

## **Form ADV Part 2A: Firm Brochure**

July 16, 2012

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Clarium Capital Management, LLC (also referred to as Clarium) is an investment adviser that is registered with the United States Securities and Exchange Commission (SEC). Registration with the SEC does not imply a certain level of skill or training.

**This brochure provides information about the qualifications and business practices of Clarium. If you have any questions about the contents of this brochure, please contact us at (415) 248-5140. The information in this brochure has not been approved or verified by the SEC or by any state securities authority.**

**Additional information about Clarium is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

## Material Changes

Since the last annual Firm Brochure, dated March 30, 2012, we have updated our client assets under management in Section 1, added information pertaining to pending Facebook litigation in Section 6, and added information regarding our President's involvement with other investment advisers (including Mithril) in Section 7.

## Table of Contents

1.	Advisory Business .....	1
2.	Fees and Compensation .....	2
3.	Performance-Based Fees and Side-By-Side Management .....	3
4.	Types of Clients .....	4
5.	Method of Analysis, Investment Strategies and Risk of Loss .....	5
6.	Disciplinary Information.....	17
7.	Other Financial Industry Activities and Affiliates .....	17
8.	Code of Ethics, Participation or Interest in Client Transactions and Personal Trading .....	20
9.	Brokerage Practices .....	23
10.	Review of Accounts .....	26
11.	Client Referrals and Other Compensation .....	27
12.	Custody .....	28
13.	Investment Discretion .....	28
14.	Voting Client Securities .....	29
15.	Financial Information.....	30

### 1. Advisory Business

Clarium Capital Management, LLC (also referred to as Clarium), founded in 2002, is an investment management firm that provides investment advisory services to a suite of hedge funds (including Clarium LP) and certain other separate portfolio accounts. Clarium is the successor firm to Thiel Capital Management, LLC, which launched in 1996. Our firm's sole beneficial owner is Peter Thiel.

We are a broadly opportunistic investment adviser that seeks superior long-term capital appreciation by pursuing absolute returns using moderate leverage and risk across a "global macro" spectrum. Our "global macro" strategy involves the trading of futures contracts and other derivatives (including securities futures contracts), spot currencies, bonds, equities (including private equity investments) and such other instruments as may efficiently express one or more themes based on major macroeconomic trends that are influenced by government policies, economic cycles, new technology, innovations, or major commodity fluctuations. We attempt to time trades by using various quantitative and qualitative market- and sentiment-based indicators. In general, we seek to enter a trade when it is contrary to what most participants in the market believe and how they are positioned, as we believe fundamentally justified trades are generally less risky and have the greatest potential for appreciation when they are sufficiently contrarian.

Our firm tailors our advisory services to the individual needs and specified investment mandates of our clients. In the case of our hedge fund clients, our portfolio managers adhere to the investment strategy set forth in each client's private placement memorandum. We do not tailor our advisory services to the individual needs or any specified investment mandates of the investors in our hedge fund clients. For proprietary account clients, we execute an advisory agreement that defines a particular client's investment objective, and to which our portfolio managers adhere. Proprietary account clients may impose upon us restrictions on investing in certain securities or types of securities. These types of terms are all arranged on a case-by-case basis.

We do not participate in wrap fee programs.

The amount of client assets that we managed on a discretionary basis, as of June 1, 2012, was approximately \$1,125,900,000. We do not manage any client assets on a non-discretionary basis.

## **2. Fees and Compensation**

Our firm receives compensation from our hedge fund clients based on performance achieved for each client's account. We typically structure our performance-based fees as profit-sharing allocations through a general partner interest that we hold in the master fund into which our client hedge funds invest substantially all of their assets. For investors in our hedge fund clients, our fees are not negotiable, except under certain limited circumstances, such as where our employees or immediate family members of our employees are investors in our hedge fund clients. We generally do not charge proprietary account clients any performance-based fees. We only offer our advisory services to U.S. investors who are "qualified purchasers," as we discuss further in Section 4. Our non-U.S. investors are not subject to any particular wealth requirements.

We deduct the performance-based fee described above from our hedge fund clients' accounts at the end of each year, or whenever an investor in a hedge fund client is making a withdrawal, but only on the withdrawn amount.

We only charge performance-based fees when a client's or an investor's account is above its high water mark, or, in other words, when a client's or an investor's account value as of the end of the relevant period has recovered any losses from prior periods.

All of our clients may incur the following expenses:

- fees related to voting proxies;
- interest and commitment fees on loans and debit balances;
- banking charges;
- borrowing charges on securities sold short;

- custodial fees;
- brokerage commissions;
- trading expenses and trade processing fees, including clearing and settlement charges;
- taxes and costs incurred in acquiring, holding, selling or otherwise disposing of assets;
- research fees and materials (including publications, pricing feeds and software);
- costs of any outside appraisers, accountants, attorneys or other experts or consultants engaged in connection with specific transactions;
- insurance premiums, costs associated with indemnification and/or litigation and other extraordinary expenses;
- governmental, regulatory, licensing, filing or registration fees incurred in compliance with the rules of any self-regulatory organization or any national, state or local laws;
- costs of preparing and mailing reports to clients and/or investors;
- costs of meetings of investors (for example, an annual general meeting of shareholders), including any reasonable travel-related expenses our firm may incur in attending the meetings;
- costs associated with a client's liquidation; and
- any other expenses that are not typical operating expenses of an investment adviser.

Investors in our hedge fund clients also bear their share of any of the above expenses incurred by the master fund into which their assets are invested.

For more information on brokerage transactions and costs, please see Section 9 of this brochure.

None of our clients pays our fees in advance.

Neither our firm nor any of our employees receives any transaction-based compensation for the sale of securities or other investment products.

### **3. Performance-Based Fees and Side-By-Side Management**

Our firm receives performance-based fees from our hedge fund clients. Performance-based fees are calculated based on income, capital gains and capital appreciation attributed to a client's or an investor's investment above its high-water mark, as we explain in Section 2. We do manage certain proprietary accounts that we do not charge any management-based or performance-based fees. One of these accounts follows the same investment strategy as, and generally trades in parallel with and on the same terms as, our hedge fund clients, with certain exceptions described in our offering documents – for example, such account may not trade private equity instruments in parallel with our hedge fund clients. Other proprietary accounts may, or may not, follow the same investment strategy as, or trade in parallel with and on the same terms as, our hedge fund clients. In order to mitigate any potential conflicts of interest that may arise in the course of managing our proprietary accounts and our other client accounts, we follow, at all times, our trade allocation policy described in Section 9 of this brochure, in addition to our other compliance policies and procedures.

#### **4. Types of Clients**

Our firm provides investment services to hedge fund clients and proprietary accounts, which are typically comprised of investors that are:

- Individuals;
- Pension and profit sharing plans;
- Trusts, estates or charitable organizations;
- Corporations, partnerships and other business entities; and/or
- Funds of funds.

#### **Investment Requirements**

To invest in our hedge fund clients, we generally require a minimum investment of \$1,000,000. We do not have any stated minimum investment amount in connection with the proprietary accounts that we advise.

To comply with Securities and Exchange Commission regulation, we require that U.S. investors in our hedge funds clients qualify as accredited investors, qualified clients and qualified purchasers. Accredited investors are generally (i) individuals with \$1,000,000 of net worth (excluding their primary residence) or who have made \$200,000 in each of the two previous years (or \$300,000 joint income with one's spouse) or (ii) entities with assets totaling over \$5,000,000. Qualified clients are individuals or entities with over \$2,000,000 of net worth. Qualified purchasers are generally individual investors or certain family-owned entities with over \$5,000,000 in investments or entities with over \$25,000,000 in investments. Our non-U.S. investors are not subject to any particular wealth requirements. .

This firm brochure is not an offer to invest in our hedge funds.

## **5. Method of Analysis, Investment Strategies and Risk of Loss**

Generally speaking, our style of “global macro” investing involves the trading of futures contracts and other derivatives (including securities futures contracts), spot currencies, bonds, equities (including private equity investments) and such other instruments as may efficiently express one or more themes based on major macroeconomic trends that are influenced by government policies, economic cycles, new technology, innovations, or major commodity fluctuations. We attempt to time trades by using various quantitative and qualitative market- and sentiment-based indicators. In general, we seek to enter a trade when it is contrary to what most participants in the market believe and how they are positioned, as we believe fundamentally justified trades are generally less risky and have the greatest potential for appreciation when they are sufficiently contrarian.

We develop our investment themes based on a mix of fundamental, technical, political, quantitative and sentiment analysis. Our firm seeks investment opportunities resulting from large, pervasive distortions in the markets of which other participants are either not aware or have not determined an efficient way to trade. Generally, we do not emphasize external research when generating trading ideas; instead, we review external research to determine market consensus and to compare that consensus to the economic conclusions at which we have arrived internally. Examples of data sources we consult include implied option volatilities, commitments of traders, corporate insider buying and selling, the Federal Reserve’s Flow of Funds, Bureau of Economic Analysis trade flows, currency-adjusted commodity and equity price charts, ad-hoc consultants, long-range historical price data, independent research, investment bank research and proprietary indicators, among others.

Despite our research and analysis, investing in any securities or commodities involves a risk of loss that any clients and investors in our clients must be prepared to bear. Please read below for a detailed explanation of the investment strategies we employ and some of the significant risks associated with them.

Certain risks associated with an investment in any client we advise include:

- *Investment Judgment and Market Risk:* The success of our investment programs depends, in large part, on correctly evaluating future price movements of potential investments. We cannot guarantee that we will be able to accurately predict these price movements and that our investment programs will be successful.
- *Financial Markets and Regulatory Change:* The instability pervading global financial markets has heightened the risks associated with the investment activities and operations of hedge funds, including those resulting from a reduction in the availability of credit and the increased cost of short-term credit, a decrease in market liquidity and an increased risk of bankruptcy of third parties with which we work. Market disruptions over the recent years and the increase in

capital being allocated to hedge funds and other alternative investment vehicles have led to increased scrutiny and regulation over the hedge fund and asset management industry. In addition, the laws and regulations affecting business continue to evolve unpredictably. Laws and regulations applicable to our clients, especially those involving taxation, investment and trade, can change quickly and unpredictably in a manner adverse to our clients' interests.

The following is a description of the various strategies that we utilize in advising our clients and some important risks associated with each strategy. The following explanation of certain risks is not exhaustive, but rather highlights some of the more significant risks involved in our investment strategies.

- *Global Macro:* Our “global macro” strategy involves making investments based on what we believe are asset price distortions caused by macroeconomic factors, most notably, the cycle of asset bubbles, implosions and their corresponding policy responses. It contemplates investment opportunities in numerous markets and various financial instruments. In pursuing a global macro strategy for our clients, we analyze and seek to forecast interest rate trends, political situations, the general flow of money, foreign exchange rates, stock markets and other broad systemic movements. Macro trading enables us to allocate capital to the asset class, sector or country where we believe the best opportunities lie.

In our global macro approach to investing, we have historically concentrated our clients' investments in futures, foreign currency forwards and other derivatives (all discussed below), while employing a moderate-to-high amount of leverage. However, at times we may find it consistent with our strategy to invest in other types of securities as well – for example, we anticipate that private equity investments (also discussed below) may in the near term continue to represent a significantly higher percentage of our clients' portfolio investments than they have historically.

Although portfolios following a global macro strategy may experience high volatility at times, a global macro strategy may also protect portfolio capital during difficult market conditions.

- *Arbitrage:* Much of our clients' success depends on our ability to exploit price discrepancies in the markets. In the event that the relationships underlying our clients' arbitrage positions fail to converge toward or diverge further from the ranges we predicted, our clients may incur losses.
- *Derivatives:* Our clients' activities may involve investing in various derivative instruments. A derivative is a financial instrument that is a contract between two parties, the value of which is linked to another security or commodity, known as an “underlying asset”, or to a reference interest rate.

Any derivative contract typically involves leverage, as it exposes our clients to potential gain or loss from a change in the price of an underlying asset in an

amount that exceeds the amount of cash or assets required to establish or maintain the derivative contract. Consequently, an adverse change in the price of the underlying asset can result in a loss to our clients that is more exaggerated than would have resulted from an investment that did not involve the use of leverage inherent in a derivative contract. Finally, derivative contracts are risky because, ultimately, their success depends in part on the counterparty's financial condition, that is, the counterparty's ability to turn over the cash flow it promised.

We may trade derivatives over-the-counter, instead of on an exchange. The risk of nonperformance by opposing parties on over-the-counter derivatives is typically greater than the risk of nonperformance on exchange-traded derivatives. Also, derivative instruments not traded on exchanges are not subject to the same level of government regulation as are exchange-traded instruments, and many of the protections afforded to participants in a regulated environment may not be available in connection with over-the-counter derivative transactions.

A discussion of some of the particular types of derivative contracts in which we invest follows below.

- *Options:* There are risks associated with the sale and purchase of options. Our clients may invest in call and/or put options. Call options are the right to buy a security at a certain price within a defined time period. Put options are the right to sell a security at a certain price either within a defined time period or at a certain specific time. A buyer of either type of option assumes the risk of losing its entire investment in the option. A buyer of a call option risks losing its investment if the particular security never reaches the designated price within the set time period or at the specific time set for exercising the option. A buyer of a put option risks losing its investment if the particular security does not decline enough to reach the designated price within the set time period or at the specific time set for exercising the option.
- *Option Writing:* Our clients may write (sell) covered call and put options on securities. The applicable client receives a premium from writing a call or put option, which increases the client's return if the option expires unexercised or is closed out or exercised at a net profit. When a client writes a covered call option, it gives up the opportunity to profit from any increase in the price of a security above the exercise price of the option; when it writes a put option, the client takes the risk that it will be required to purchase a security from the option holder at a price above the current market price of the security.
- *Warrants:* On behalf of our clients, we may from time to time trade warrants. Warrants are derivative instruments that entitle the holder to buy the underlying stock of an issuing company at a fixed exercise price until an expiration date. Warrants are similar to options, except that warrants are issued by the issuing company (instead of a third party), are often attached to bonds or preferred stock and usually have longer exercise windows. Warrants often can be detached from bonds or stock and sold separately. Warrants do not carry with them the right to



dividends or voting rights with respect to the securities that they entitle the holder to purchase, and they do not represent any rights in the assets of the issuer. As a result, warrants may be considered more speculative than certain other types of equity-like securities. In addition, the values of warrants do not necessarily change with the values of the underlying stock and warrants cease to have value if they are not exercised prior to their expiration dates.

- *Futures:* Futures contracts, also known as “futures”, are contractual agreements to buy or sell a particular commodity or financial instrument at a pre-determined price in the future. At times, futures may be illiquid investments because certain commodity exchanges limit fluctuations in particular futures contract prices during a single day. Once the price of a futures contract has increased or decreased by an amount equal to the daily limit, that contract cannot be traded unless traders are willing to trade it within that limit. This could prevent us from promptly selling unfavorable contracts and thus would subject our clients to substantial losses. There is also the risk that an exchange or the Commodity Futures Trading Commission may suspend trading, order immediate liquidation or settlement in a particular contract. This could also prevent us from promptly selling unfavorable contracts.

In addition, margin requirements for futures contracts are typically low relative to the value of the futures contracts. Low margin requirements mean that a relatively small price movement in a futures contract could cause immediate and substantial losses. For example, if, at the time of purchase, 10 percent of the price of a futures contract is deposited as margin, a 10 percent decrease in the price of the futures contract would, if the contract is then closed out, result in a total loss of the margin deposit before any deduction for brokerage commission. Thus, like other leveraged instruments, any purchase or sale of a futures contract may result in losses in excess of the amount invested.

Typically, we ultimately settle the differences in a futures contract for cash rather than delivering or receiving the underlying commodity or financial instrument.

- *Forwards:* A forward contract, or “forward”, is a contract between two parties to buy or sell an asset at a specified future date at a price agreed upon at the time the contract is made. It is similar to a futures contract, except that forward contracts are negotiated privately and are not traded on an exchange, and are not, for example, subject to limitations on daily price moves. On the other hand, this means that there may not be a large secondary market for forwards, which means they may be difficult to sell should they become unfavorable for our clients. In addition, because forward contracts are not guaranteed by an exchange or other central clearinghouse, there is a higher risk that a counterparty will default in a forward contract than there is with derivatives that are traded on exchanges.

On behalf of our clients, we may enter into foreign currency forward contracts under which we agree to exchange one currency for another at a future date. Our

clients may experience a loss on these contracts if we fail to accurately predict the direction of currency exchange rates.

- *Swaps:* A swap is a type of derivative in which counterparties agree to exchange one stream of cash flows for another, each stream being based on an underlying asset or reference interest rate. For example, an investor realizing returns from an equity investment can swap those returns into less risky fixed income cash flows without having to sell its equities. Swaps are particularly sensitive to various market variables, such as interest rates and foreign currency values, which can affect the values of the cash flows, causing them to fluctuate. In addition, if a counterparty's creditworthiness declines, the risk of our swap agreement will rise, potentially resulting in losses to our clients.
- *Currency Trading:* A significant aspect of our clients' investment strategy involves trading in foreign currencies. We trade currencies on the foreign exchange market, a worldwide over-the-counter market. Investors should be aware that changes in currency exchange rates may adversely affect our clients. In addition, because currency trades are not cleared through a central counterparty (or clearinghouse) and there is minimal cross-border regulation, there is always the risk that the counterparty to one of our transactions may default, and we may not have any recourse against the defaulting counterparty.
- *Publicly Traded Equity Securities:* We may buy, on our clients' behalf, equity securities we believe to be undervalued and an efficient means of expressing macroeconomic views. For example, we may buy equity securities of an oil company if they are inexpensive compared to oil itself. The value of these investments will generally vary with their issuer's performance and movements in their issuer's industry and in the equity markets. Consequently, our clients may suffer losses if they invest in equity instruments of issuers whose performance diverges from our expectations.
- *Short Selling:* Short selling of securities occurs when we borrow securities, promising to buy them at a later date. If the price drops, we can buy the securities at the lower price and make a profit on the difference. If the price of the securities rises, we have to buy them back at the higher price, and the investment will lose money. Buying the securities can itself cause the price of the securities to rise further which would exacerbate the potential for loss. The risk of loss on short sales is theoretically unlimited, although we attempt to limit exposure through our risk policies.
- *Private Equity:* Our clients invest in securities issued by privately held companies. Because there is generally little or no publicly available information about privately held companies, we must rely on the information we are able to obtain through our own diligence efforts when deciding to invest in them and monitoring our investments. We cannot assure you that our diligence efforts will uncover all material information about privately held businesses necessary to make fully informed investment decisions.

In addition, private equity securities are subject to certain legal restrictions on resale that are generally not applicable to publicly traded securities. For example, unless an exemption is available, we will not be able to sell any of the private securities that our clients hold without the expense and time required to register the securities under the Securities Act of 1933 and applicable state securities laws. Even if these securities were to become publicly traded, our ability to sell them may still be restricted because we acquired them from the issuer in “private placement” transactions or because we may be deemed to be an affiliate of the issuer. Moreover, private equity securities may be subject to contractual restrictions on resale, such as rights of first refusal or market stand-off agreements, that would further limit our ability to resell them.

The market for privately held securities is smaller than the market for publicly traded securities and therefore our clients may find that disposing of privately held securities is more difficult than disposing of publicly traded securities. See “*Illiquid Investments*” immediately below.

- *Illiquid Investments:* From time to time our clients may make investments that are illiquid (including certain private equity investments described immediately above) or that become illiquid sometime after the investment is made. Illiquid investments are investments that are not heavily traded and cannot easily be converted to cash without material loss of value. If any of our clients requires cash and we must sell illiquid investments at an inopportune time, we might not be able to sell illiquid investments at prices that reflect our assessment of their value or the amount paid for them.
- *Fixed-Income Securities:* Some of our clients may invest in bonds or other fixed-income securities. Fixed-income securities (excluding fixed-income derivatives) provide periodic returns and the eventual return of the principal at the end of the term. The value of fixed-income securities changes in response to interest rate fluctuations and market perception of the issuer’s ability to pay off its obligations. Fixed-income securities are also subject to the risk that their issuer may default on its obligations and be unable to make interest or principal payments.
- *Strips:* We may occasionally trade strips on behalf of our clients. A strip entitles its buyer to either the interest or the principal payment of a bond, but not both. Similar to the risks associated with fixed-income securities, clients buying strips bear the risk that an issuer may be unable to make interest or principal payments on the underlying security.
- *Convertible Securities:* Convertible securities are bonds, debentures, notes, preferred stocks or other securities that can be converted into or exchanged for a specified amount of stock of the same or a different issuer within a particular period of time at a specified price or formula. The holder of a convertible security typically receives interest or a dividend until the security matures or is converted or exchanged. Convertible securities are unique in that they generally (1) have higher yields than common stocks, but lower yields than comparable non-

convertible securities; (2) are less subject to fluctuation in value than the underlying security due to their fixed-income characteristics; and (3) provide potential for capital appreciation if the market price of the underlying security increases.

The value of a convertible security is a function of its “investment value” and its “conversion value.” A convertible security’s investment value is determined by its yield in comparison to yields of other securities of comparable maturity and quality that do not have a conversion privilege. Changes in interest rates influence a convertible security’s investment value, as investment value declines as interest rates increase and vice versa. The issuer’s credit standing and other factors may also affect the convertible security’s investment value. A convertible security’s conversion value is determined by the market price of the underlying security. If the conversion value is low relative to the investment value, then the investment value principally governs the price of the convertible security. As the market price of the underlying security approaches or exceeds the conversion price, the conversion value will increasingly influence the price of the convertible security.

A convertible security generally will sell at a premium over its conversion value by the extent to which investors place value on the right to acquire the underlying security while holding a fixed-income security. Typically, the amount of the premium decreases as the convertible security approaches maturity.

A convertible security may be subject to redemption at the issuer’s option. If one of our clients’ accounts holds a convertible security that its issuer redeems, this could adversely affect our client’s ability to achieve its investment objective.

- *Leverage/Borrowing:* We may borrow against the assets of our clients when we believe that the proceeds from doing so will exceed the interest paid on the borrowing. Borrowing involves risk to our clients because the interest on the borrowed amount may be greater than the income from or increase in the value of the securities purchased with the borrowed amount. Also, the value of the securities purchased with the borrowed amount can decline below the amount borrowed.

Any investment profits made with the proceeds of borrowings in excess of interest paid on the borrowings will cause the income and value of a client portfolio to be greater than would otherwise be the case. On the other hand, if the value of the additional securities purchased with the borrowed money does not increase enough to cover the interest paid on the borrowings, then the income and value of a client portfolio will be less than would otherwise be the case. Generally, borrowing-type techniques used to increase potential returns are all forms of leverage.

Ultimately, to the extent our clients employ leverage, their assets will tend to increase or decrease at a greater rate than if they did not utilize borrowed money.

Clients and investors in our clients may experience differing tax consequences as a result of our clients' use of leverage. Clients and investors in our clients should consult their tax advisors regarding the tax treatment of gains from borrowed funds.

- *Margin Transactions:* To increase their buying power, sometimes our clients engage in margin transactions. Trading on margin is a form of leverage. Specifically, when our clients trade securities (excluding derivatives) on margin, they are borrowing from a broker to purchase more securities than they otherwise would be able to with their initial cash investment. The securities purchased on margin serve as collateral for the broker's loan. Trading on margin is risky because it can not only increase gains, but can also amplify losses to the point that a client may lose more than its initial investment.

Some of our clients employ short-term margin borrowing, which can be especially risky. For example, should the collateralized securities decline in value, a client could be subject to a "margin call," under which it must either deposit additional funds or securities with the broker or sell the pledged securities to compensate for the decline in value. If the value of a client's assets suddenly drops, the client might not be able to liquidate assets quickly enough to satisfy its margin requirements.

- *Hedging Transactions:* Our clients may engage in hedging transactions. Employing hedging techniques can reduce a portfolio's vulnerability to various risks. Hedging entails determining certain risks to one's portfolio and making trades to offset those risks. For instance, if an investor buys stock in a non-U.S. company, it may also short that company's local currency in order to hedge the risk associated with exchange-rate fluctuations. Hedging against a decline in the value of a portfolio position does not eliminate fluctuations in the values of portfolio positions or prevent losses if the values of such positions decline, but rather it establishes other positions designed to gain from those same developments, thus moderating the decline in the portfolio positions' value. On the other hand, hedging transactions also limit the opportunity for gain if the value of the portfolio position should increase.

The success of a client's hedging strategy is subject to our portfolio managers' ability to correctly assess the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the investments in the portfolio being hedged. There is a risk that we may not always choose the right variable to hedge against. For example, a client may own stock in an oil and gas company and bet that the price of oil will fall as a hedge, only to find out that the company's main asset is gas. Also, it is important to note that we may not always choose to hedge against, or might not anticipate, certain risks, and, our clients' portfolios will always be exposed to certain risks that cannot be hedged. In fact, many of our clients' positions are typically unhedged because, in our view, no satisfactory hedge exists.

Many other investment strategies we employ can be used as hedging techniques, such as options, forward contracts, futures contracts, swaps and short selling.

- *Commercial Mortgage-Backed Securities:* At times, we may invest in commercial mortgage-backed securities. Commercial mortgage-backed securities are interests in packages of mortgage loans that are backed by commercial property, such as apartments and retail shops. Typically, mortgage loans on commercial properties are structured so that a substantial portion of the loan principal is payable at maturity (rather than during the course of the loan term). Thus, repayment of the loan principal often depends on the future availability of real estate financing and/or the current value and salability of the real estate. If real estate financing is unavailable at that time or borrowers are unwilling to refinance or dispose of encumbered property to pay off the loans, the loans may default.

Most commercial mortgage loans underlying mortgage-backed securities are nonrecourse obligations, which means that the holder can make no claim against the borrower's assets other than confiscating and selling the property (foreclosure). Foreclosure can be costly and delayed by litigation or bankruptcy. When considering factors such as the property's location, the legal status of title to the property, the property's physical condition and financial performance, environmental risks and governmental disclosure requirements with respect to the property's condition, a third party may be unwilling to purchase the property at a foreclosure sale or pay a price sufficient to satisfy all of the borrower's obligations. In addition, the borrower may always retain any revenues from the underlying property or use the revenues to pay others, maintain insurance, pay taxes or pay maintenance costs. Such diverted revenue generally cannot be recovered without a court-appointed receiver to control cash flow related to the property.

Finally, mortgage-backed securities are subject to prepayment risk – the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. If the mortgage-backed securities in which we invest our clients' assets experience prepayments, our clients may sustain lower returns than we anticipated because we may have to reinvest their funds at lower interest rates.

- *Asset-Backed Securities:* Asset-backed securities are securities backed by assets other than mortgages or other mortgage-related assets. Credit card receivables, automobile, boat and recreational vehicle installment sales contracts, commercial and industrial bank loans, home equity loans and lines of credit, manufactured housing loans, corporate debt securities and various types of accounts receivable commonly support asset-backed securities. Asset-backed securities present certain risks that are not presented by mortgage-backed securities. Primarily, asset-backed securities do not have the benefit of the same security interest in the related collateral. Credit card receivables, for example, are generally unsecured and credit card debtors are entitled to the protection of a number of state and federal consumer loan laws, many of which give debtors the right to set off certain amounts owed on the credit cards, reducing their balance due. The risk of

investing in asset-backed securities is ultimately dependent upon payment of consumer loans by the debtor.

The collateral supporting asset-backed securities is of shorter maturity than mortgage loans and is less likely to experience substantial prepayments. The value of an asset-backed security is affected by changes in the market's perception of the asset backing the security and the creditworthiness of the servicing agent for the loan pool, the originator of the loans or the financial institution providing any credit enhancement, as well as by the expiration or removal of any credit enhancement.

- *Investing in Loans Generally:* When investing in any type of loan, there is always the risk that a borrower made a material misrepresentation or omission in the process of obtaining the loan. This inaccuracy or incompleteness can adversely affect the valuation of the collateral underlying the loan and/or can adversely affect our clients' ability to perfect or effectuate a lien on the collateral securing the loan.
- *Long-Term Investment:* Our clients often hold investments for substantial periods of time. Although certain long-term investments our clients make may generate some current income, the return of capital and realization of gains, if any, will generally only occur when a client sells an investment.
- *Short-Term Trading:* On the other hand, our clients may, from time to time, take shorter-term positions in response to adverse market, economic, political or other conditions. Short-term trading involves a certain degree of risk. Short-term trading denies a client the strategy of minimizing risk by holding a position over a longer time period. In addition, frequent trading results in high turnover and brokerage commission expenses, which can adversely affect a client's performance if its trading is not sufficiently profitable.
- *Investing in Small-Capitalization Companies:* Market capitalization is a measurement of a company's size equal to the share price times the number of shares outstanding (shares that have been authorized, issued and purchased by investors). From time to time, we may invest some of our clients' assets in the securities of small-capitalization companies and recently organized companies. Historically, these securities have been more volatile in price than those of large-capitalization and more established companies. Small-capitalization and recently organized companies' securities pose greater investment risks because the companies may have limited product lines, distribution channels and financial and managerial resources. Further, there is typically less publicly available information concerning such companies than there is for larger, more established businesses. In addition, the small-capitalization companies' securities may not be traded in the volumes typical for larger companies, and therefore it may take longer to sell such securities or we may have to accept potentially less favorable purchase prices. Ultimately, investing in companies with limited operating

histories is more speculative and entails greater risk than does investing in companies with an established operating record.

- *Limited Number of Investments:* Although, on behalf of our clients, we seek limited diversification, typically our clients participate only in a limited number of investments. In fact, there may be rare occasions during which a client may hold all of its assets in a single investment. Consequently, the success of each of our clients could be substantially adversely affected by the unfavorable performance of a single investment.
- *Foreign Securities:* Investing in securities of non-U.S. companies or governments poses currency exchange risks, including the risk of fluctuation between exchange rates, a risk we may not hedge against, and the costs of converting from one currency to another. Non-U.S. securities could also be subject to or affected by expropriation, imposition of foreign taxes, political or social instability, illiquidity, price volatility and market manipulation. In particular, non-U.S. markets often have lower trading volume than those of the U.S. and therefore may have less liquidity and experience more rapid and erratic price fluctuations. In addition, there may not be much information available regarding non-U.S. securities because non-U.S. companies and governments may not be subject to accounting, auditing and financial reporting standards and requirements comparable to those of the U.S. Along those lines, government supervision and regulation of exchanges, brokers and issuers is generally less onerous abroad than in the U.S. Also, it may be more difficult to take appropriate legal action in non-U.S. courts.

Finally, non-U.S. markets have different clearance and settlement procedures, which, in some markets, have difficulty keeping pace with large volumes of transactions. This can lead to substantial delays and settlement failures that could adversely affect our clients' performance.

- *Investing in Emerging Markets:* Emerging markets are countries that are less developed than the United States and other economically advanced countries such as Japan, Germany and the United Kingdom, but whose social and economic activity is in the process of reform and who are experiencing rapid growth and industrialization. While the growth of emerging economies may, at times, be more volatile and unpredictable than that of developed economies, investing in the markets of emerging economies may offer an opportunity to take advantage of their faster rates of growth. Other risks associated with investing in some emerging markets include less publicly available information, less strict securities market regulation, less favorable tax provisions, a greater likelihood of severe inflation, unstable currencies and war. Generally, emerging markets are not as efficient as markets in developed countries. Therefore, when trying to sell emerging market securities, there may be a small market or no market for the securities and transactions may need to be made on alternative exchanges, if they can be made at all. In addition, issuers located in emerging markets are not usually subject to uniform reporting standards and requirements, which increase the risk of fraud and other deceptive practices. Furthermore, due to quality and



reliability concerns, official data published by the government or securities exchanges in emerging markets may not accurately reflect the actual circumstances being reported.

Some banks and financial institutions that issue emerging market securities may be subject to less stringent regulations than would be the case in developed countries and therefore potentially carry greater risk. Also, custodial expenses for a portfolio of emerging market securities are generally higher than for a portfolio of securities issued in developed countries.

- *Pooled Investment Vehicles:* We may invest client assets in other collective investment vehicles, the managers of which possess unique access and abilities in markets that our clients would have difficulty trading in alone, such as certain emerging markets. Investing in pooled investment vehicles could cause our clients to indirectly pay a portion of the fees and expenses charged at the underlying fund level in addition to those they pay in connection with our operation of their account, which would, in turn, lower the return on the investment. The return on an investment in another collective investment vehicle depends on the ability of its manager to realize its investment objectives. While we choose only investment vehicles advised by managers that we believe are well positioned to succeed, our clients may experience losses in connection with such investments that are beyond our direct control. Furthermore, client investments in other collective vehicles may be subject to multi-year “lock up” provisions and therefore may be impossible to exit in the short run.
- *Short-Term Debt:* Client assets not being deployed to effect the above strategies will be held in custody or placed in U.S. Treasury Bills or money-market instruments, such as short-term certificates of deposit. Even though the Federal Deposit Insurance Corporation (FDIC) does not insure money-market instruments and we cannot guarantee that they will retain their value, money-market instruments typically do not carry much risk of loss. However, their potential for gain is negligible when compared to other strategies mentioned above.

We do not recommend primarily any single type of security. We encourage our investors to consider all of the risk factors we have explained, as any investment can be risky and investors must be prepared to assume any potential loss, including the entire amount they invest.

For a further description of our investment strategy and risk factors associated with an investment in one of our hedge fund clients, we refer eligible investors to the relevant confidential private placement memorandum or confidential explanatory memorandum provided in connection with an initial investment.

## **6. Disciplinary Information**

Other than as described below, neither our firm, nor any of our directors, officers or principals has been involved in any of the following that would be material to an evaluation of our firm's advisory business or the integrity of our firm's management:

1. Any investment-related criminal or civil actions in a domestic, foreign or military court;
2. Any administrative proceedings before the Securities and Exchange Commission, any other federal regulatory agency, any state regulatory agency or any foreign financial regulatory authority; or
3. Any self-regulatory organization proceedings.

Certain entities that are not advisory affiliates of our firm but that are affiliates of Clarium's President, Peter Thiel, were selling stockholders in the May 2012 initial public offering of Facebook, Inc. ("Facebook"). Mr. Thiel also is a director of Facebook. Clarium understands that Mr. Thiel, along with all other Facebook directors, has been named in various putative securities class action lawsuits and shareholder derivative actions related to the Facebook initial public offering, alleging violations of Sections 11, 12 and 15 of the Securities Act of 1933, and breaches of fiduciary duty and related claims, respectively. Clarium further understands that the defendants, including Mr. Thiel, deny any wrongdoing and intend to vigorously defend these cases.

## **7. Other Financial Industry Activities and Affiliates**

Neither our firm, nor any of our directors, officers or principals is registered as a broker-dealer or a representative of a broker-dealer or has an application pending to register as a broker-dealer or a registered representative of a broker-dealer.

Neither our firm nor any of our directors, officers or principals is registered, or has an application pending to register, as a futures commission merchant, commodity pool operator, a commodity trading adviser, or is an associated person of any of the above.

### Relationships with Pooled Investment Vehicles and Investment Companies

#### *Clarium Capital LLC*

In addition to serving as its investment adviser, Clarium Capital Management, LLC also serves as the managing member of our onshore hedge fund client, Clarium Capital LLC. Because we control Clarium Capital LLC as its managing member, there was no independent negotiation of our fees or other terms of Clarium Capital LLC's operating agreement. Although this arrangement may give us heightened control and discretion over Clarium Capital LLC, we manage any potential conflicts of interest by strictly adhering to the investment strategy and investment allocation policy discussed in its

offering documents. Clarium Capital LLC invests substantially all of its assets in a master fund, Clarium LP, which acts as a trading vehicle. We also control Clarium LP.

#### *Clarium Capital Fund Ltd.*

Certain Clarium employees serve on the board of directors of our offshore hedge fund client, Clarium Capital Fund Ltd. We address this potential conflict of interest by fully disclosing that these Clarium employees sit on our offshore client's board of directors in Clarium Capital Fund Ltd.'s offering documents. Although this arrangement may give us heightened control and discretion over Clarium Capital Fund Ltd., we manage any potential conflicts of interest by strictly adhering to the investment strategy and investment allocation policy discussed in its offering documents. Clarium Capital Fund Ltd. invests substantially all of its assets in a master fund, Clarium LP, which acts as a trading vehicle. We also control Clarium LP.

#### *Clarium Macro Investments Ltd.*

Clarium's President, Peter Thiel, is an investor in Clarium Macro Investments Ltd., a private investment company for which Clarium Capital Management, LLC serves as investment manager. Some of Clarium Macro Investments Ltd.'s assets follow the same investment strategy as, and generally trade in parallel with and on the same terms as, Clarium LP, with certain exceptions – for example, such assets may not trade private equity instruments in parallel with Clarium LP. On the other hand, some of Clarium Macro Investments Ltd.'s assets do not follow the same investment strategy as, or trade in parallel with or on the same terms as, Clarium LP. We manage any potential conflicts of interest by strictly adhering to the investment strategy and investment allocation policy discussed in our hedge funds' offering documents, as well as through certain compliance procedures devised by our Conflicts Committee to mitigate specific risks related to the trading of multiple, non-parallel accounts.

#### *Clarium Multi-Manager Fund Ltd.*

Clarium's President, Peter Thiel, is an investor in Clarium Multi-Manager Fund Ltd., a private investment company for which Clarium Capital Management, LLC serves as investment manager. Clarium Multi-Manager Fund Ltd. allocates funds to third party asset managers for investment. Because the strategy of Clarium Multi-Manager Fund Ltd. is substantially different from the strategy that we generally pursue on behalf of our other clients, we believe that our President's involvement with Clarium Multi-Manager Fund Ltd. does not create a material conflict of interest with our other clients.

### Relationships with Investment Advisers

#### *Founders Fund*

Clarium's President, Peter Thiel, is a Managing Member of, and owns a significant interest in, Founders Fund LLC, The Founders Fund Management LLC, The Founders Fund II Management LLC, The Founders Fund III Management LLC, The Founders Fund IV Management LLC and certain other entities, which serve as investment advisers

to a series of venture capital funds and co-investment vehicles collectively referred to as Founders Fund. We do not believe that our President's involvement with Founders Fund creates a material conflict of interest with our clients because the investment focus of Founders Fund is generally different from that of our clients. However, there may be circumstances where Founders Fund and our clients would invest in private equity securities of the same company. In these circumstances, our Conflicts Committee would be responsible for identifying, monitoring and resolving any material conflicts of interest.

#### *Valar Ventures*

Clarium's President, Peter Thiel, is President of, and owns a significant interest in, Valar Ventures Management LLC, Valar Ventures GP LLC and VV GP LLC, which serve as investment advisers to certain internationally-focused venture capital funds collectively referred to as Valar Ventures. We do not believe that Mr. Thiel's involvement with Valar Ventures creates a material conflict of interest with our clients because the investment focus of Valar Ventures is generally different from that of our clients. However, there may be circumstances where Valar Ventures and our clients would invest in private equity securities of the same company. In these circumstances, our Conflicts Committee would be responsible for identifying, monitoring and resolving any material conflicts of interest.

#### *Mithril*

Clarium's President, Peter Thiel, is Chairman of the Investment Committee of, and owns a significant interest in, Mithril GP LLC, which serves as the general partner of Mithril LP, a growth-stage investment fund. We do not believe that our President's involvement with Mithril creates a material conflict of interest with our clients because the investment focus of Mithril is generally different from that of our clients. However, there may be circumstances where Mithril and our clients would invest in private equity securities of the same company. In these circumstances, our Conflicts Committee would be responsible for identifying, monitoring and resolving any material conflicts of interest.

#### *Grandmaster Capital*

Clarium's President, Peter Thiel, is the beneficial owner of a minority interest in Grandmaster Capital Management LLC (also referred to as Grandmaster Capital), an investment adviser to a hedge fund that follows a long-short equity strategy. Patrick Wolff, a former Clarium employee, manages Grandmaster Capital. Jack Selby, currently a Managing Director of Clarium, is also an employee of Grandmaster Capital and allocates a portion of his business time to Grandmaster Capital. Mr. Thiel, in addition to his minority interest in the management company, has a substantial investment in the hedge fund that Grandmaster Capital manages, but has no active management role and does not participate in Grandmaster Capital's investment decision-making process. We do not believe Mr. Selby's or Mr. Thiel's involvement with Grandmaster Capital creates a material conflict of interest with our clients because Grandmaster Capital's strategy, with its focus on publicly-traded equities, is substantially different from the strategy we pursue on behalf of our clients. We have implemented certain compliance procedures to mitigate

any potential issues relating to the possession or sharing of material non-public information by or between Clarium and Grandmaster Capital.

#### *Octave Japan*

Clarium's President, Peter Thiel, owns a significant interest in Octave Japan Co., Ltd. (also referred to as Octave Japan), an investment adviser and real estate broker that focuses on real estate debt investments primarily in Japan and Asia. Matt Danzeisen, a Portfolio Manager of Clarium, also has an indirect ownership interest in, and serves on the board of directors of, Octave Japan. Octave Japan seeks to raise funds for investment in various Japanese real estate-related products and provides brokerage and advisory services in connection with Japanese real estate-related investments. We do not believe that Mr. Thiel's or Mr. Danzeisen's involvement with Octave Japan creates a material conflict of interest with our clients because the investment focus of Octave Japan is substantially different from that of our clients. Investments attractive to Octave Japan would generally not be consistent with our clients' investment strategy and vice versa.

#### Other Investment Advisers

We may recommend or select other investment advisers for our clients, including by investing our clients' assets in other pooled investment vehicles. We do not receive any compensation in connection with these recommendations, but any net gains or losses on such investments are included in calculating our performance-based fees as described in Section 2. We do not have any business relationships with the advisers of these vehicles that could create a material conflict of interest.

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

We have adopted a Code of Ethics in accordance with the Securities and Exchange Commission's requirements. Our Code of Ethics works to ensure that our employees honor their fiduciary duties to our firm and our clients. It focuses on specific areas where employee conduct has the potential to affect clients' or investors' interests adversely.

Specifically, our Code of Ethics requires employees to abide by federal and state securities laws and regulations, including insider trading prohibitions, obtain prior approval before investing in initial public offerings or private placements or serving as a director of any publicly-traded company, promptly report violations of the Code of the Ethics or any potential conflicts of interest and report any personal securities holdings. Our Code of Ethics also requires certain employees to submit quarterly transaction reports and annual reports that set forth all of their current holdings and to instruct their brokers to provide us with confirmations of securities transactions and copies of periodic statements upon our request. In addition, it provides for sanctions should anyone violate the Code of Ethics. We provide a copy of our Compliance Manual, which contains our Code of Ethics, to any client or qualified potential client or any investor or qualified potential investor in our clients that requests one. Our Compliance Manual is also

available on our website to our clients, investors in our hedge funds and qualified prospective clients or investors.

Under certain circumstances, we may recommend to clients, or buy or sell for client accounts, securities in which we or our affiliates have a material financial interest. In particular, we may invest, on behalf of our clients, in companies in which our employees have substantial ownership interests. In these circumstances, before we make an investment, our Conflicts Committee reviews any potential conflicts of interest.

Significantly, certain of our employees, including our President, Peter Thiel, have committed their own capital to our clients. Thus, although some of our clients may, at times, buy or sell securities in which employees have a material financial interest, the interests that our employees personally have in our clients help mitigate any potential conflicts.

### Cross Trades

To rebalance client portfolios due to capital infusion or withdrawals, we may cause one client to purchase an investment from another client (known as a cross trade), if we believe doing so would be consistent with our fiduciary duties and in the best interests of the participating clients. Cross trading may create conflicts of interest because cross trades are not independently negotiated. However, we do not take any commissions or fees in connection with effecting cross trades between our clients.

We may also cross trade in the market to rebalance client portfolios. For example, one client may sell 5,000 shares of a security while another client buys 5,000 shares of the same security. In these situations, we seek best execution for our clients in accordance with our regular brokerage practices, described in Section 9. Our policies also require that we maintain a written record that contains the date of the cross market transactions, the clients involved, the number of shares transferred, the prices received and paid and the commissions paid.

When effecting a cross trade among clients or in the market and deciding whether to effect a cross trade among clients or in the market, we always consider the best interests of our clients and our fiduciary duties to our clients.

### Principal Transactions

On occasion, our employees may engage in principal transactions with our clients, meaning that they may buy or sell securities to or from a client while acting for their own account. Principal transactions involve conflicts of interest because there is potential for employees to violate their fiduciary duties to our clients by effecting trades in their best interests rather than in the best interests of a client. We have several procedures in place to mitigate any potential conflicts that could arise in principal transactions. For example, an employee can engage in a principal transaction with one of our hedge fund clients only by a show of compelling circumstances and with prior written approval, on behalf of the relevant funds, from a majority of the disinterested members of Clarium's Conflicts

Committee and Investment Committee (and the directors of the relevant fund, if applicable).

At times, our firm, our affiliates or employees of our firm may buy or sell for themselves securities, or securities related to those, we also recommend to clients. This could create a conflict of interest if our employees receive more favorable execution prices than do our clients because our employees' trades might have driven up the market prices of target securities.

Certain personal employee trades, such as those relating to initial public offerings or private placements, placed by employees who provide our clients with investment advice or have access to material nonpublic information about our clients require the Chief Compliance Officer's prior written approval. These employees may not submit to the Chief Compliance Officer proposals to buy or sell any security that they know or have reason to know will be traded by a client within 3 trading days of the employee's proposed transaction. In addition, each employee who provides our clients with investment advice or has access to material nonpublic information about our clients has an affirmative duty to obtain pre-approval of personal securities transactions from our Chief Compliance Officer if he or she knows or has reason to know that his or her personal trading activities will have a material effect on the price of any security. We also prohibit these employees from trading in any securities on our restricted list, which includes securities of issuers of which we believe we may have material non-public information.

The personal securities trading activities of all employees who provide our clients with investment advice or have access to material nonpublic information about our clients must be reflected in their periodic reports they are required to submit to us. This allows us to monitor their trading activities and determine whether their trading activities are interfering with our clients' interests.

We manage certain proprietary accounts owned by Peter Thiel, our firm's President. One of these accounts follows the same investment strategy as, and generally trades in parallel with and on the same terms as our hedge fund clients, with certain exceptions—for example, such account may not trade private equity instruments in parallel with our hedge fund clients. Other proprietary accounts may, or may not, follow the same investment strategy as, or trade in parallel with and on the same terms as, our hedge fund clients. Managing proprietary accounts may give us an incentive to allocate particularly favorable investments to a proprietary account instead of to our other clients. However, we mitigate any potential conflicts of interest this arrangement may cause by strictly following our trade allocation policy described in our hedge fund clients' private placement memoranda and in our Compliance Manual (also see Section 9). In addition, our Conflicts Committee has implemented a set of guidelines intended to mitigate any potential conflicts relating to our management of Mr. Thiel's accounts and periodically reviews the accounts' trading activities to evaluate compliance with our conflict of interest and trade allocation policies. For a description of our trade allocation policy, see Section 9. Finally, the periodic reports that we send to investors in our hedge fund clients

contain information regarding the amount of assets trading under the same strategy, including those belonging to Mr. Thiel's accounts.

All of our employees have a duty to report any potential conflicts of interest to our Chief Compliance Officer as promptly as possible. Our Chief Compliance Officer or our Conflicts Committee, which is chaired by our Chief Compliance Officer, is at all times responsible for identifying, monitoring and resolving conflicts of interest. We require many of our senior employees to complete an annual conflicts questionnaire. Our Chief Compliance Officer reviews these questionnaires, while our General Counsel reviews our Chief Compliance Officer's questionnaire.

Lastly, when a Clarium employee proposes to trade a new account as a client of our firm, our Conflicts Committee meets to identify any conflicts that may arise in connection with the new managed account, prescribe controls to mitigate any conflicts that it may identify, review disclosures of potential conflicts to investors in our hedge fund clients and formulate any special review procedures as it deems appropriate.

## **9. Brokerage Practices**

In selecting broker-dealers for our clients, it is our firm's policy to obtain "best execution" for our clients' transactions. In other words, we seek to execute securities transactions for our clients so that a client's total costs or proceeds in each transaction are most favorable under the circumstances. We do not determine best execution solely based on commission costs, but rather by best qualitative execution. The brokerage costs our clients pay may not, in each individual case, be the lowest that are available. The factors we may consider when determining which broker-dealer to select for a client's transaction and the reasonableness of its compensation include:

- the net price of each transaction;
- the capability and efficiency of a broker-dealer;
- a broker-dealer's expertise;
- a broker-dealer's facilities;
- a broker-dealer's block trading and block positioning capabilities, or in other words, a broker-dealer's ability to effect certain large securities transactions;
- a broker-dealer's willingness to execute related or unrelated difficult transactions in the future;
- the financial services that a broker-dealer offers;
- a broker-dealer's willingness and ability to commit capital;



- a broker-dealer's available liquidity (including the availability of securities to borrow for short trades);
- a broker-dealer's responsiveness to our firm;
- a broker-dealer's financial responsibility, reputation, financial strength and stability;
- a broker-dealer's fairness in resolving disputes;
- the timing and size of the order(s);
- market conditions;
- research that a broker-dealer may be able to provide; and
- other matters generally involved in receiving brokerage services.

#### "Soft Dollar" Benefits

As a general policy, we use brokerage commissions that our clients bear to pay only for the execution of securities transactions and their incidental functions (such as clearance, settlement, and custody). Although the quality of a broker-dealer's research is one factor among many that we may consider when determining the reasonableness of its commissions, it is not our practice to enter into explicit arrangements with broker-dealers for any third party research or services, or for any services other than research internally generated by a broker-dealer. Receiving investment and research information from broker-dealers through the payment of commissions is a type of "soft dollar" benefit. The research services that broker-dealers provide us with include written information and analyses concerning specific securities, companies or sectors; market, financial and economic studies and forecasts; statistics and pricing or appraisal services; and discussions with research personnel. We may use this research in connection with our advisory services for any of our accounts, not necessarily only for the account that "paid" for them. We also do not necessarily aim to allocate the research we may receive to each client account in proportion to the volume of trading activity each client generates; however, we do seek to utilize any research we obtain from broker-dealers in a fair and equitable manner among our client accounts.

The Securities and Exchange Commission created a safe harbor that protects financial advisers from liability for a possible breach of fiduciary duty to their clients when advisers receive soft dollar benefits. The safe harbor protects advisers if they make a good faith determination that the amount of the commission paid was reasonable in relation to the value of the services received. Any soft dollar benefits that we may receive fall within this safe harbor.

Using client transactions to obtain research creates incentives that result in conflicts of interest between advisers and their clients. When we receive research products and

services in connection with commissions that our clients incur, our firm receives a benefit because we do not have to produce or pay for the research products and services. The availability of these benefits may influence us to select one broker-dealer rather than another to perform services for clients, based on our interest in receiving the products and services instead of on our clients' interest in receiving the best execution prices. Obtaining these benefits may cause our clients to pay higher fees than those charged by other broker-dealers. Because we receive a limited amount of research from broker-dealers, we do not believe that our receipt of research from broker-dealers poses any additional potential conflicts of interest between our firm and our clients.

Ultimately, as a firm policy, we must determine in good faith that the commissions our clients pay broker-dealers are reasonable in relation to the brokerage and research services they receive, viewed in terms of the particular transaction at hand or our firm's overall responsibilities for the accounts over which we exercise investment discretion.

We direct our clients' transactions to broker-dealers based on overall best execution, as explained above. Our Best Execution Committee, chaired by a senior member of our trading team, retrospectively reviews the quality of client execution twice a year and determines whether our clients have been receiving best execution overall.

#### Brokerage for Client Referrals

From time to time, our firm may make arrangements with broker-dealers under which they refer prospective clients or investors to us. Referral arrangements with broker-dealers create conflicts of interest because we may have an incentive to select a broker-dealer based on our firm's interest in receiving client or investor referrals, rather than based on receiving most favorable execution for our clients' transactions. In order to comply with our fiduciary duties to our clients, we regularly review the rates our clients pay broker-dealers to determine whether they are reasonable in relation to the value of the brokerage and/or other services that the broker-dealers are providing. We have not entered into any such arrangements during the past fiscal year.

#### Directing Brokerage

Our firm does not recommend, request or require that our proprietary client accounts, our hedge fund clients or investors in our hedge fund clients, direct us to execute transactions through a specified broker-dealer.

#### Trade Aggregation and Allocation

Many of our clients follow generally the same investment strategy, although certain clients, such as certain of our proprietary accounts, do not. However, all of our clients do tend to participate in many of the same investment opportunities. For each shared investment opportunity, we typically place one aggregate order on behalf of all participating clients, unless, under a particular circumstance, we believe that doing so would not be in the best interests of our clients or consistent with our best execution policy. When an aggregated order is filled in its entirety, we allocate the order to participating accounts *pro rata* based on their estimated net assets for accounts that

follow the same strategy, or such other allocation as the relevant portfolio manager may pre-determine for accounts that follow different strategies. If an order cannot be fully executed under current market conditions, we usually allocate the executed portion of the trade among the participating client accounts, using an average price, *pro rata* according to the procedure described above, to the extent practicable.

In addition to the procedures described above, our trading desk may consider any or all of the following factors in determining how to allocate aggregated trades, especially in situations in which *pro rata* allocations are not feasible:

- account-specific investment restrictions;
- undesirable position size (for example, if an amount that may be allocated to an account would create an undesirably small or large position);
- a need to restore appropriate balance to an account if it has become over or underweighted due to market action or new capital or withdrawals;
- client sensitivity to turnover (we may exclude these clients from participating in positions that we do not expect to be long-term holdings);
- client tax status;
- regulatory restrictions;
- common-sense adjustments that lead to cost savings or other transactional efficiencies; and
- whether an allocation would trigger undesired reporting requirements, obligations or other duties associated with a threshold position size.

## **10. Review of Accounts**

Each trading day, one or more members of our operations team reviews our clients' accounts to monitor trading activity. In addition, a senior member of our operations team reviews each client account at least once a week. Our firm conducts all of these reviews to ensure that we are maintaining consistency with the stated investment strategy of our clients. Finally, as we explained above in Section 9, our Best Execution Committee, chaired by a senior member of our trading team, reviews the quality of client execution twice a year to monitor whether our clients have been receiving overall best execution in connection with their trading activities.

We may conduct additional reviews if requested by a client or if we believe that a trade, allocation or operational error may have occurred.

Our administrator, Citco, provides investors in our hedge fund clients with individual written monthly performance statements. In addition, soon after the end of each year, we

provide investors in our hedge fund clients with the following written financial statements:

- an audited statement of financial condition as of the end of the year;
- a statement of operations for the past year; and
- a statement of change in net assets during the past year.

In exceptional circumstances, we may agree to provide certain investors with additional or more frequent information than described above.

We provide our proprietary account clients and their shareholders with written monthly performance statements.

## **11. Client Referrals and Other Compensation**

Our firm does not, nor do any employees of our firm, receive any economic benefit from non-clients for providing advisory services to our clients. Employees may, however, receive compensation from non-clients for participating on their boards of directors. Employees may also serve on the boards of directors of companies in which our clients invest. Any compensation received by our employees as a result of their service on a board of a company in which our clients invest will be reviewed by our Conflicts Committee to determine whether such arrangement creates a material conflict of interest with our clients.

Although we do not presently utilize any solicitors, our firm has previously engaged several solicitors to which we paid retainer fees for marketing our advisory services and introducing us to prospective investors. While these solicitors focused on overseas markets, we may, at our discretion, retain solicitors to perform similar services in the U.S. The solicitors we previously engaged tended to focus on retaining investors for our hedge fund clients, but if we engage solicitors in the future, they may also solicit potential managed account clients, in which case our firm and the solicitors would comply with the “cash solicitation” rule of the Investment Advisers Act of 1940. The cash solicitation rule requires, among other things, that:

- We pay the solicitors in accordance with a written agreement that specifies the solicitors’ compensation and activities;
- At each initial solicitation, the solicitors must deliver a current copy of this brochure and an additional written disclosure that describes, among other things, the solicitors’ compensation;
- The solicitors receive a signed and dated acknowledgment of the disclosure delivery described above from each potential client; and

- The solicitors must not be subject to certain statutory disqualifications under the Investment Advisers Act of 1940.

## **12. Custody**

While it is our firm's practice not to accept or maintain physical possession of any of our clients' assets, we are deemed to have custody of some of their assets under Rule 206(4)-2 of the Investment Advisers Act of 1940, as amended, because we have the authority to access clients' funds and deduct fees and expenses from clients' accounts.

### Hedge Fund Clients

In order to comply with Rule 206(4)-2, we use the services of a bank or qualified custodian (as defined under Rule 206(4)-2) to hold all assets of our hedge fund clients. We also direct the qualified custodian to maintain these funds in accounts that contain only clients' funds and securities. In accordance with Rule 206(4)-2, we also (1) engage an outside auditor to audit our hedge fund clients at the end of each fiscal year and (2) distribute the results of the audit in audited financial statements that are prepared in accordance with generally accepted accounting principles to all investors in our hedge fund clients within 120 days after the end of the fiscal year.

### Proprietary Account Clients

In order to comply with Rule 206(4)-2, we use the services of a bank or qualified custodian (as defined under Rule 206(4)-2) to hold all assets of our proprietary accounts, which are structured as pooled investment vehicles. We also direct the qualified custodian to maintain these funds in accounts that contain only clients' funds and securities. In accordance with Rule 206(4)-2, we also (1) engage an outside auditor to audit our proprietary account clients at the end of each fiscal year and (2) distribute the results of the audit in audited financial statements that are prepared in accordance with generally accepted accounting principles to the proprietary accounts' owner within 120 days after the end of the fiscal year.

## **13. Investment Discretion**

### Scope of Authority

Our firm accepts discretionary authority to manage our clients' securities accounts. This means that we have the authority to determine, on behalf of our clients and without obtaining specific client consent, which securities to buy or sell and the amount of securities to buy or sell, the brokers through which we effect trades and the commission rates at which we effect trades. Despite this broad authority, we are committed to adhering to the investment strategy and program set forth in each of our clients' private placement memorandum and/or investment management agreement. In addition to

describing each client's general investment strategy, these documents may cover matters such as the types of securities of which a client's portfolio will consist.

At times, proprietary account clients may place conditions on our authority to act for their accounts.

#### Procedures for Assuming Authority

Before accepting their subscriptions for interests or shares, as the case may be, we provide all investors in our hedge fund clients with a private placement memorandum that sets forth, in detail, our investment strategy and program and the terms of investment for investors, including a description of the applicable fund's fees and expenses. By completing our subscription documents to acquire an interest in one of our funds, investors give us complete authority to manage their investments in accordance with the private placement memorandum they have received.

Prior to providing investment advice to our proprietary account clients, we require each client to execute an advisory agreement that gives us full discretion over the trading of its securities and may appoint us as agent and attorney-in-fact of its portfolio that we manage.

### **14. Voting Client Securities**

#### Proxy Voting Policies and Procedures

Our firm typically votes proxies of an issuer in which our clients hold 5 percent or more of an issuer's outstanding shares, although we may vote any proxies if we determine that doing so is necessary or advisable in the exercise of our fiduciary duties to our clients. Our President is ultimately responsible for ensuring that we vote all proxies that we are required to vote under our policies and that we do so in accordance with our clients' best interests.

The actual voting of proxies may be delegated by our President to one or more of our employees. Employees with proxy voting responsibilities must review all proxy materials to determine whether the subject of each proxy involves routine matters or non-routine matters, as each category is described in our proxy voting policy. Our employees should vote proxies concerning routine matters in accordance with the issuer's board of directors' recommendation, unless we determine that doing so would not be in a client's best interests. If voting as recommended by an issuer's board of directors would not be in a client's best interests, employees must consult with our President to obtain his approval before voting.

On the other hand, if a client's proxy involves what we consider to be a non-routine matter, employees must consult with our President, who, with the relevant employees, will review the subject of the proxy on a case-by-case basis and vote the proxy in a manner that our President determines to be in a client's best interest.

Clients cannot direct our portfolio managers' proxy votes.

#### Potential Conflicts of Interest

If we identify any material conflict or potential conflict of interest between our firm (including any manager, officer or employee of our firm) and our clients in connection with voting a client proxy, it will be referred to our Conflicts Committee for resolution.

#### Recordkeeping

Our firm maintains the following records relating to proxy voting:

- Copies of our proxy voting policies and procedures and any amendments;
- Proxy statements received for client securities (although we may rely on a third party to retain copies of such statements or rely on obtaining copies of them from the Securities and Exchange Commission's EDGAR database, any successor system to EDGAR, or the equivalent in other countries);
- Records of proxy votes cast on behalf of our clients;
- Records of requests from clients and investors in our hedge fund clients for proxy voting information; and
- Any documentation that was material to making a proxy voting decision or that memorializes the basis for a proxy voting decision.

Upon request, any of our clients or any of the investors in our hedge fund clients can obtain a copy of our proxy voting policies and procedures and information concerning proxy votes on its behalf. In addition, clients and investors in our hedge fund clients can access our Compliance Manual, which contains our complete and definitive proxy voting policy, on our firm's website.

## **15. Financial Information**

We do not require nor do we solicit prepayment of more than \$1,200 in fees per client, six months or more in advance.

We are not aware of any financial condition that is likely to impair our ability to meet our contractual commitments to our clients.

Clarium Capital Management, LLC has never been the subject of a bankruptcy petition.