns. They believe that their long portfolio is a collection of stocks superior to any index and so they don't want to hedge away any of their upside. By managing their options overlay, the team can change the extent to which its investors are exposed to the stock markets movements. At base, as they sell more index options, they reduce the degree to which the fund is exposed to the market. Their plan is to keep net market exposure somewhere in the range of 35-65%, with a 50% average and a healthy amount of income.

On whole, the strategy has worked.

Their long portfolio has outperformed the S&P 500 by an average of 5% per year for 14 years. The entire strategy has outperformed the S&P in the long-term and has matched its returns, with less volatility, in the shorter term. Gargoyle has outperformed the S&P500 in 10 of the past 14 years. The fund has also outpaced the S&P500 since its conversion to a mutual fund in April 2012 through January 30, 2014.

Throughout, it has sort of clubbed its actively-managed long-short peers. More significantly, it has substantially outperformed the gargantuan Gateway Fund (GATEX). At $8.3 billion, Gateway is – for many institutions and advisors – the automatic go-to fund for an options-hedged portfolio. It's not clear to me that it should be. Here's the long-term performance of Gateway (green) versus Gargoyle's institutional shares (blue):



Two things stand out: an initial investment in Gargoyle fourteen years ago would have returned **more than twice as much** as the same investment at the same time in Gateway (or the S&P 500). That outperformance is neither a fluke nor a one-time occurrence: Gargoyle leads Gateway over the past one, three, five, seven and ten-year periods as well.

The second thing that stands out is Gargoyle's weak performance in the 2008 crash. The fund's maximum drawdown was 48%, between 10/07 and 03/08. The managers attribute that loss to the nature of the fund's long portfolio: it buys stocks in badly dented companies when the price of the stock is even lower than the company's dents would warrant. Unfortunately in the meltdown, those were the stocks people least wanted to own so they got killed. The fund's discipline kept them from wavering: they stayed 100% invested and rebalanced monthly to buy more of the stocks that were cratering. The payback came in 2009 when they posted a 42% return against the S&P's 26% and again in 2010 when they made 18% to the index's 15%.

The managers believe that '08 was exceptional, and note that the strategy actually made money from 2000-02 when the market suffered from the bursting of the dot-com bubble. President Schaja notes that "We are going to have meltdowns in the future, but it is unlikely that they will play out the same way as it did 2008…a market decline that is substantial but lasts a long time, theoretically would play better for Gargoyle that sells 1–2% option premium and therefore has that as a cushion every month as compared to a sudden drop in one quarter where they are more exposed. Similarly, a market decline that experiences movement from growth stocks to value stocks theoretically would benefit a Gargoyle, as compared to a 2008." I concur. Just as the French obsession with avoiding a repeat of WW1 led to the disastrous decision to build the Maginot Line in the 1930s, so an investor's obsession with avoiding "another '08" will lead him badly astray.

What about the ETF option? Josh and Alan believe they have the following two distinct structural advantages over a buy-write, passively managed ETF: (1) They buy stocks they believe to be superior to those in broad indexes and (2) they manage their options portfolio moment by moment, while the ETF frequently remains inactive for 29 out of 30 days.

> There's evidence that they're right. The ETFs are largely based on the CBOE S&P Buy-Write Index (BXM). Between 2000 and 2012, the S&P 500 returned 24% and the BXM returned 52%; the options portion of the Gargoyle portfolio returned 110% while the long portfolio crushed the S&P.

By carefully selecting a value-oriented stock portfolio and seeking to limit losses, the fund has produced an astounding long-term record. From inception through the end of 2013, the fund has returned 9.1% annually while the S&P500 has returned just 3.6% and it has done so with a beta of 0.74.

Bottom Line On average and over time, a value-oriented portfolio works. It outperforms growth-oriented portfolios and generally does so with lower volatility. On average and over time, an options overlay works and an actively-managed one works better. It generates substantial income and effectively buffers market volatility with modest loss of upside potential. There will always be periods, such as the rapidly rising market of the past several years, where their performance is pedestrian rather than spectacular. That said, Messrs. Parker and Salzbank have been doing this and doing this well for decades. What's the role of the fund in a portfolio? For the guys, it's virtually 100% of their US equity exposure. In talking with investors, they discuss it as a substitute for a large-cap value investment; so if your asset allocation plan is 20% LCV, then you could profitably invest up to 20% of your portfolio in Gargoyle. Indeed, the record suggests "very profitably."

The market commentary expresses the author's views as of the date this report and should not be relied on as research or investment advice. These views and characteristics are subject to change. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results.

In terms of the Fund's net long market exposure, Gargoyle considers an exposure between 35% and 65% to be steady. There is no guarantee that the previous premium achieved by the options portfolio will be achieved and should not be considered a forecast of future results.

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole.

To determine if this Fund is an appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges, and expenses before investing. This and other information may be found in the Fund's summary or full prospectus, which may be obtained by calling 888.564.4517, or by visiting the website at www.riverparkfunds.com. Please read the prospectus carefully before investing.

Standard Performance as of 12/31/2013: **RGHIX**: 1 Year: 29.38%, 5 Year: 18.98%, 10 Year: 8.77% Since Inception: 9.14%. Since Inception of Mutual Fund (4/30/2012): 21.82%. **RGHVX**: 1 Year: 29.16%, 5 Year: 18.88%, 10 Year: 8.72% Since Inception: 9.11%. Since Inception of Mutual Fund (4/30/2012): 21.51%.

The performance data quoted for periods prior to April 30, 2012 is that of the Predecessor Fund. The Fund is managed in a materially equivalent manner to its predecessor. The Predecessor Fund was not a registered mutual fund and was not subject to the same investment and tax restrictions as the Fund. If it had been, the Predecessor Fund's performance might have been higher. Performance shown for periods of one year and greater are annualized. Inception Date of the Predecessor Fund is 12/31/1999.

The performance quoted herein 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 their original cost, and current performance may be higher or lower than the performance. Performance as of the most recent month end can be found at www.riverparkfunds.com.

Gargoyle's investment approach involves modifying and combining what it believes are two time-proven investment strategies—value investing and option buy-writing. Option buy-writing is a strategy that involves owning the underlying securities and writing (selling) call options on such underlying securities. In the Fund's case, the Stock Portfolio as a whole serves as the underlying securities and a basket of index call options are written (sold) in place of individual equity options. While Gargoyle views the Fund as one integrated portfolio with the goal of achieving its stated objective, the Stock Portfolio and the Options Portfolio investment approaches can be viewed independently.

Mutual fund investing involves risk including possible loss of principal. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from social, economic or political instability in other nations.

Due to the inherent leveraged nature of options, a relatively small adverse move in the price of the underlying instrument may result in immediate and substantial losses to the Fund. The value of the Fund's positions in index options fluctuates in response to changes in the value of the underlying index.

The seller of a "naked" call option (or the seller of a put option who has a short position in the underlying instrument) is subject to the risk of a rise in the price in the underlying instrument above the strike price, which risk is reduced only by the premium received for selling the option. In exchange for the proceeds received from selling the call option (in lieu of an outright short position), the option seller gives up (or will not participate in) all of the potential gain resulting from a decrease in the price of the underlying instrument below the strike price prior to expiration of the option. The seller of a "naked" put option (or the seller of a call option who has a long position in the underlying instrument) is subject to the risk of a decline in price of the underlying instrument below the strike price, which risk is reduced only by the proceeds received from selling the option. In exchange for the premium received for selling the put option (in lieu of an outright long position), the option seller gives up (or will not participate in) all of the potential gain resulting from an increase in the price of the underlying instrument above the strike price prior to the expiration of the option.

Selling index call options can reduce the risk of owning stocks, but it limits the opportunity to profit from an increase in the market value of stocks in exchange for up-front cash at the time of selling the call option. Unusual market conditions or the lack of a ready market for any particular option at a specific time may reduce the effectiveness of the fund's option strategies, and for these and other reasons the Fund's option strategies may not reduce the Fund's volatility to the extent desired. Accordingly, the purchase of Fund shares should be viewed as a long-term investment. There can be no assurance that the Fund will achieve its stated objectives. Diversification does not protect against market loss.

The RiverPark Gargoyle Hedged Value Fund is sub-advised by Gargoyle Investment Advisor LLC. The RiverPark mutual funds are distributed by SEI Investments Distribution Co., which is not affiliated with RiverPark Advisors, LLC, Gargoyle Investment Advisor LLC, or their affiliates.