

FORM ADV PART 2A: FIRM BROCHURE

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This brochure provides information about the qualifications and business practices of Stellus Capital Management, LLC. If you have any questions regarding the contents of this brochure, please contact us at (713) 292-5414 or via email at thuskinson@stelluscapital.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority. Registration with the SEC or any state securities authority does not imply a certain level of skill or training.

Additional information about Stellus Capital Management, LLC can also be found on the SEC's website at www.adviserinfo.sec.gov.

Item 2 – Material Changes

This brochure reflects our initial filing and should be read in its entirety. In the future, Item 2 will only discuss specific material changes that have been made since our last filing and will provide a summary of those changes which are reflected in the updated brochure.

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Item 4: Advisory Business

Background

Stellus Capital Management, LLC (“Stellus”) , a Delaware limited liability company, is a newly formed investment advisory firm comprised of certain members of the direct capital team which was spun out from D. E. Shaw & Co., L.P. (“DESCO”), on January 3, 2012. Stellus’ team will consist of 21 people, including the management team. Its headquarters will be in Houston, Texas, with people located in San Francisco, metro NYC and Bethesda, Maryland. There is one principal owner, Robert Ladd.

Stellus’ strategy will be focused on providing debt and equity capital to small and midsized businesses in all industry sectors throughout North America. The team will provide capital solutions at all levels of the capital structure, including:

- Senior Debt
- Second Lien Debt
- Mezzanine Debt
- Convertible Debt
- Preferred and common equity

Capital solutions can range from \$10 million to over \$100 million for public and private entities seeking capital for various purposes, including:

- Acquisitions
- Recapitalizations
- Growth opportunities
- Leveraged buyouts
- Rescue finance
- Distressed or turnaround situations
- Bridge loans

The management team of Stellus has worked together for a number of years across several different companies. In 2004, certain members of the team joined DESCO to start the direct capital business, a strategy within certain investment vehicles advised by DESCO. On July 1, 2008, DESCO launched D.E. Shaw Direct Capital Portfolios, L.L.C. (the “DC Fund”). The DC Fund is advised by D. E. Shaw Direct Capital, L.L.C., (“DESDC”).

Stellus has entered into an ongoing strategic relationship with DESCO and DESDC pursuant to which Stellus has been engaged by DESCO and DESDC to assist such entities in managing certain investment positions held in the portfolios managed by such entities.

As of January 3, 2012, Stellus will only provide investment advisory services to DESCO in respect of certain direct capital positions in vehicles advised by DESCO (the “DC Positions”), and to DESDC, with respect to the DC Fund (each of the DC Fund and the vehicles in which the “DC Positions” are held, a “Portfolio”, and collectively, the “Portfolios”).

In each case, with respect to the investment activities within each Portfolio, Stellus will perform certain investment management and other financial services for DESCO and DESDC. Any transactions recommended by Stellus with respect to the DC Positions or the DC Fund will be subject to veto by DESCO or DESDC, as applicable. DESCO and DESDC will continue to be responsible for the valuation of all the DC Positions and the DC Fund’s investments and the preparation of any related financial statements and investor reporting.

The Portfolios are investment vehicles that are not registered or required to be registered under the Investment Company Act of 1940, as amended (the “Investment Company Act”). The securities of the Portfolios are not registered or required to be registered under the Securities Act of 1933 (“the Securities Act”) and are privately placed to qualified investors.

As of January 3, 2012 Stellus had no assets under management. Stellus expects to provide investment management services on a non-discretionary basis to DESCO and DESDC.

Item 5 – Fees and Compensation

Fees paid to Stellus

Pursuant to the strategic relationship with the D. E. Shaw group, Stellus expects to be paid management fees and performance fees by DESCO and DESDC with respect to the DC Positions and DC Fund, respectively. No additional management fee or performance fee is expected to be charged to the investors of the Portfolios as a result of the strategic relationship between Stellus and the D. E. Shaw group. Management fees are expected to be received monthly in arrears and performance fees will be received annually from DESCO in arrears and monthly in arrears during the year from DESDC.

Neither Stellus nor its supervised persons receives compensation for the sale of securities or other investment products to investors.

The Portfolios may incur expenses in connection with custodial or brokerage services discussed in Item 12. In addition, the Portfolios bear their own operating costs and expenses. Furthermore, Stellus, DESCO and DESDC may be entitled to be reimbursed for some or all expenses that it or its related persons incur on behalf of a relevant investment vehicle.

The Portfolios have fund offering documents that describe all of the fees and expenses paid by each investment vehicle.

New Stellus Funds

Stellus has only two clients, DESCO and DESDC; however Stellus intends to dedicate a portion of its time during 2012 and beyond to launching and advising new investment vehicles. Should Stellus be successful in launching new investment vehicles, in connection with the spin-out of the direct capital team to Stellus, DESCO has the right to receive a portion of certain revenues and proceeds received by Stellus related to such new endeavors.

Item 6: Performance-Based Fees and Side- by-Side Management

As discussed above, DESCO and DESDC have veto power in respect of all investment recommendations made by Stellus in connection with the services to be provided by Stellus to these entities in connection with the DC Positions and the DC Fund.

Stellus expects to receive performance-based fees for providing advisory services to DESCO and DESDC, as discussed in Item 5 above.

If Stellus is paid a higher performance-based fee from one Portfolio, it may have an incentive to devote more research and development or other activities, and/or to recommend the allocation of investment opportunities, to such higher fee-paying Portfolio.

When making investment recommendations in respect of the Portfolios, there may be differing performance-based fees. Stellus will endeavor to recommend the allocation of investment opportunities in a fair and equitable manner.

Item 7: Types of Clients

As stated above, as of January 3, 2012, Stellus' clients are DESCO and DESDC. The Portfolios are not registered or required to be registered under the investment Company Act and their securities are not

registered or required to be registered under the Securities Act and are privately placed to qualified investors. The Portfolios generally have a minimum investment requirement that may be waived by the investment manager at its sole discretion.

Item 8: Methods of Analysis, investment Strategies, and Risk of Loss **Methods of Analysis and investment Strategies**

Stellus will provide investment recommendations related to the Portfolios primarily with respect to corporate loans, and also with respect to securities, commodities, other financial instruments, and other interests. Stellus' focus will be on providing debt and equity capital to small and mid-sized businesses in all industry sectors throughout North America.

Stellus will seek to accomplish its investment objective through the origination of debt and/or equity financing and, purchase and sale of investments. The Portfolios in respect of which Stellus expects to provide investment recommendations may include for example, loans, bonds, notes, debentures, bills, trade claims, and other forms of indebtedness or liability issued or incurred by corporations or other entities; common and preferred stock of corporations (including investment companies); options, rights, warrants, convertible securities, exchangeable securities, synthetic and/or structured convertible or exchangeable products, participation instruments, and investment contracts; bank notes, term loans, debtor-in-possession ("DIP") loans, revolving loans, bank guarantees, letters of credit, and other forms of lender assets or obligations; currencies; swaps and other derivative instruments; futures, options on futures, and forward contracts; mortgages, mortgage- and other asset-backed securities, real estate, easements, other forms of real property-related instruments, and interests in the foregoing and in real estate investment trusts ("REITs"); commodities; money market instruments; receivables; financial interests in settlements of legal disputes; assets with specified tax attributes; limited partnership and other limited liability interests; general partnership and other unlimited liability interests; royalty rights and real property interests; and/or contracts or derivatives relating to the foregoing; in each case whether now existing or created in the future. Stellus may also engage in activities in furtherance of or incidental to the origination, purchase and sale, and/or holding of the above investments, including entering into repurchase agreements, reverse repurchase agreements, buy-sellbacks, sell-buybacks, and other trading or financing transactions.

Potential Risk Factors

The following analysis of risk factors refers to Stellus and discusses certain risks that may exist for investors in Portfolios advised by Stellus. Note that as of January 3, 2012, Stellus is providing investment advisory services only to DESCO and DESDC with respect to the DC Positions and the DC Fund. DESCO

and DESDC have veto power over all investment recommendations made by Stellus with respect to the DC Positions and the DC Fund.

Any investment involves substantial risks that should be carefully considered. Certain risk factors that may be considered applicable to an investment recommended by Stellus are outlined below. Additional risk factors are outlined in the offering documents for the applicable Portfolio. It should be noted, however, that there may be other risk factors applicable to such an investment that are not identified but that might still result in material losses to investors. Prospective investors should also consult their own legal, investment, tax, and other advisers, and the applicable offering documents, as to whether an investment recommended by Stellus is appropriate for them. All investments in securities involve a risk of loss that investors should be prepared to bear.

It should be noted that many of the risks outlined under one caption or heading are applicable to one or more other captions and headings.

No Assurance of investment Return

An investment in a Portfolio sub-advised by Stellus is not intended as a complete investment program. Such an investment should be regarded as speculative in nature and appropriate only for a sophisticated investor that can afford a loss of all of such investment and that is able to invest for an indefinite period. It should not be assumed that an investment in a Portfolio will be profitable. In addition to the risk of loss on its investments, Portfolio investments are subject to the direct and indirect fees and expenses or applicable offering documents, which will reduce returns and require that Stellus make a certain level of profit from its investing activities in order for an investment simply to break even.

Past performance of Stellus' strategies or the investment vehicles that it has advised and/or managed, or of any investment strategies operated within any such investment vehicle, is not indicative of the results that will be achieved by Stellus in the future and provides no assurance of the success of Stellus in achieving its investment objective.

General Factors

The prospects of an investment in a Portfolio could be materially adversely affected by changes or instability in market, economic, political, technological, regulatory, and social conditions, and by numerous other factors outside the control of Stellus.

Disruptions in the global financial markets may have materially adverse, and in certain cases catastrophic, consequences for the values, liquidity, and stability of certain investments. Such

disruptions may occur in the future, and the duration, severity, and ultimate effect of such disruptions are difficult to forecast.

In addition, some of Stellus' investment strategies and/or investments are likely to be exposed to risks relating to weaknesses in various global economies and risks relating to the economic cycle. Numerous factors affecting the performance of Stellus' investment strategies, such as interest rates, commodity prices, equity prices, availability, and terms of financing, demand from market participants, and deflationary and inflationary pressures, may be affected by the economic cycle and long-term economic trends. Predictions about financial market conditions and economic factors are highly uncertain, and the presence, duration, and impact of any market or economic conditions could have a material adverse effect on Stellus' investment strategies.

Special Risks of Certain Markets

Certain markets may pose special risks due to, among other factors, the limited availability of useful information, the reliance on self-interested persons for price and other information, and more or less regulation. For example, price information might be available only from dealers and might not be verifiable. Further, less regulation in certain markets might enable market intermediaries or other investors to engage in "frontrunning" (whether directly or through their customers or agents) of Stellus' trades, to misuse information about positions managed by Stellus to reduce the value or liquidity of those positions, and to take other actions that materially adversely affect Stellus' investment strategies. The limited availability of price information or actions of market intermediaries or investors could exacerbate other risk factors outlined in this brochure, including short squeezes, and could have a material adverse effect on Stellus' investment strategies. In addition, dealers may withdraw or substantially reduce the scope of their activity with regard to certain markets or investments without notice, resulting in disruptions to strategies, pricing, and/or the ability to liquidate or close out positions. Any of the foregoing could have a material adverse effect on Stellus' investment strategies.

Availability of Investment Opportunities

Identification and exploitation of investment opportunities and investment strategies by Stellus involve a high degree of uncertainty. Stellus makes decisions based on its assumptions, assessments, and estimates, all of which are subject to error. There can be no assurance that Stellus will be able to identify and/or successfully take advantage of suitable investment opportunities. Even if Stellus takes advantage of an investment opportunity, there is a risk that such investment opportunity will result in losses. If Stellus is not able to identify and/or take advantage of suitable investment opportunities, it may change its risk parameters in order to deploy capital, which may have a material adverse effect on Stellus' investment strategies. In addition, Stellus may rely on market participants to inform it of

particular trading and/or other investment opportunities. Returns may be reduced if market participants fail to provide such information or if Stellus is otherwise unable to source opportunities it considers appropriate for its investment strategies.

Origination Activities

Stellus engages in the origination of debt and/or equity financing. The Portfolios are subject to applicable laws in each jurisdiction in which such activities take place.

The market for originating debt and equity financing is highly competitive, and Stellus may be unable to compete effectively with other market participants for origination opportunities. Price pressure from competitors (including market participants that are not directly originating loans) may cause Stellus to recommend a client lower the interest rates that it charges borrowers, which consequently may lower the value of the loans. Further, if competitors adopt less stringent loan origination standards in order to maintain their loan origination volume, Stellus may cause clients to do so as well. If Stellus adopts less stringent loan origination standards, a client will bear increased risk for each loan originated under such less stringent standards, which may not be compensated by an increase in price.

Alternatively, Stellus may determine not to adopt less stringent origination standards in this competitive environment, which decision may result in a loss of market share. Increased pressure on pricing and origination opportunities likely would reduce the volume and quality of Stellus' origination activity and materially adversely affect clients. Some competitors may have higher risk tolerances or different risk assessments than Stellus, thereby allowing such competitors to achieve a broad diversification of investments and to establish more relationships than Stellus. These competitive pressures could have a material adverse effect on clients.

Limited Diversification; Concentration; Correlation

Investments recommended by Stellus may not be broadly diversified among particular issuers, issuances, companies, countries, industries, exchanges, counterparties, strategies, types of investments, or other shared characteristics. In general, less diversification may lead to greater volatility and/or risk than would be the case with a more broadly diversified portfolio. Even if investments in respect of which Stellus has provided advice are diversified, however, there can be no assurance that such diversification will reduce volatility and/or risk. In addition, a portfolio may be concentrated in particular issuers, issuances, companies, countries, industries, exchanges, counterparties, strategies, types of investments, and/or other shared characteristics, without any limitation other than applicable law or regulation (if any). Such concentration would magnify the risks associated with such investments, including the risk of significant losses.

There can be no assurance that Stellus will achieve returns that are not closely correlated with various market indices or the returns of other investment vehicles. There can be no assurance that Stellus will value less-correlated returns more highly than any other factor in selecting the investments and strategies. In addition, certain of the strategies deployed by Stellus may maintain (possibly extensive) unhedged exposure for an indefinite period to various sources of equity, credit, interest-rate, and/or other risk, whether known or unknown, while other strategies deployed may have such unhedged exposures from time to time. There can be no assurance that an investment with Stellus would improve the risk/return profile of any investor's portfolio or otherwise improve the performance of the investor's overall portfolio.

Low Creditworthiness Investments

There is no minimum credit standard for any of Stellus' investment strategies, and a (possibly substantial) portion may, whether at the time of investment or at a later time, involve investments that are unrated; rated below "investment grade" by recognized rating services; and/or defaulted. Unrated, sub-investment-grade, and defaulted investments generally involve greater risk of loss in either a short or a long position than do investment-grade investments. For example, the market values and yields of unrated, sub-investment-grade, and defaulted investments generally react more dramatically to changes in general economic conditions, in the levels of interest rates, and in the financial condition and prospects of their issuers than do those of more highly rated investments. During periods of economic downturn or rising interest rates, issuers of unrated, sub-investment-grade, and defaulted investments may experience, to a greater degree than issuers of more highly rated investments, certain forms of financial stress that could materially adversely affect such investments. Such issuers may be in early stages of development; may not have proven operating histories; may be operating at a loss or have significant variations in operating results; may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence; may require substantial additional capital to support their operations, to finance expansion, or to maintain their competitive position; or may otherwise have a weak financial condition. Additionally, such issuers may be highly leveraged, which may present greater risks to these companies.

Adverse publicity and investor perceptions, whether based on fundamental analysis, market rumors, distress of related issuers, or other sources, may materially adversely affect such low creditworthiness investments. Adverse effects on long positions in these investments include the increased probability of default, the decreased value of any recovery in connection with a reorganization proceeding, decreased secondary market prices (if any) for these investments, and general decreases in the liquidity of these investments. The secondary market for these investments is concentrated among relatively few market-makers or investors and may be expected to be less liquid than the secondary market for investments

that have higher ratings or are issued by non-distressed issuers. In addition, the lower liquidity of unrated, sub-investment-grade, and defaulted investments, as well as other factors outlined above, could exacerbate the risks of short positions in these investments.

Certain forms of low creditworthiness investments may be issued pursuant to note indentures, promissory notes, or other indicia of indebtedness that contain fewer debt covenants, rights, and remedies compared to those afforded to lenders under a credit agreement. As a result, such investments may be more sensitive to certain risk factors as compared to similar debt instruments with greater debt covenants, rights, and remedies. Moreover, the lack of certain financial covenants with respect to such investments may result in a higher risk of loss and may hinder the ability of Stellus to restructure a problematic loan in order to mitigate its exposure to loss.

Derivative Instruments

Stellus may recommend all types of derivative instruments without limitation other than any applicable limitations imposed by regulations and/or by counterparties and clearing brokers. Derivative instruments are financial instruments that derive their performance, at least in part, from the performance of an underlying asset, index, interest rate, or other reference instrument. Examples of derivative instruments include swaps, futures, forwards, options, warrants, options on futures, and swaptions.

Investments and trading in derivative instruments are generally highly speculative and involve various risks that are different in certain respects from, and are possibly greater than, the risks associated with investing directly in the applicable underlying assets or reference instrument.

Debt investments

Without limiting the scope of its possible activities, Stellus may recommend holding, structuring, and restructuring loans and other forms of indebtedness.

Secured Loans; Second Lien Loans; Unsecured or Subordinated Loans

Measures taken by Stellus to protect investors' interests in loans in which they may invest, including the validity or enforceability of such loans and the creation and maintenance of the anticipated priority and perfection of applicable security interests, may prove to be inadequate. There can be no assurance that any collateral would be sufficient to cover the obligations being collateralized or the amount of an investor's investment. Any collateral may decline in value; may be subject to competing claims of

creditors; may be difficult to recover or sell due to legal, regulatory, or other reasons; or otherwise may be inadequate to allow an investor to recoup its investment.

Stellus may recommend an investment in certain loans (“Second Lien Loans”) that are secured by a second priority interest or lien on collateral but are subordinated to other secured obligations. Second Lien Loans are subject to a risk that the cash flow of the related borrower and the property securing the Second Lien Loan may be insufficient to make scheduled payments on the Second Lien Loans after giving effect to any obligations in respect of the senior secured loans of the borrower. Second Lien Loans are also expected to be less liquid than senior secured loans.

Finally, Stellus may recommend investments in various types of unsecured indebtedness (such as senior unsecured, subordinated, or general indebtedness) that would be junior in priority to the claims of secured creditors. The claims of secured or senior creditors may exhaust some or all of the assets of a borrower before unsecured, subordinated, or general creditors may participate in such assets.

Lender Liability; Equitable Subordination; Fraudulent Conveyance

Investments structured as loans or other forms of indebtedness may subject investors to claims of lender liability and/or may be subject to claims of equitable subordination or recharacterization.

The risk of such claims may be exacerbated if an investor holds a significant equity position and/or certain management positions (including representation on the board of directors) with respect to the applicable borrower. Under the concept of “equitable subordination,” a court may subordinate the claim of a lender or bondholder to the claims of other creditors in certain circumstances, such as if the court finds that such lender or bondholder engaged in inequitable conduct to the detriment of other creditors. In addition, under certain circumstances, a loan may be recharacterized as an equity contribution if a court determines that the loan was in substance a disguised equity contribution to a company. If a court recharacterizes a loan as an equity contribution, such loan would be made subordinate to the claims of all creditors. Any successful claims of lender liability against an investor or any successful claims of equitable subordination or recharacterization could have a material adverse effect on such investment held by such investor (possibly resulting in losses that exceed the value of such investment).

Investments structured as loans or other forms of indebtedness may also be subject to claims of fraudulent conveyance. Any claims of fraudulent conveyance or preferential payment with respect to an investment could have a material adverse effect on an investor, which could be required to return related payments.

Certain Additional Risks

The terms of certain loans or other forms of indebtedness held by investors advised by Stellus may obligate such investors to extend to a borrower additional credit in the future, either at the request of the borrower or if certain other conditions are met. Any such additional extension of credit would increase such investor's exposure to the applicable borrower. In addition, if an investor does not have adequate available funds or chooses not to fund at the time additional credit is required, the borrower may seek to assert claims for damages against such investor.

Certain of the loans in which Stellus may recommend investing may require the investor to indemnify or reimburse the lead or agent bank for the loan for costs incurred by such bank. Such indemnification or reimbursement may cause substantial losses to the investor and may be required in addition to any costs incurred by such investor itself. In addition, lenders and other persons may seek to bring claims against the investor for the acts or omissions of a lead or agent bank.

Distressed Issuers

Stellus may recommend that an investor invest in long and short positions in investments issued by or otherwise related to companies that at the time of the applicable investment are experiencing, or subsequent to the applicable investment do experience, various forms of financial, business, operational, legal, and/or other distress or impairment, including companies involved in bankruptcy or other reorganization or liquidation proceedings (collectively, "Reorganization Proceedings"), as well as those emerging from Reorganization Proceedings and those seeking financial restructurings or reorganizations outside such proceedings. These investments involve a high degree of risk and the total value of the applicable investment may be lost.

Stellus also may recommend that an investor purchase from banks, other financial institutions, or other investors bank loans (whether through assignment or participation transactions) and other forms of direct or indirect indebtedness (including revolving loans and letters of credit) of distressed companies.

Investments in loan participations would expose an investor to risks related to the creditworthiness of the banks or other financial institutions issuing such participations.

Stellus also may recommend that an investor purchase bankruptcy claims (including trade claims), which are amounts owed to creditors of a distressed company. Investments in bankruptcy claims are difficult to value. Moreover, bankruptcy claims generally are illiquid and non-interest-bearing, and there can be no assurance that a company will be able to satisfy its obligations under a claim.

Sophisticated financial and legal analysis is often necessary for successful investment in distressed companies. There is no assurance that Stellus will correctly evaluate the value of the collateral (if any) supporting the investments held by an investor or the prospects for a successful reorganization or similar action. Such investments may be subject to additional risks, such as significant volatility in the value of the investment; the involuntary exchange of such investments for cash, financial instruments, or other property (including illiquid investments) having substantially less value than the original investment; and/or delayed or extended payment for such investments.

In addition, Reorganization Proceedings, as well as other financial restructurings or reorganizations, are subject to a number of risks. For example, such proceedings may be of uncertain duration; may be subject to unanticipated and possibly lengthy delays; may involve substantial legal, professional, and administrative costs to the reorganizing company and its investors; may involve other factors that are beyond the control of the reorganizing company and its investors; and/or may result in the liquidation of the reorganizing company. Further, Stellus, on behalf of an investor, may decide to become involved in the restructuring of a particular distressed company, including through representation on creditors' or equity holders' committees or other groups (whether formal or informal) and participation in litigation or direct negotiations with the company's management, each of which may involve special risks and/or conflicts of interest for an investor. The occurrence of any of these risks could have a material adverse effect on the value of the applicable investment or on Stellus' ability to dispose of or to act to protect the value of such investment.

Illiquid Investments

Stellus may recommend that an investor make investments characterized by varying degrees of liquidity, such as investments for which there exists no actively traded secondary market and which are thus highly illiquid or for which there is an absence of readily ascertainable market values. Any illiquidity with respect to the investments recommended by Stellus may or may not be anticipated and/or may vary over time. Such investments may constitute a substantial portion of the investor's assets in respect of which Stellus provides investment recommendations and may involve significant transaction costs when they are purchased or disposed of, whether through adverse price movements (whether related to liquidity or otherwise), increased spreads between quotes and dealer mark-ups (which may already be material for such investments), and/or other transaction costs. Stellus may recommend to liquidate illiquid investments (quickly or otherwise) if it believes that such liquidations may be warranted by market conditions or other considerations.

In addition, Stellus may recommend that an investor make investments that are subject to resale restrictions due to regulatory, statutory, or contractual provisions that limit the ability of Stellus to liquidate such investments. Such regulatory, statutory, or contractual restrictions could cause liquidity-

related losses, could result in exposure to unhedged positions, and could have other material adverse effects on investors.

Leverage

Stellus may recommend that investors borrow or otherwise use leverage to increase profit potential while increasing risk of loss and volatility. Leverage may take the form of borrowed money, uncovered short positions, uncovered put options, derivative instruments that are inherently leveraged, and other forms of direct and indirect borrowings. If the interest expense on borrowings were to exceed the net return on the portfolio of securities purchased with borrowed funds, returns would be lower than if the investors were not leveraged. Additionally, the use of leverage, while providing the opportunity for higher returns, also increases volatility and the risk of loss.

Private Investment Activities

Stellus may engage in certain private investment activities, certain risks of which are outlined below.

Private Equity-Related investments Generally

Stellus may recommend that an investor acquire controlling or non-controlling positions in privately held companies.

Private equity-related investments are generally characterized by an extremely high degree of illiquidity, frequently lasting several years and possibly indefinitely. The realization of a private equity return, if any, generally occurs only upon the partial or complete monetization of an investment by means of a dividend, distribution, recapitalization, initial public offering, asset liquidation, sale, other disposition, or similar financial event. Contractual or legal restrictions may delay realization of a private equity-related investment beyond the occurrence of any such financial event. In addition, an investor generally is expected to earn little or no current cash income on such investments prior to any realization event. Private equity-related investments may be extremely difficult to value, particularly in the absence of a specific liquidity event, readily available comparables, or a material change in the company associated with such investment or the industry in which such company operates. Even if a valuation change is ultimately made, the change may be, by necessity, highly subjective.

The long time horizons of investing in private equity-related investments may expose an investor to shifts in market, economic, political, technological, regulatory, and/or social conditions to an unusual degree. Developments occurring after a private equity-related investment is acquired may

fundamentally alter the anticipated market for such investment, preventing Stellus from disposing of the investment profitably or at all, or subjecting investors to risk of a potentially complete loss on such investment.

Stellus may become involved in the exercise of control of a particular privately held company, including in the form of representation on the boards of directors, equity holders' committees, or other groups (whether formal or informal) and participation in litigation.

Follow-on investments; Co-investments

Following an initial investment in a privately held company, Stellus may be presented with the opportunity to provide additional capital to such company. Even if such an investment is desired, it is possible that investors will have insufficient available capital to act. Any recommendation by Stellus not to make a follow-on investment or any inability by an investor to fund such an investment could have a material adverse effect on a privately held company in need of capital, potentially materially adversely affecting investors.

Stellus may recommend co-investing with third parties (including other investors advised by Stellus, or other Related Persons of Stellus) through consortiums of investors, partnerships, joint ventures, or other similar arrangements. Such investments may involve risks in connection with such third-party involvement, including the possibility that any such third party may have financial, legal, or regulatory difficulties that have a material adverse effect on such investment, may have economic or business interests or goals that are inconsistent with those of the relevant investor, may pursue interests inconsistent with those of the relevant investor, may default on their obligations, and/or may be in a position to take (or block) action in a manner contrary to the relevant investor's investment objective. In addition, an investor may in certain circumstances be liable for the actions of its co-investors. Such investments may involve performance charges, incentive compensation arrangements, and/or other fees payable to such third parties.

Hedging Transactions

Stellus may seek to limit an investor's exposure to various risk factors through the use of various hedging techniques. There can be no assurance that such hedging techniques will be effective or that they will result in higher or more stable returns than would have been the case had they not been employed. Moreover, such hedging techniques will tend to limit any potential gain that might result from an increase in the value of a hedged position.

It should be noted that any hedging techniques recommended by Stellus would be intended only to reduce exposure to certain risks and not to reduce all forms of investment risk. Further, Stellus is not obliged to hedge any particular form of risk in any particular situation, and Stellus will be free to recommend investors assume such risks and/or change their investment policies and practices in any manner as determined by Stellus. Moreover, certain of the investment strategies recommended by Stellus may from time to time have extensive unhedged exposure to various sources of equity, credit, interest rate, and/or other risk, whether known or unknown.

Under certain circumstances, hedging techniques intended to reduce certain forms of risk may actually increase risk, whether due to the unintended market impact of hedging transactions, leverage effects associated with hedging positions, unexpected adverse price movements of a hedging instrument relative to the hedged instrument (i.e., adverse changes in the “basis” between the hedging and hedged instrument), lower liquidity of the hedged and hedging positions relative to an unhedged position, the risks related to the use of derivative instruments, or other factors. In addition, even where Stellus seeks to hedge a particular risk, a suitable hedging transaction might not be identified by Stellus, not be available to an investor, and/or not be successfully executed.

Unlimited Liability investments

Stellus may recommend that an investor invest directly or indirectly in unlimited liability entities, which investments would expose such investor to a risk of loss in excess of its initial investment in such entities. Such investments may be made in general partnerships and/or other unlimited liability entities.

Price Volatility

The price of investments increases or decreases due to among other things credit risk, interest rate risk or changes in market factors (market risk). Generally, the longer the portfolio duration, the greater the degree of price fluctuation. Also, more concentrated portfolios have greater potential volatility. Below investment -grade securities are more susceptible to market risk and general economic factors than investment-grade securities, and, thus, typically bear increased price volatility risk.

Bridge Investments

Investments may include bridge financing to portfolio companies. While a bridge financing is outstanding, the bridge lender bears the risk of changes in the capital markets. A portfolio company's inability to refinance a bridge loan may result in retaining a long-term investment in a junior security or having its bridge loan converted to equity.

Participation on Creditors' Committees and Boards of Directors.

Representatives of Stellus, on behalf of the investors, may participate on committees formed by creditors to negotiate with the management of financially troubled companies that may or may not be in bankruptcy. Stellus may also seek to negotiate directly with debtors with respect to restructuring issues. In the situation where a representative of Stellus chooses to join a creditors' committee, the representative would likely be only one of many participants, each of whom would be interested in obtaining an outcome that is in its individual best interest. There can be no assurance that the representative would be successful in obtaining results most favorable to the investors advised by Stellus in such proceedings, although the representative may incur significant legal fees and other expenses in attempting to do so. As a result of participation by the representative on such committees, the representative may be deemed to have duties to other creditors represented by the committees, which might thereby expose the investors advised by Stellus to liability to such other creditors who disagree with the representative's actions. It is possible that Stellus or its affiliates will be represented on the boards of some of the companies in which investors advised by Stellus make investments. Such representation may have the effect of impairing the ability of Stellus to sell such investors' related investments when, and upon the terms, they might otherwise desire, including as a result of applicable securities laws. If Stellus or any of Stellus' affiliates or employees earns compensation with regard to any such board representation, such compensation will generally be remitted to the applicable investors advised by Stellus.

Item 9: Disciplinary Information

Stellus believes there are no legal or disciplinary events that are material to a client's evaluation of Stellus' advisory business or the integrity of its management.

Item 10: Other Financial Industry Activities and Affiliations

DESCO will have the right to receive a share of Stellus' revenues for a limited number of future years, and a share of the proceeds of any future sale of Stellus.

Item 11: Code of Ethics, Participation or Interest in Clients Transactions, and Personal Trading

Stellus has adopted a code of ethics (the "Code") that establishes the standard of business conduct that must be followed by, among others, all partners, directors, officers, and employees of Stellus (collectively "Supervised Persons"). The Code incorporates the following general principles, which all Supervised Persons are expected to uphold: act in the best interests of clients; conduct personal securities transactions in a manner consistent with the Code, which seeks to address certain conflicts of interest in this regard; avoid taking any inappropriate advantage of one's position at Stellus; maintain confidentiality of information concerning Stellus' securities recommendations and portfolio holdings and

transactions; and provide accurate disclosure in reports required by auditors, regulators, or government bodies.

Stellus believes that these general principles not only help Stellus fulfill its obligations undertaken as an investment adviser, but also protect Stellus' reputation and instill in employees Stellus' commitment to honesty, integrity, and professionalism.

The Code also provides guidelines for Supervised Persons regarding adherence to securities laws generally, transactions in personal accounts involving public and private securities and commodities, activities outside of the investment adviser's business, giving and receiving business-related gifts, and the maintenance and memorialization of certain family and/or close personal relationships. For example, the Code requires that all Supervised Persons obtain approval prior to effecting any securities or commodities transaction in a personal or related account for which the employee exercises control so that potential conflicts can be addressed. In addition, the Code requires that all Supervised Persons report Code violations and outlines potential sanctions for such violations. Stellus' Chief Compliance Officer is responsible for various aspects of the Code's administration, including without limitation the monitoring and review of personal securities and commodities transactions of Supervised Persons, and is available for any questions Supervised Persons have regarding the Code. Stellus will provide a copy of the Code to any client or prospective client upon request and may elect to provide a copy of the Code to investors in investment vehicles advised or sub-advised by Stellus.

Certain Potential Conflicts of Interest

Certain activities of Stellus may present a potential conflict of interest. These activities may include for example, advising other clients of Stellus, to the extent there are any, sponsoring other investment vehicles (including those with investment objectives similar to or overlapping with those of the Portfolios), making investments for their own accounts, or engaging in other lines of business.

Stellus and its related persons may have various advisory, transactional, financial, and other interests in securities and/or other financial instruments that may be purchased or sold by the Portfolios. These other activities could compete for the purchase, sale, trading, structuring, and restructuring or other investment vehicles in respect of which Stellus provides investment advice of investments. In addition, such activities could conflict with advice Stellus gives to DESCO or DESDC. For example, Stellus could advise that the Portfolios, or other investment vehicles in respect of which Stellus provides investment advice, buy or sell certain investments while simultaneously advising other clients to undertake a different (including potentially opposite) strategy with respect to those investments. Any common (or opposing) positions described above may limit the ability of Stellus to add to the position held on behalf of any Portfolio (or any other investment vehicle in respect of which Stellus provides investment advice),

to readily liquidate such a position, or to obtain a favorable price in the course of such liquidation. In effecting transactions for the Portfolio, a related person, and/or any other persons or entities, it may not always be possible or consistent with the investment objective of the Portfolio or of such other persons or entities to take or liquidate the same investment positions at the same time or at the same prices. The “market impact” associated with liquidation by such other persons or entities may adversely affect the ability of a portfolio, other person, or entity to liquidate its position; or where the position is liquidated, the price at which such liquidation occurs; or where the position of a Portfolio or other person or entity does not liquidate its position, the mark-to-market value of such position.

In general, Stellus will act in the best interests of its clients, subject to applicable law and to any agreement, organizational or other document, or disclosure applicable to a particular Portfolio or underlying investor. Stellus and/or its related persons may hold the same (or the opposite) position in a given security, commodity, or other financial instrument as that held by the Portfolio at the same time.

Such activities could also expose Stellus to material risks. Stellus has established a variety of restrictions, procedures, and disclosures designed to address potential conflicts between the interests of its clients and the interests of itself and/or its related persons in this regard, to ensure that its actions are consistent with the best interests of its advisory clients in this context. When conflicts of interest in this regard arise, they are addressed in compliance with all legal requirements and such restrictions, procedures, and disclosures, as applicable. Restrictions and procedures generally are established by heads of the applicable strategies, senior management, and/or compliance personnel.

Although Stellus expects to devote a certain amount of time and effort to the business and affairs of each client, it will also devote a substantial amount of its working time and effort to generating new business. These other activities may require substantial commitments of time and resources by Stellus.

Stellus may establish a new investment vehicle in the future that would be exposed to certain investment strategies deployed on behalf of Portfolios. Current Portfolio investors might or might not be permitted to participate in such new investment vehicle as determined by Stellus.

As disclosed in the applicable offering documents, Stellus has no obligation to recommend for purchase or sale by the Portfolios any securities that Stellus, or any of its related persons may purchase for themselves or for any other Portfolio or client. In addition, the ability of Stellus to effect and/or recommend transactions for certain or all Portfolios or clients may be restricted due to actual or perceived regulatory requirements in the United States or elsewhere, to Stellus’ or a related person’s internal policies designed to comply with such requirements, to actual or perceived conflicts of interest, to operational issues, and/or to other issues. Regulatory or contractual limitations related to effecting transactions for certain clients may not apply to other clients, resulting in differences in investments and returns.

Stellus generally does not itself trade securities on a principal basis with the Portfolios. Certain Portfolios and related persons of Stellus, however, could be principals (and in the future other Portfolios may be deemed principals), based on SEC staff guidance, due to an investment in any such Portfolio or related person by Stellus and controlling persons exceeding 25% of that Portfolio's or related person's assets. To the extent that Stellus and/or its related persons (including the Portfolios) engage (or are deemed to engage) in principal securities transactions, any such transactions will comply with applicable law. Stellus and/or its related persons may have interests in such transactions that are adverse to a particular Portfolio or other client.

To the extent permitted by applicable law and the applicable governing documents, Stellus may effect "cross transactions" between the Portfolios. Stellus would recommend the Portfolios to enter into such transactions only if the transactions were consistent with the best interests of both Portfolios and at a price that Stellus and/or its related persons believe constitutes best execution for both Portfolios. Neither Stellus nor any related party receives any commission or commission equivalent in connection with these transactions.

Disclosures regarding conflicts of interest and their resolution generally will be contained in the applicable offering documents, this brochure, and/or another document. Other documents, such as financial or periodic reports, furnished to investors may contain disclosure regarding conflicts of interest.

Item 12: Brokerage Practices

Generally, Stellus does not recommend the financial institution or counterparty to be used, if any, for each transaction executed on behalf of the DC Positions and DC Fund.

If Stellus were involved in selecting such financial institutions or counterparties for transactions, Stellus would seek to obtain the best execution of transactions under the circumstances (consistent with what it believes to be the best overall interests of clients), but need not solicit competitive bids, and would not have an obligation to seek the lowest available commission cost. The price offered by a financial institution or counterparty, including commissions and commission equivalents, if any, and other transaction costs, is normally an important factor in this decision, but financial institution and counterparty selection also takes into account the overall quality of the execution services offered, including without limitation such factors as: execution capability; willingness and ability to commit capital; creditworthiness and financial stability; clearance and settlement capability; ability to maintain confidentiality; the provision of research and other services; and potential or perceived conflicts between and/or among the Portfolios and Stellus related persons and/or other Stellus clients. Accordingly, transactions may not always be executed at the best price or the lowest available commission. Clients advised by Stellus may need to maintain and use a number of brokerage accounts

to facilitate the various trading strategies deployed by Stellus. Nevertheless, the clearing, settlement, and custody of Portfolio or other client positions may be carried out by a limited number of counterparties and, depending on the investment, may require negotiation on a transaction-by-transaction basis. This may create a concentration of exposure to the creditworthiness of the counterparties carrying out such clearing, settlement, and custody. Any failure of any such counterparty could have a material adverse effect on the Portfolios or other Stellus clients, as applicable.

If investment recommendations were to be made contemporaneously for multiple clients in the same instrument, Stellus may, if consistent with market conditions, portfolio characteristics, and applicable law, bunch or aggregate orders (including orders for clients in which Stellus, its related persons, and/or its personnel have beneficial interests) for execution. Such bunched or aggregated orders might facilitate execution and may reduce brokerage and other costs. Stellus, however, is not required to bunch or aggregate orders. If Stellus is unable to or does not fully execute a bunched transaction or if Stellus determines that it would be impractical to allocate a small number of positions among all of the accounts initially intended to participate in the transaction, Stellus may allocate such positions in a manner determined in good faith to be an appropriate allocation.

Subject to applicable legal restrictions, Stellus or its related persons may execute transactions in which it or its related persons act as principal as applicable, and may also execute transactions in which Stellus has an interest, as described in Item 10.

Stellus attempts to correct any identified potential trade errors. As with all financial gains and losses attributable to its investments, any financial gains or losses resulting from trade errors are generally borne by the applicable client and underlying investors (as more fully described in the applicable offering documents).

When trading on behalf of multiple clients with differing performance-based fees, Stellus endeavors to allocate investment opportunities among clients in a fair and equitable manner. Stellus' trade allocation for any given client may vary based on differences in investment objectives among clients, different capital constraints of each client, varying leverage preferences of each client, and any scheduled increase or decrease of any particular client's assets under management. Stellus does not alter its allocation policy with respect to a client, or allocate trades among multiple advisory clients, without the approvals of relevant senior management and compliance personnel.

Stellus does not currently participate in directed brokerage.

Item 13: Review of Accounts

For the purposes of providing services to DESCO and DESDC, Robert Ladd, Managing Partner and Chief investment officer of Stellus is expected to review potential investments and to approve (or disapprove) all programs of acquisition, loan originations, programs of disposal, and hedging strategies that are recommended to DESCO and DESDC by Stellus. Mr. Ladd, senior management of DESCO, DESDC and Stellus, and/or other supervisors are expected to be responsible for reviewing certain documents prepared in the investment process, trade data, and other reports on a regular basis and for overseeing the investment activity, trading activity, and loan origination performed on behalf of the Portfolios.

Stellus is expected to assist DESCO and DESDC in providing the Portfolios and/or investors in the Portfolios with written reports on a periodic basis that generally include, among other things, the net asset value or the capital balance of the account and a measure of performance based on the change in valuation of the account during the report period. The Portfolios' respective investment managers provide investors with annual reports including audited financials.

Item 14: Client Referrals and Other Compensation

Stellus may enter into capital introduction agreements with certain financial institutions under which the financial institution does not receive compensation for this service. Stellus does not currently use solicitors for client referrals. Stellus may engage internal and/or external placement agents for placement of new fund interests. Additionally, Stellus does not currently select or recommend broker-dealers based on whether Stellus or its related persons receive client referrals.

Item 15: Custody

Stellus is not deemed to have custody of any client assets.

Item 16: Investment Discretion

Stellus expects to provide investment advice on a non-discretionary basis to DESCO and DESDC with respect to the Portfolios. The Portfolios' respective managers must authorize all transactions.

Item 17: Voting Client Securities

Stellus does not vote proxies.

Item 18: Financial Information

Stellus does not require or solicit prepayment of fees more than 6 months in advance. Stellus has not been the subject of a bankruptcy petition at any time during the past ten years.