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Long/Short Strategy Benefits

By limiting declines in a portfolio, long/short strategies can potentially recover more quickly after a market downturn.

Long/short strategies utilize broad investment flexibility to seek attractive risk-adjusted returns for investors. The risk-mitigating characteristics of these types of strategies offer the potential for achieving higher risk-adjusted returns by using hedging strategies that long-only strategies are unable to leverage. In a long/short investment strategy, managers buy stocks they expect will outperform and sell short stocks they believe will underperform. For example, utilizing short positions during declines in the equity market can reduce potential investor losses, as shown in Figure 1.

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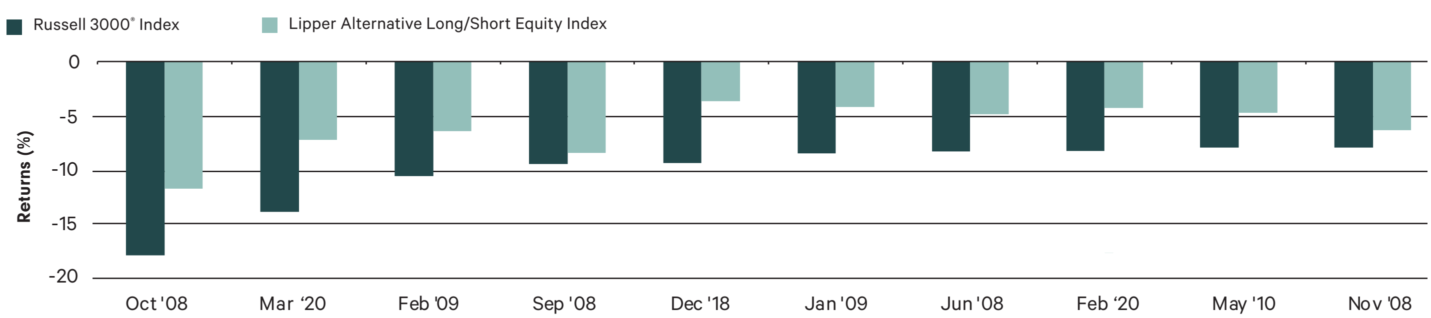
FIGURE 1: 10 Worst Months for the Russell 3000® Index since October 2003*



October 2003 is the inception of the Lipper Alternative Long/Short Equity Index. Data is obtained from FactSet Research Systems and is assumed to be reliable.* ***Past performance is no guarantee of future results.*

By limiting declines in a portfolio, long/short strategies can potentially recover more quickly after a market downturn. The following example illustrates this point: Unhedged Portfolio A declines 50% so it will need to grow 100% to regain its original value before the decline; Hedged Portfolio B declines 25% so it will need to appreciate 33% to regain its original value before the decline.

To further demonstrate how long/short equity presents the opportunity for downside mitigation, the charts on the next page show how reducing losses can be an important driver to achieving potential higher overall returns. The dark green line in both charts represents the cumulative performance of the Russell 3000® Index of 145% over the past 20 years. The lighter green line in Figure 2 represents a return of 166% if an investor captured 60% of the Russell 3000's gains and 50% of its losses. The lighter green line in Figure 3 represents a return of 288% if an investor captured 60% of the Russell 3000's gains and reduced losses to 40% of the index. Clearly, a reduction in portfolio losses over market cycles can provide a meaningful boost to long-term returns.

FIGURE 2: Risk Mitigation 60-50

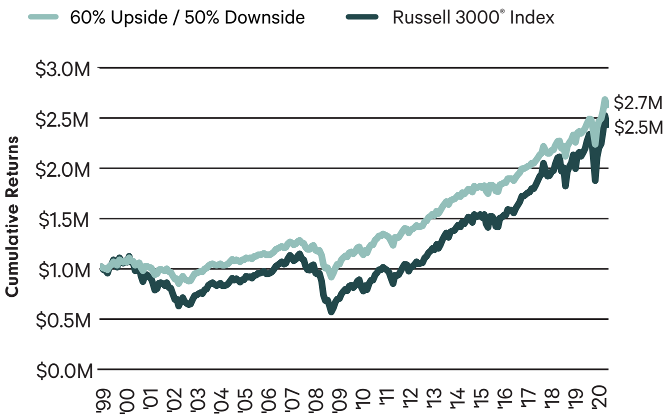
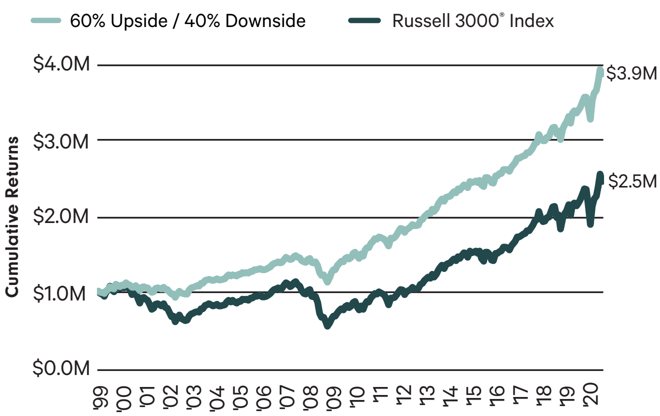


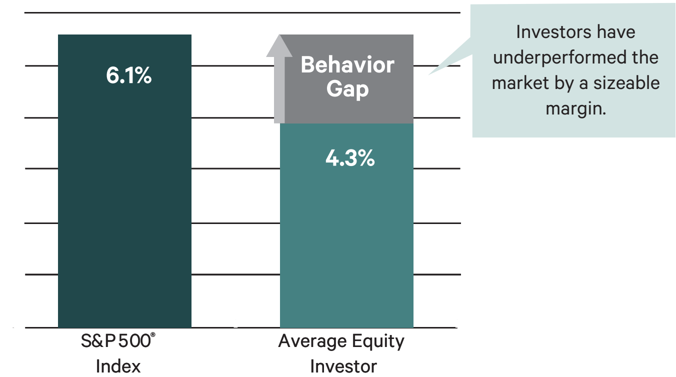
FIGURE 3: Risk Mitigation 60-40



Data is obtained from FactSet Research Systems and is assumed to be reliable. ***Past performance is no guarantee of future results.***

From a psychological perspective, limiting the declines in a portfolio may also help protect an investor from selling in a down market. Experiencing a sharp selloff can be extremely stressful for even the most expert investor and may prompt an emotional or fear-driven decision. Too often, panicked selling during a decline leads to sitting in cash as the market recovers and then re-entering after meaningful price appreciation already has occurred. Selling low and buying high produces returns, something known as the "Behavior Gap", that trail the returns of the overall market (as seen in Figure 4). A long/short strategy that reduces downside volatility can offer investors the peace of mind needed to stay fully invested during turbulent times with the added benefit of being in position to participate in a subsequent market rally.

FIGURE 4: 20-Year Average Index vs. Investor Returns



Data is as of December 31, 2019. Data is obtained from DALBAR, Inc. and is assumed to be reliable. ***Past performance is no guarantee of future results.***

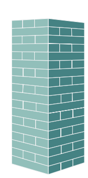
KAR LONG/SHORT STRATEGY

The KAR Long/Short Equity strategy seeks to generate attractive risk-adjusted returns using a disciplined quality-driven investment process to purchase long positions in companies with durable competitive advantages and strong management teams, and sell short positions in companies with poor financial performance, flawed business models and/or high financial leverage.

The long investment strategy aims to purchase the stock of businesses deemed by KAR as high-quality companies at attractive valuations. Attributes KAR uses to define "high-quality" companies include a durable competitive advantage, a strong management team and a strong balance sheet.

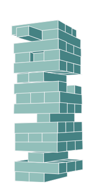
The short investment strategy aims to sell short the stock of low-quality companies whose share price the KAR team expects to drop because it does not accurately reflect the poor fundamentals of the business. Attributes KAR uses to define "low-quality" companies include erratic or mediocre financial performance, poor history of capital allocation, a compromised business model and/or high financial leverage.

WHAT WE BUY AND WHAT WE SELL



WE BUY BUSINESSES THAT EXHIBIT:

- ✓ Durable competitive advantages
- ✓ Strong fundamentals
- ✓ Reasonable valuations



WE SELL BUSINESSES THAT EXHIBIT:

- ✓ Lack of a durable competitive advantage
- ✓ Mediocre financial performance
- ✓ High financial/balance sheet risk

THE STRATEGY'S SHORT POSITIONS CAN GENERALLY BE CATEGORIZED INTO ONE OF THREE CATEGORIES:

SECULAR SHORTS

These are low-quality businesses that are in secular decline. Our expectation is that these companies will continue to generate inferior financial performance during the holding period.

- Typically the share price and financials have already shown weakness and we expect this situation to continue.
- Regardless of the market environment (high-quality vs. low-quality preference), the share price will follow the decline of the reported financials over time.

CYCLICAL SHORTS

These are low-quality businesses that are facing meaningful cyclical headwinds.

- For these types of shorts, we prefer companies with high financial leverage.
- As the cycle peaks and turns negative, the lack of pricing power and large amounts of debt cause equity values to compress.

TACTICAL SHORTS

These are businesses that have heightened near-term financial performance risk.

- The stock and financials may not have shown weakness yet, but the expectation is for that to change soon due to competition, customer concentration, input cost inflation, contagion effects, etc.

THE STRATEGY'S PORTFOLIO CONSTRUCTION GUIDELINES:

	LONG	SHORT
Position Weights	• Typically 20 – 30 holdings	• Typically 20 – 30 holdings • No overlap with any other KAR long-only strategy
Market Cap	• Target over $300 million market cap	• Target over $300 million market cap
Sector Tolerances	• Agnostic with respect to sector weights in Russell 3000 Index, but seek broad diversification	• Agnostic with respect to sector weights in Russell 3000 Index
Holding Period	• Typically 3-to-5 years	• Can be one year or less
Exposure	• Typically 80% – 100%	• Typically 20% – 30%, unlevered product
Position Size	• Typically 3% – 5% at cost, max is 10% at market	• Typically 1% – 2% at cost

In addition, the strategy's short positions target companies with a short interest ratio no greater than 10 days and a short interest/float of less than 20%. This is important because stocks with a large short interest can be at risk of a short squeeze (i.e., the stock price rises rapidly due to a rush of short sellers closing a position) and they tend to be expensive to short (short sellers have to pay interest when shorting a stock). It is also worth emphasizing that we do not use the proceeds from our short sales to increase our long exposure above 100% since that is a form of leverage. From the KAR perspective, adding leverage to the long portfolio adds unnecessary risk and can magnify losses in a downturn and, more importantly, it is in conflict with the strategy's primary goal of providing downside protection.

Finally, the strategy's net market exposure (long exposure minus short exposure) will fluctuate based on the number and quality of investment ideas KAR is able to find as a result of its bottom-up fundamental analysis. KAR avoids macroeconomic calls. The strategy will generally have a net long bias, which means that the long exposure will typically exceed its short exposure.

KEY DIFFERENTIATORS OF THE STRATEGY

Broadly speaking, many long/short strategies available today hold hundreds of stocks, have high turnover (100%+) and tend to have a valuation-based approach with respect to the selection of longs and shorts (i.e., long "cheap" stocks and short "expensive" stocks). Some of these strategies also dynamically adjust their net exposure based on a macroeconomic outlook by increasing their cash holdings and/or shorting ETFs instead of individual stocks, which the KAR Long/Short Equity strategy avoids. KAR's bottom-up research is focused on identifying companies with a durable competitive advantage, which we term "high-quality". High-quality is the strategy's starting point and these are the types of businesses owned in the long portfolio. The opposite is true of the strategy's shorts, whereby KAR wants to be short "low-quality" businesses. By focusing on quality, the way KAR picks stocks for the long and short positions is different from the valuation-based approach of others. A focus on quality also means there is intimate knowledge of the businesses owned so the strategy tends to be more concentrated than other offerings and KAR holds positions for the long term resulting in less turnover. The strategy's investing edge derives from KAR's rigorous research process, long-term mindset and quality investment analysis. As a result, KAR never attempts to time the market, such as adjusting net exposure with ETFs, like some of the strategy's competitors.

By owning a portfolio of businesses built to succeed over various economic and market cycles and shorting companies whose financial and competitive prospects are far less certain, KAR expects to generate attractive risk-adjusted returns over the long term.

KAR LONG/SHORT STRATEGY	OTHER LONG/SHORT STRATEGIES
Select long and short positions based on **quality**: long "high quality" stocks and short "low quality" stocks	Select long and short positions based on **valuations**: long "cheap" stocks and short "expensive" stocks
Typically **20 - 30** holdings	**100s** of holdings
Lower turnover	**Higher** turnover
KAR **never** attempts to time the market	Dynamically adjusts net exposure based on macroeconomic outlook

This report is based on the assumptions and analysis made and believed to be reasonable by KAR. However, no assurance can be given that KAR's opinions or expectations will be correct. This report is intended for informational purposes only and should not be considered a recommendation or solicitation to purchase securities. ***Past performance is no guarantee of future results.***