

## STOP CHASING RETURN. START MANAGING RISK.



**CHARLES C. KANTOR,**  
**PORTFOLIO MANAGER**  
NEUBERGER BERMAN  
LONG SHORT FUND

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A key aspect of the long/short value proposition is flexibility.

### Bridging the Gap between Risk Aversion and Return Potential with Fundamental Long/Short Investing

In today's low interest rate environment and with rising equity market valuations, we believe that a long/short strategy, with the ability to unlock different sources of returns in both up and down markets, can be a valuable addition to a diversified portfolio—particularly when it employs a fundamental approach to identify securities with attractive risk-adjusted return potential.

### AN ASSET ALLOCATION CONUNDRUM

Today, many investors face an asset allocation conundrum as they struggle to find a balance between return and risk. Unconventional global monetary policy has resulted in low yields on government bonds that have left savers with little income and a lower margin of safety should interest rates suddenly move higher. Investment-grade bonds now carry elevated interest rate risk, while higher-yielding bonds generally force investors to assume more credit risk. More “conservative” stocks, including those with high dividends, still subject investors to a level of equity risk that may not be appropriate for their portfolios.

### SELECTING A LONG/SHORT MANAGER

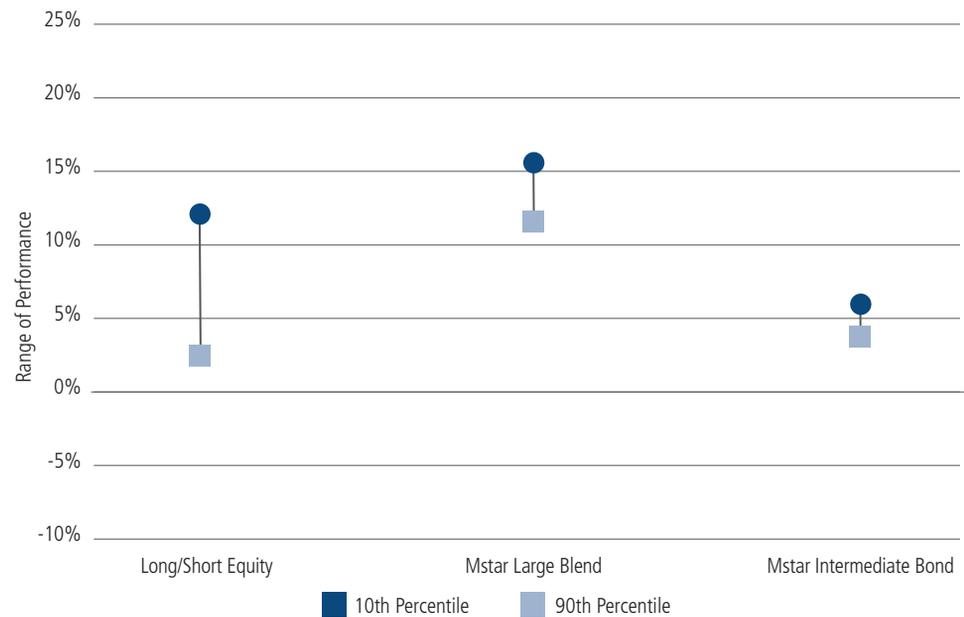
A key aspect of the long/short value proposition is flexibility. A long/short strategy allows a portfolio manager greater investment latitude in search of strong risk-adjusted returns and alpha—not only by taking traditional long positions that can benefit from appreciation but also through short positions that may serve a dual purpose: to generate alpha and to decrease exposure to systematic market risk. This tends to generate smoother return profiles than long-only equity indices by dampening equity market volatility with less directional market exposure.<sup>1</sup> It should be kept in mind that these strategies are not designed to outperform during strong market rallies.

However, choosing to access this strategy is only a first step, especially given the wide differences in manager style associated with the long/short universe and the variety of targeted outcomes of those managers (see display). Clearly, investors and their advisors cannot be on automatic pilot when it comes to choosing a particular long/short strategy.

<sup>1</sup> From January 2000 through December 2014, the HFRI Equity Hedge Index provided a total return of 3.06% and standard deviation of 7.21%, compared to the S&P 500 Index's 4.24% and 15.22%, respectively. **Past performance is no guarantee of future results.** Source: FactSet. Index returns are for illustrative purposes only. Indexes are unmanaged and not available for direct investment. Indexes are not intended to predict performance of the fund. For recent fund performance information, please visit [www.nb.com/mutualfundperformance.aspx](http://www.nb.com/mutualfundperformance.aspx). Investing entails risk, including possible loss of principal. Standard deviation measures the dispersal or uncertainty in a random variable (in this case, investment returns). It measures the degree of variation of returns around the mean (average) return. The higher the volatility of the investment returns, the higher the standard deviation will be. For this reason, standard deviation is often used as a measure of investment risk.

We believe that the world's rather uncertain and shifting environment offers a favorable backdrop environment for long/short investors.

**FIGURE 1: PERFORMANCE DISPERSION: U.S. LONG/SHORT VS. LONG-ONLY HEDGE FUNDS**



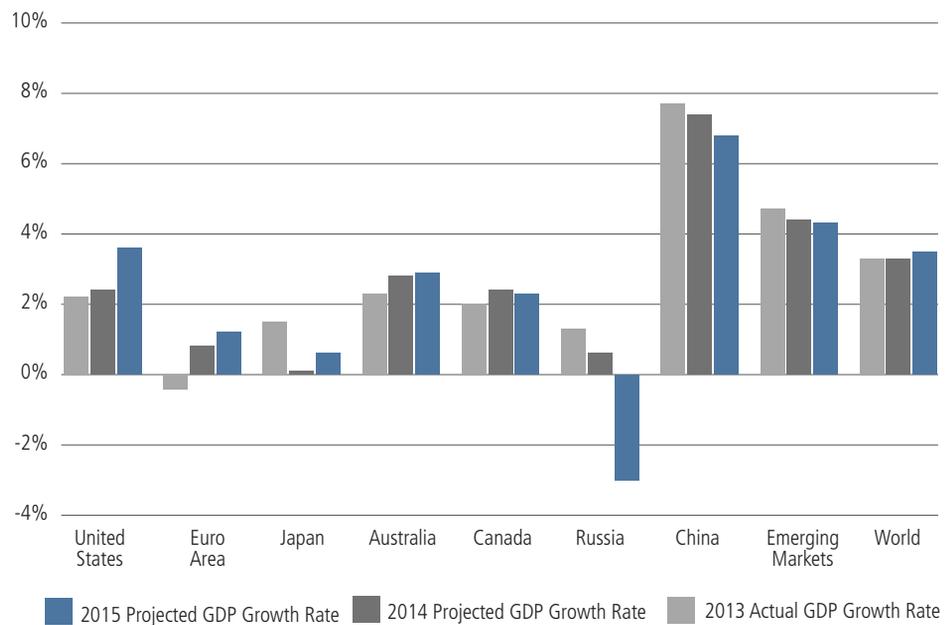
Sources: Neuberger Berman, Morningstar as of December 31, 2014.

In our opinion, building a long/short strategy based on rigorous, bottom-up security analysis is the most effective and transparent way to leverage the inherent advantages of the long/short framework in seeking to achieve favorable risk-adjusted returns over the long term.

**THE TIME IS NOW**

Once you have assessed the constructive role that long/short strategies can play in portfolios, a key question becomes whether the current market presents a fertile backdrop for the investment approach. Indeed, we believe that the world's rather uncertain and shifting environment offers a favorable backdrop environment for long/short investors.

**FIGURE 2: GLOBAL ECONOMIES ARE DIVERGING**



Source: International Monetary Fund, Neuberger Berman. As of January 31, 2015.

To our team, one way to achieve reasonable risk-adjusted returns is paramount—developing a thorough understanding of a company’s fundamentals.

The dynamics affecting markets are becoming increasingly complex. The paths of the largest global economies, including the United States, Europe, Japan and China, are beginning to diverge, and along with them, their respective approaches to central bank policy. These differences have increased volatility in interest rates, currencies and commodities, and have the potential to create further dispersion among equities in different geographies, sectors and market capitalizations.

In addition, a shift toward higher interest rates in the United States could highlight the differences between companies with stronger and weaker balance sheets. All these dynamics create potential for fundamentally oriented long/short strategies to capitalize on any short-term dislocation.

**FOR US, IT’S A MATTER OF FUNDAMENTALS AND KNOWING YOUR COMPANIES**

What “works” in long/short investing? There are likely a variety of ways to achieve reasonable risk-adjusted returns, but, to our team, one is paramount—developing a thorough understanding of a company’s underlying fundamentals. To achieve this entails rigorous security analysis that includes meeting management, analyzing financial statements, understanding key drivers of growth, assessing risk and, most important, understanding the capital allocation philosophy of senior management with regard to maximizing shareholder value.

**EVA AS A WAY TO VALUE CAPITAL ALLOCATION DECISIONS**

A measure we study closely is economic value added, or EVA, which provides an economic lens to judge the efficacy of a company’s capital allocation decision. For valuation, EVA attempts to put a microscope on the amount of future growth value priced into a security today. Within an EVA framework, earnings that are less risky—and by implication, less capital intensive—are worth more than those that require greater capital intensity and tie up significant balance sheet capacity.

Each capital allocation decision comes with its own unique risk and reward. Each unit of capital is scarce and carries an implicit charge; therefore, we believe capital must be carefully managed, measured and optimized to maximize shareholder wealth. For example, capital allocated to projects with earnings-per-share accretion that are not properly adjusted for the cost of capital has the potential to erode shareholder wealth over time. In these instances, we feel shareholders could be better served with a return of capital in the form of dividends or share repurchases.

Drilling down further from a fundamental perspective, we feel that stock selection should be closely tied to understanding a company’s ability to generate future cash flow growth relative to what is already implied by the current market value. Every publicly traded security has future earnings expectations that are built into its share price. A stock may be a viable candidate for a long position when the market appears to be underappreciating the company’s future growth prospects. The role of the fundamental analyst is to identify opportunities where the analyst has a differentiated view from that implied by the market. That view is determined by the analyst’s knowledge of the company and industry, the duration of the competitive advantage and an understanding of the expected rate of return on new capital invested.

Having a flexible approach with the ability to move quickly is essential before the market closes the perceived inefficiency.

### HANDS-ON PORTFOLIO MANAGEMENT ACROSS MULTIPLE AREAS OF OPPORTUNITY

In looking at long investments, we consider three broadly defined buckets of opportunity: capital growth, total return and opportunistic.

- Capital growth includes companies that are generally “income statement-constrained.” In other words, much of the investing is taking place through the income statement, in things such as brand building, people, research and development and marketing. We also think of this bucket as “believable” growth. When evaluating companies in this opportunity set, we begin by asking ourselves certain questions. For example, is there something about the company that allows management to grow revenue? And as companies in this bucket grow, will they produce more cash flow? Do they tend to earn above their cost of capital on reinvestment opportunities?
- The total return bucket focuses primarily on equity securities that we believe have the potential to produce a stable and growing stream of income, and may at times have the flexibility to include select fixed-income investments if we determine that the credit offers an attractive risk-adjusted return. This bucket tends to focus on companies that are very capital intensive and earn a small but consistent spread on their return on capital versus cost of capital. Moreover, the return on capital may be regulated, and thus more valuable, as regulation creates a competitive moat for the company.
- The third and historically smallest bucket is opportunistic. This entails identifying “hidden asset value” that comes about from industry or company-specific change, which may be the result of profits unrecognized in the company’s share price or prospective returns on invested capital. We look for companies where management action or industry change appears likely to drive future returns on capital higher and above the companies’ cost of capital.

Looking at the short side of portfolios, we believe that shorting increases the opportunity to generate returns from security selection, particularly in uncertain market environments. However, the thesis for a fundamental individual equity short should be highly differentiated from market expectations. A short position is not the inverse of our long investment process and must have a potential short-term catalyst that could have negative effects on value and that the market appears to underappreciate. This catalyst may manifest itself in a downward earnings reset or a competitive threat that is not yet understood. As such, having a flexible approach with the ability to move quickly is essential before the market closes the perceived inefficiency. In addition, hedging certain long exposures also may limit or reduce market risk (“systematic or undiversifiable risk”). This is implemented on the portfolio level across asset classes, sectors, geographies or market capitalizations.

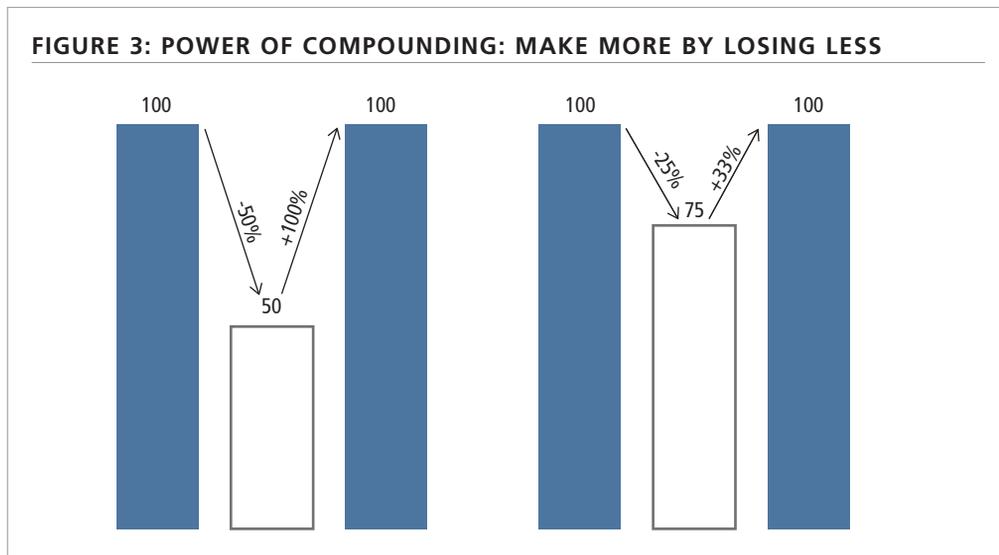
In our view, risk management for fundamental investors should start with company-specific analysis, including dialogue with management teams, that may reveal issues before any sign of market volatility emerges.

Keep in mind, however, that the hedging element of long/short only works if the short is matched against an asset with similar characteristics. For example, a long/short macro portfolio takes significant basis risk by investing long in U.S. equities and short European bonds. In this case, the short really isn't seeking to mitigate U.S. equity risk; rather the portfolio is making two distinct bets in search of alpha, and any potential losses could be magnified if they are done on leverage.

**KNOW YOUR ENVIRONMENT**

In our view, risk management for fundamental investors should start with company-specific analysis, including dialogue with management teams, that may reveal issues before any sign of market volatility emerges. In addition, having a broader awareness of other macro signals such as credit and equity volatility is imperative. When credit spreads are widening or there is increased equity market volatility for a prolonged period, we favor reducing risk on the margin, which typically involves bringing down gross and/or net exposure in a portfolio. However, idiosyncratic volatility also creates opportunities to increase and/or exit positions at more attractive prices, both long and short. Taking an active approach to equity investing allows managers the opportunity to capitalize on any near-term volatility.

Overall, we believe a long/short manager's mindset should always remain the same: pursue attractive returns, taking a reasonable amount of risk while focusing on mitigating downside risk exposure. In addition, a disciplined research process that is also flexible, scalable and repeatable is equally important. Our perspective is that thoughtful investing is about the opportunity to compound capital and protecting on the downside. Simply put, in the long run, investors can make more by losing less.



Source: Neuberger Berman. This is a hypothetical example for illustrative purposes only.

**MORE ACCESS, MORE TO THINK ABOUT**

Long/short strategies are well-known to institutions and high-net-worth individuals, but are still relatively new to many individual investors who increasingly access them through “liquid alternatives” (40 Act mutual funds or UCITS) portfolios. In our view, strategies such as long/short should be considered as part of all asset allocation discussions. Long/short can provide an opportunity to pursue attractive returns with reduced directional exposure to the full volatility of the equity markets.

**An investor should consider the Neuberger Berman Long Short Fund's investment objectives, risks and fees and expenses carefully before investing. This and other important information can be found in the Fund's prospectus or summary prospectus, which you can obtain by calling 877.628.2583. Please read the prospectus or, if available, summary prospectus carefully before making an investment.**

Small- and mid-capitalization stocks are more vulnerable to financial risks and other risks than stocks of larger companies. They also trade less frequently and in lower volume than larger company stocks, so their market prices tend to be more volatile. Large-cap stocks are subject to all the risks of stock market investing, including the risk that they may lose value.

Short sales involve selling a security the Fund does not own in anticipation that the security's price will decline. Short sales may help hedge against general market risk to the securities held in the portfolio but theoretically present unlimited risk on an individual stock basis, since the Fund may be required to buy the security sold short at a time when the security has appreciated in value. The Fund may not always be able to close out a short position at a favorable time and price. If the Fund covers its short sale at an unfavorable price, the cover transaction is likely to reduce or eliminate any gain, or cause a loss to the Fund, as a result of the short sale. There is no guarantee that the use of long and short positions will succeed in limiting the Fund's exposure to market movements, sector swings or other risk factors.

Investing in foreign securities may involve greater risks than investing in securities of U.S. issuers, such as currency fluctuations, potential social, political or economic instability, restrictions on foreign investors, less stringent regulation and less market liquidity. Securities issued in emerging market countries may be more volatile and less liquid than securities issued in foreign countries with more developed economies or markets, as such governments may be less stable and more likely to impose capital controls as well as impose additional taxes and liquidity restrictions.

Exchange rate exposure and currency fluctuations could erase or augment investment results. The Fund may hedge currency risks when available through the hedging instruments may not always perform as expected. Derivatives contracts on non-U.S. currencies are subject to exchange rate movements.

Shares in the Fund may fluctuate based on interest rates, market condition, credit quality and other factors. In a rising interest rate environment, the value of the Fund's fixed-income investments is likely to fall.

Derivatives may involve risks different from, or greater than, those associated with more traditional investments. Derivatives can be highly complex, can create investment leverage and may be highly volatile, and the Fund could lose more than the amount it invests. The Fund's investments in the futures markets also introduce the risk that its futures commission merchant ("FCM") would default on an obligation set forth in an agreement between the Fund and the FCM, including the FCM's obligation to return margin posted in connection with the Fund's futures contracts. The use of options involves investment strategies and risks different from those associated with ordinary portfolio securities transactions. If the Fund's portfolio manager applies a strategy at an inappropriate time or judges market conditions or trends incorrectly, options may lower the Fund's return.

Derivative instruments and short sales may also have an effect similar to that of leverage and can result in losses to the Fund that exceed the amount originally invested in the derivative instruments. Leverage may amplify changes in the Fund's net asset value ("NAV").

ETFs are subject to tracking error and may be unable to sell poorly performing stocks that are included in their index. ETFs may trade in the secondary market at prices below the value of their underlying portfolios and may not be liquid. Through its investment in exchange-traded funds, the Fund is subject to the risks of the ETF's investments, as well as to the ETF's expenses.

The HFRX Equity Hedge Index comprises equity hedge strategies. Equity hedge strategies maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. Equity hedge managers would typically maintain at least 50%, and may in some cases be substantially entirely invested, in equities, both long and short. Constituent funds are selected from an eligible pool of the more than 7,500 funds worldwide that report to the Hedge Fund Research (HFR) Database. Constituent funds must meet all the following criteria: report monthly; report performance net of all fees; be U.S. dollar-denominated; be active and accepting new investments; have a minimum 24-month track record; and the fund's manager must have at least \$50 million in assets under management. Constituents are weighted by a representative optimization methodology. The index is rebalanced quarterly.

The S&P 500® Index is a float-adjusted market capitalization-weighted index that focuses on the large-cap segment of the U.S. equity market, and includes a significant portion of the total value of the market.

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Neuberger Berman LLC  
605 Third Avenue  
New York, NY 10158-3698  
800.223.6448

[www.nb.com](http://www.nb.com)

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