

**Palace Capital Management LLC**  
**Part 2A of Form ADV: Firm Brochure**  
**3/31/11**

Palace Capital Management LLC  
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**PALACE CAPITAL MANAGEMENT LLC PART 2A OF FIRM ADV – FIRM BROCHURE**

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Date of Brochure: 3/31/11

*This brochure provides information about the qualifications and business practices of Palace Capital Management LLC. If you have any questions about the contents of this brochure, please contact us at 505.984.9143 or [bcnaylor@palacecap.com](mailto:bcnaylor@palacecap.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.*

*Additional Information about Palace Capital Management LLC also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).*

*Registration with the SEC as a registered investment adviser does not imply a certain level of skill or training.*

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**2. Material Changes**

This brochure amendment contains material changes from the 2010 Palace Capital Management LLC Form ADV II update submitted on 3/31/10. Those material changes include:

- 1) The addition of the Palace Capital Offshore Fund Ltd. as a client of Palace Capital Management LLC. The Palace Capital Offshore Fund Ltd, is a Cayman Islands Exempted Company, to which Palace Capital Management LP serves as the investment manager.
- 2) Palace Capital Management LLC adopted a Code of Ethics in 2010. The Code of Ethics is summarized in Section 11.

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**4. Advisory Business**

- A. Palace Capital Management LLC is an investment advisor focused on alternative investments, primarily hedge funds. The firm was founded in 2002 by Blair C. Naylor. Ms. Naylor is the sole owner and principal of the firm.
- B. Palace Capital Management LLC primarily advises accredited investors on the selection of hedge fund managers and private equity managers. Palace Capital Management LLC or an affiliate manages investment accounts and provides investment supervisory services on a discretionary basis for a fund of private investment partnerships, otherwise known as a “fund of hedge funds”, and an offshore fund, a Cayman Islands company.  
Advisory services include the recommendation of hedge fund and private equity managers following extensive research, due diligence and monitoring of such managers.
- C. Advisory services are tailored to clients needs within the context of alternative investing. Clients may not impose restrictions on investing in certain securities or types of securities.
- D. Palace Capital Management LLC does not participate in any wrap fee programs at this time.
- E. As of 12/31/10, client assets total \$52.67 million. Client assets are managed on a discretionary and non-discretionary basis.  
Discretionary Assets Under Management = \$21.38 million as of 12/31/10  
Non-Discretionary Assets Under Management = \$31.29 million as of 12/31/10

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**5. Fees and Compensation**

- A. Palace Capital Management LLC offers investment advisory services for a percentage of assets under management. Palace Capital charges a management fee of 1.5% annually to each Fund. The value of the account on which the Management Fee is based is the market value on the last business day of the preceding quarter. Generally, fees are not negotiable.  
For accounts of "high net worth individuals," Palace Capital generally charges a quarterly fee, in advance, at the annual rate of 1.0% on the first \$10 million in assets under management; 0.75% on the next \$10 million in assets under management; and 0.5% on assets under management exceeding \$20 million. Generally, fees are not negotiable.
- B. Palace Capital bills the Funds and clients for its fees on a quarterly basis. Payment is due upon receipt of the Palace Capital's bills. Fees are deducted from the Funds quarterly.
- C. The Funds may pay custody, administrative, legal, tax and audit expenses. Expenses are deducted from the fund. All performance reported is net of fees and expenses.
- D. Upon termination of an investment advisory contract, all unaccrued, pre-paid fees are refunded to the client. Investment Advisory contracts may be terminated upon receipt by either party of 30 days' prior written notification.
- E. No employee of Palace Capital Management accepts compensation for the sale of securities or investment products.

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**6. *Performance-Based Fees* and Side-By-Side Management**

Generally, Palace Capital Management LLC does not charge performance-based fees. The Funds, Palace Capital Partners LP and Palace Capital Offshore Fund, Ltd., do not charge a performance fee. One Limited Partner in the Fund (Palace Capital Partners LP) has a side letter agreement dated April 1, 2006 under which an annual performance fee is charged. This is the only Limited Partner to which a performance fee is applicable. There is no conflict of interest as the Fund is managed to the benefit of all Limited Partners invested.

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**7. Types of *Clients***

Palace Capital Management LLC provides investment advisory services to high net worth individuals, to Palace Capital Partners LP (a fund of hedge funds), and to Palace Capital Offshore Fund, Ltd., a Cayman Islands Exempted Company. For an investment in the Funds, Palace Capital Partners LP or Palace Capital Offshore Fund Ltd., the initial subscription requirement is \$500,000, although investments of a lesser amount may be accepted. High net worth individuals are also subject to \$500,000 minimum to establish an account. There is not a required minimum balance to maintain an account. In addition to the initial investment we also require clients to read the offering memorandum, limited partnership agreement and to complete the fund subscription document.

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**8. Methods of Analysis, Investment Strategies and Risk of Loss**

**A. Methods of Analysis and Investment Strategies:**

The Investment Advisor seeks to identify hedge fund managers with attractive (and verifiable) risk-adjusted returns, understandable and sustainable investment strategies, substantial investment experience, strong analytical skills and portfolio management capabilities, the ability to measure and control risk, and significant personal investment within their funds. Generally, only after the completion of the due diligence process will a manager be considered for inclusion within the Fund. The final decision is based upon a number of factors, including but not limited to, 1) the need for an additional manager within a certain strategy allocation, 2) the need for the replacement of an existing manager within a certain strategy allocation, or 3) the initiation of a new strategy allocation within the Partnership for which there are currently no managers. Although Palace Capital endeavors to mitigate risk on behalf of its clients, investing in securities involves risk of loss of capital.

**B. Material Risks:**

We believe that the primary risks perceived for our strategy are as follows:

- 1) *Co-investor risk.* While Palace Capital intends to invest with its underlying hedge fund managers on a long-term basis, its “co-investors” within those investment partnerships often have short-term investment time horizons and/or opposing risk/return profiles (i.e. “hot money” investors). Such investors can be destabilizing factors and result in mass redemptions during periods of market distress and/or manager underperformance. Palace Capital manages this risk by avoiding hedge funds with concentrations of such investors.
- 2) *Liquidity risk.* As referenced above, certain strategies and managers utilize illiquid or thinly traded securities as core positions. Palace Capital continually monitors its strategy and manager allocations to ensure that its liquidity at the fund of funds level is sufficient to meet its investors’ quarterly redemption privileges.
- 3) *Manager risk.* While constructing a portfolio of multiple managers reduces the risk of manager fraud or gross negligence, it does not eliminate that risk. Palace Capital’s intensive initial and ongoing due diligence process is the cornerstone of managing the risk inherent in investing with external managers. As a complement to its own internal due diligence process Palace Capital may also outsource portions of its due diligence to services specializing in hedge fund manager background investigations.
- 4) *Strategy risk.* Although Palace Capital will invest across multiple strategies in an effort to reduce risk, there may be periods of time in which the inclusion of certain strategies effectively increases the level of risk within the portfolio. Therefore, the strategy allocation constraints as set forth in the Private Placement Memorandum for the Funds will be adhered to by the Investment Advisor. Furthermore, strategy weightings will be closely monitored on a monthly basis.

Regular risk assessments based upon monthly and/or quarterly exposure reports from the underlying managers will be conducted and may result in manager and/or strategy allocation changes within the portfolio.

In an effort to reduce the risk attendant to any single manager or strategy, the Partnership will invest no more than 15% of its assets with any one manager and no more than 50% of its assets in what the Investment Advisor considers any given investment strategy. The Investment



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Advisor expects to include a minimum of 2 funds per strategy, generally with 3-5 strategies in place at any given time. While the Fund may employ the use of leverage from time to time as stated in the Fund's Private Offering Memorandum, the Investment Advisor does not intend for leverage to be a significant or material part of the Partnership's strategy. Likewise, Palace Capital's underlying hedge fund managers generally do not rely upon high degrees of leverage in order to generate returns. Allocations to managers and strategies investing in illiquid or "thinly traded" securities will be limited and regularly monitored in order to maintain sufficient liquidity for Palace Capital's investors.

**C. Hedge Fund Risks**

Investing in hedge funds carries certain risks. The risks mentioned above for the strategy are the same risks applicable to investing in hedge funds.

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**9. Disciplinary Information**

N/A - Palace Capital Management LLC has had no disciplinary or legal action brought against the firm or any of its management persons.

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**10. Other Financial Industry Activities and Affiliations**

- A. N/A - Palace Capital Management LLC is not a registered broker dealer and has no pending application to become a registered broker dealer.
- B. N/A - Blair Naylor, the management person, is not a registered representative of a broker dealer and has no pending application to become a registered representative of a broker dealer.
- C. The following describes the nature of any relationship to our business or to our clients that the firm or any management person has with any related person listed below:
  - 1. Broker-dealer, municipal securities dealer, or government securities dealer or broker – No relationship
  - 2. Investment company or other pooled investment vehicle – No relationship
  - 3. Other investment advisor or financial planner – No Relationship
  - 4. Futures commission merchant, commodity pool operator, or commodity trading advisor – No Relationship
  - 5. Banking or thrift institution – No relationship
  - 6. Lawyer or law firm – No relationship
  - 7. Insurance company or agency – No relationship
  - 8. Pension consultant – No relationship
  - 9. Real estate broker or dealer – No relationship
  - 10. Sponsor or syndicator of limited partnership – Yes – Palace Capital Management LLC is the investment advisor to Palace Capital Partners LP and Palace Capital Offshore Fund, Ltd.
- D. Palace Capital Management LLC selects hedge fund managers, who may be SEC registered investment advisors for its “fund of hedge funds”, Palace Capital Partners LP and Palace Capital Offshore Fund Ltd. Palace Capital Management LLC does not receive compensation from those advisers.

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**11. Code of Ethics, Participation or Interest in *Client* Transactions and Personal Trading**

- A. Palace Capital Management LLC, has adopted a Code of Ethics pursuant to SEC rule 204A-1. Palace Capital Code of Ethics will be provided to any client or prospective clients upon request. The Code of Ethics in summary expects all Palace Capital employees to act with honesty, integrity and professionalism and to adhere to federal securities laws. All Palace Capital employees must adhere to the Code of Ethics. All employees must comply with the applicable federal securities laws. Palace Capital may impose penalties for breaches of the policies and procedures contained in the Code of Ethics. Employees must avoid personal conflicts of interest with Palace Capital and its clients. Employees will not knowingly divulge, furnish, or make available to any third person or entity, without Palace Capital's prior written consent, the identity of any Client (current, past or prospective) or other information about such Clients or their investments and positions. Employees may not accept extravagant gifts or entertainment from persons or companies trying to solicit business from the firm. Gifts and entertainment given or received must be reported to the Chief Compliance Officer. Employees may not borrow money from any of Palace Capital's suppliers or clients unless otherwise agreed to by the Chief Compliance Officer, or its designee. Insider trading is prohibited. Insider trading definitions and guidelines are outlined in the Code of Ethics and are consistent with SEC rules. The Code of Ethics for Palace Capital outlines Personal Securities Transactions reporting requirements and personal trading procedures. All employees are required to report actual or known violations or suspected violations of Palace Capital's Code of Ethics promptly to the Chief Compliance Officer.
- B. N/A - Palace Capital Management LLC does not recommend to clients, nor does it buy or sell for client accounts, securities in which it has a material financial interest.
- C. N/A – Palace Capital Management LLC does not invest in securities that we recommend to clients.
- D. N/A – Palace Capital Management LLC does not recommend, buy or sell securities at the same time that we buy or sell the same securities for our own accounts.

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**12. Brokerage Practices**

- A. N/A - Palace Capital Management LLC does not select or recommend broker-dealers for client transactions and therefore does not receive compensation for selecting or recommending broker dealers to clients. Palace Capital Management LLC does not have any soft dollar arrangements with broker-dealer or third party firms. Palace Capital Management LLC does not receive client referrals from a broker dealer or third party firm in connection with selecting or recommending broker dealer firms.
- B. N/A – Palace Capital Management LLC does not aggregate the purchase or sale of securities for client accounts.

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**13. Review of Accounts**

- A. Blair C. Naylor, Managing Member, reviews each account weekly in a manner consistent with the investment goals of each account.
- B. Client accounts may be reviewed more frequently if triggered by economic or market conditions.
- C. Statements are produced monthly. The independent administrator sends an electronic notification informing clients that statements are available on the administrator's website. The statements show performance data and capital account balances.

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**14. Client Referrals and Other Compensation**

- A. N/A – Someone who is not a client does not provide any economic benefit to Palace Capital by providing advice or other services.
- B. Palace Capital may enter into agreements with individuals who solicit clients for Palace Capital or investors for the fund of hedge funds. Palace Capital does not currently have any such agreements in place.

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**15. Custody**

Palace Capital Management LLC does have custody of client funds. An independent administrator sends a monthly electronic notification informing clients that statements are available on the administrator's website. The statements show performance data and capital account balances. Clients should carefully review statements each month.



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**16. Investment Discretion**

Palace Capital Management LLC manages investment accounts and provides investment supervisory services on a discretionary basis for the Funds, (Palace Capital Partners LP and Palace Capital Offshore Fund Ltd. ). Palace Capital has complete investment discretion as to which securities, and in what amounts, are bought and sold. Clients may not place limitations on Palace Capital's investment discretion authority. We assume this authority once the investor has signed the subscription documents and has wired the investment into the Fund account.

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**17. Voting *Client* Securities**

Palace Capital follows an established policy to vote proxies on behalf of its clients. The purpose of this policy is to further the best interests of the client. This policy has been and will be distributed to all prospective clients. This policy is available to clients upon request. Further, clients may request a record of how proxies have been voted on their behalf. Clients may not direct a vote in a particular solicitation.

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**18. Financial Information**

- A. Palace Capital Management LLC does not require or solicit prepayment of fees from clients six months or more in advance.
- B. Palace Capital Management LLC has discretionary authority and custody of client funds. Palace Capital custodies client funds with major bank custodians. Should those custodians experience financial impairment, client funds may be at risk or temporarily restricted.
- C. Palace Capital Management LLC has not been the subject of a bankruptcy petition at any time.

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**19. Requirements for State-Registered Advisers**

- A. **Blair C. Naylor** is the Managing Member of Palace Capital Management LLC. Prior to forming Palace Capital, Ms. Naylor was President of Draycott Capital Inc., a Santa Fe-based family office. In this capacity she managed a portfolio of traditional and alternative managers encompassing a variety of asset classes and investment strategies. From 1989-1998 Ms. Naylor was an investment advisor with Smith Barney (1990-98) and Merrill Lynch (1989-90), specializing in asset allocation and manager selection for private investors. Ms. Naylor joined Bear Stearns & Co. in 1987, shortly after receiving her B.A. from Tulane University.
- B. N/A – Palace Capital is not engaged in any other business.
- C. Generally, Palace Capital Management LLC does not charge performance-based fees. One Limited Partner in the Fund (Palace Capital Partners LP) has a side letter agreement dated April 1, 2006 under which an annual performance fee is charged. This is the only Limited Partner to which a performance fee is applicable. There is no conflict of interest as the Fund is managed to the benefit of all Limited Partners invested.
- D. N/A - Palace Capital Management or any of its management persons has never been found liable in any type of arbitration claim alleging damages involving investment or investment-related business activity, fraud, false statements or omissions, theft, embezzlement, bribery, forgery, counterfeiting, extortion, dishonest, unfair or unethical practices.  
N/A - Palace Capital Management or any of its management persons has never been found liable in any type of civil, self-regulatory organization or administrative proceeding involving investment or investment-related business activity, fraud, false statements or omissions, theft, embezzlement, bribery, forgery, counterfeiting, extortion, dishonest, unfair or unethical practices.
- E. N/A - Palace Capital Management or any of its management persons does not have any relationship or arrangement with any issuer of securities.