

Shorting and Stock Picking in **130/30 Funds**

On Monday, June 2, the Wall Street Journal (“Journal”) published an article entitled, “No Shortcuts Here: 130/30 Funds Require a Long, Hard Look.” The article correctly pointed out two potential pitfalls involving 130/30 funds with which we agree.

The first involves the manager’s experience shorting stocks. One of the key sources of return in any 130/30 strategy is the manager’s short positions. Many firms have an investment process that ranks stocks using some proprietary metric for predicting future performance. Based on this, long only managers then end up overweighting those stocks which have a high rating with the hopes of beating the market. While it might be easy for these managers to identify stocks that have a low rating, it’s not so easy to incorporate them into the portfolio to add return.

Most managers, including many offering 130/30 strategies, have little or no experience shorting stocks. This is a skill that requires a different trading strategy, even a different mind set than traditional investment managers have developed during their careers. The Journal correctly pointed out the danger in investing in a 130/30 fund that is managed by a firm with little experience shorting stocks. Wilshire Mutual Funds’, Inc.’ approach in our Large Cap Core 130/30 Fund (“Fund”) was to find investment managers with extensive shorting experience. Each of the four subadvisors of the Fund has a demonstrated track record of adding value through their short positions.

But shorting skills are not enough to ensure good performance. The Journal article also pointed out another potential pitfall with 130/30 funds, that applies to any actively managed investment strategy: “Other funds are run by skippers who may have experience shorting stocks but lackluster stock-picking records.” Because 130/30 funds amplify the impact of a manager’s good and bad stock picks, it’s critical to understand the manager’s skill. In selecting the four subadvisors for the Wilshire Large Cap Core 130/30 Fund, we focused on those managers whose historical performance resulted from demonstrated and consistent stock selection ability. Using Wilshire’s proprietary equity risk analytics, we were able to isolate the portion of each manager’s return due to their stock selection skills, both on their long and short positions. Some managers we evaluated had a good track record, but it was due to other factors, such as a style or size bias that is inappropriate for a large cap core strategy.

The Journal article was right on point, in making two observations that should be evident to investors: make sure managers have good stock picking skills and demonstrated shorting experience before investing in 130/30 strategies. The Wilshire Large Cap Core 130/30 Fund uses subadvisors that meet both tests.

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