

X-Square Capital, Inc.

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3.12.13

This brochure provides information about the qualifications and business practices of X-Square Capital, Inc. If you have any questions about the contents of this brochure, please contact us at 787-231-0694 and/or email us at info@xsquarecapital.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about X-Square Capital, inc. also is available on the SEC's website at www.adviserinfo.sec.gov

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Advisory Business

a

X-Square Capital Inc. or X² Capital Inc. is a newly formed Investmet Advisory Corporation in San Juan, Puerto Rico and its fully owned by Mr. Ignacio Canto, married and resident of Guaynabo, Puerto Rico

b

X² Capital will act as the investment adviser for the X² Alternative Dividend Alpha Fund, a newly formed Puerto Rico investment company whose investment objective is to provide investors with a high level of current income. The investments will cover three principal areas, fixed income; mainly mortgages, equities; mainly high dividend paying stocks in non cyclical industries, and certain commodities that might offer inflation protection

c

As investment adviser for the X² Alternative Dividend Alpha Fund, X² Capital must follow the fund investment constraints as detailed in the ruling issued by the Office of the Commissioner for Financial Institutions of Puerto Rico

d

X² Capital does not participate in wrap fee programs

e

As of 3.12.13, X² Capital does not manage any clients assets, although it expects to manage at least \$25MM in discretionary client assets by the end of the calendar year

Fees & Compensation

a

X² Capital, Inc. (the “Investment Adviser”) will serve as the Fund’s investment adviser and will receive (i) a basic investment advisory fee, payable monthly, calculated at an annual rate equal to 1.50% of the Fund’s average weekly net assets (which equals total assets minus borrowings and other leverage), plus (ii) an incentive fee, payable annually, equal to 20% of the total annual return to shareholders (if certain total return thresholds are met), including dividends and capital appreciation (which may be paid in cash or shares of the Fund, at the option of the Investment Adviser), plus (iii) an upfront management fee equal to 0.25% of the aggregate purchase price of Shares issued by the Fund.

b

The brochure will be delivered to the fund

Types of Clients

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- 1. **Purchasers must be Puerto Rico Residents.** Purchasers must be either: (i) individuals who have their principal residence in Puerto Rico; or (ii) corporations or other business organizations that have their principal office and principal place of business in Puerto Rico (“Puerto Rico Residents”), provided that if the entity is a non-business trust, the trustee and all trust beneficiaries are Puerto Rico Residents.
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- **2. Purchasers must be Accredited Investors.** Purchasers must also be “accredited investors,” as defined in Regulation D under the Securities Act of 1933. The following individuals and entities qualify as “accredited investors” under Regulation D:
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- (i) any bank, insurance company, registered investment company, business development company or small business investment company;
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- (ii) any employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of \$5 million;
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- (iii) any charitable organization, corporation, or partnership with assets exceeding \$5 million;
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- (iv) any director or executive officer of the Fund;
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- (v) any business in which all the equity owners are accredited investors;
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- (vi) any natural person who has individual net worth, or joint net worth with the person’s spouse, that exceeds \$1 million at the time of the purchase, excluding the value of the primary residence of such person;
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- (vii) any natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year; or
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- (viii) any trust with assets in excess of \$5 million, not formed to acquire the Shares, whose purchases are made by a sophisticated person.

Types of Clients

- - 3. **Purchasers must be Qualified Clients.** Purchasers must also be “qualified clients,” as defined in Rule 205-3 under the Investment Advisors Act of 1940, at the time of purchase. The following individuals and entities are “qualified clients” under such Rule:
 - (i) any natural person who, or a company that, immediately after purchasing Shares in the Fund, has at least \$1 million under the management of the Investment Adviser;
 - (ii) any natural person who, or a company that, the Investment Adviser reasonably believes, either:
 - (A) has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than \$2 million; or
 - (B) is a “qualified purchaser” as defined in section 2(a)(51)(A) of the Investment Company Act of 1940; or
 - (iii) any natural person who is:
 - (A) an executive officer, director, trustee, general partner, or person serving in a similar capacity, of the Investment Adviser; or
 - (B) an employee of the Investment Adviser (other than an employee performing solely clerical, secretarial or administrative functions with regard to the investment adviser) who, in connection with his or her regular functions or duties, participates in the investment activities of the Investment Adviser, provided, that such employee has been performing such functions and duties for, or on behalf of, the Investment Adviser, or substantially similar functions or duties for, or on behalf of, another company for at least 12 months.
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- For purposes of calculating a person’s net worth as provided in clause (ii)(A) above, a person’s primary residence may not be included as an asset, and indebtedness secured by such primary residence is not included as a liability, up to the estimated fair value of such residence, provided that any indebtedness incurred within 60 days of the investment in the Fund must be included, unless it was incurred to acquire the residence. The amount of indebtedness secured by a person’s primary residence that exceeds the primary residence’s fair market value must be included as a liability.
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- For purposes of clause (ii)(B) above, a “qualified purchaser” is:
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 - (i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an investment company that is excepted under section 3(c)(7) of the Investment Company Act of 1940 with that person’s qualified purchaser spouse) who owns not less than \$5 million in investments, as defined by the Securities and Exchange Commission;
 - (ii) any company that owns not less than \$5 million in investments and that is owned directly or indirectly by or for 2 or more natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons;
 - (iii) any trust that is not covered by clause (ii) and that was not formed for the specific purpose of acquiring the securities offered, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a person described in clause (i), (ii), or (iv); or
 - (iv) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than \$25 million in investments.
- **4. Purchasers must be able to represent that they meet certain additional qualifications relating to experience with this type of investment.** Purchasers must represent that they are: (i) familiar with the use of high levels of leverage and derivatives; (ii) sufficiently knowledgeable and experienced in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Fund; (iii) financially capable of bearing the economic risks of an investment in the Fund; (iv) willing to assume a high level of risk in order to seek a high return; and (v) owners of sufficient liquid assets to be capable of bearing the risk of losing their entire investment in the Fund.

Types of Clients

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Methods of Analysis, Investment Strategies

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- The investment approach seeks to understand and identify opportunities that have the potential to provide excess risk-adjusted returns. This analysis is done from a global macro view and drilled down to relative value assessment in the MBS space and equity selection focused on high dividend paying stocks.
- Our relative value analysis in the MBS space is executed using our proprietary tools for pricing, interest rate and prepayment models. Furthermore, our equity allocation is based on a multifactor proprietary model that is fine tuned and complemented with fundamental analysis.

Methods of Analysis, Investment Strategies

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- *Mortgage-Backed Securities.* Mortgage-Backed Securities represent direct or indirect participations in, or are secured by and are payable from, mortgage loans secured by real property (“Mortgage-Backed Securities”). Investors in Mortgage-Backed Securities typically receive interest and principal on the underlying mortgage loans (and any related credit support). The Fund’s investments in Mortgage-Backed Securities will be considered as Puerto Rico Assets when the underlying assets are substantially comprised of mortgages over real property located within Puerto Rico (“Puerto Rico Mortgage-Backed Securities”).
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- Investments in Mortgage-Backed Securities will include those issued or guaranteed by the Government National Mortgage Association (“GNMA”), Federal National Mortgage Association (“FNMA”) or Federal Home Loan Mortgage Corporation (“FHLMC”), as well as Mortgage-Backed Securities which are not guaranteed or issued by GNMA, FNMA, FHLMC, or any other government agency (“Private Label Mortgage-Backed Securities”), and in either case may include collateralized mortgage obligations (“CMOs”). Private Label Mortgage-Backed Securities represent a beneficial interest in a privately sponsored trust or other entity, the assets of which are mortgage loans or GNMA, FNMA, FHLMC, or other Mortgage-Backed Securities, including CMOs.
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- GNMA Mortgage-Backed Securities include securities which are backed by mortgage loans insured by the Federal Housing Administration or guaranteed by the Veterans Administration, and which consist of mortgage-backed certificates with respect to pools of such mortgages guaranteed as to the timely payment of principal and interest by the GNMA. That guarantee is backed by the full faith and credit of the U.S.
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- FNMA Mortgage-Backed Securities represent a beneficial ownership interest in one or more pools of mortgage loans, which may be insured by the Federal Housing Administration or the Veterans Administration, or which may not be insured or guaranteed by any governmental agency. FHLMC Mortgage-Backed Securities represent direct or indirect participations in, and are payable from, conventional residential mortgage loans. FNMA’s and FHLMC’s obligations with respect to their Mortgage-Backed Securities are not backed by the full faith and credit of the U.S., but are considered to present minimal credit risks. CMOs are multiple-class Mortgage-Backed Securities. Some CMOs are directly supported by other CMOs, which in turn are supported by pools of mortgage loans. Investors in such securities typically receive payments out of the interest and principal on the underlying mortgage loans. The portions of these payments that investors receive, as well as the priority of their rights to receive payments, are determined by the specific terms of the CMO class. CMOs involve special risks. See “RISK FACTORS — Mortgage-Backed Securities.” The type of GNMA, FNMA, FHLMC and certain other Mortgage-Backed Securities in which the Fund may invest are described in more detail in “Appendix A — Mortgage-Backed Securities.” Not all types of Mortgage-Backed Securities are currently available in Puerto Rico.

Methods of Analysis, Investment Strategies



- *U.S. Government Securities.* The Fund may invest in U.S. Government Securities. These include securities that are issued or guaranteed by the United States government and its agencies and instrumentalities, such as obligations of the Federal Home Loan Bank, which are supported by the right of the issuer to borrow from the U.S. Treasury, and obligations of the Federal Intermediate Credit Banks, which are supported only by the credit of the issuer. The Fund may also invest in reverse repurchase agreements secured by such securities.
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- *Municipal Obligations.* Municipal Obligations are debt obligations or similar securities issued by or on behalf of a State of the U.S., or any of their respective political subdivisions, organizations, agencies or instrumentalities, or by multi-state agencies or authorities. Municipal Obligations are issued for various public purposes, including construction of public or privately-operated facilities, such as airports, bridges, hospitals, housing, mass transportation, schools, streets and water and sewer works. Other public purposes for which Municipal Obligations may be issued include refinancing outstanding obligations and obtaining funds for general operating expenses and for loans to other public institutions and facilities. The types of Municipal Obligations in which the Fund may invest, and certain of the risks attached thereto, are described in Appendix B to this private placement memorandum. Not all of such types of Municipal Obligations are currently available in Puerto Rico.
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- *Asset-Backed Securities.* The Fund may invest in various types of asset-backed securities (“Asset-Backed Securities”). The securitization techniques used in the context of Asset-Backed Securities are similar to those used for Mortgage-Backed Securities. The receivables supporting Asset-Backed Securities presently are primarily home equity mortgage loans and automobile and credit card receivables, but may also consist of other types of obligations. Asset-Backed Securities and the underlying receivables are not generally insured or guaranteed by any government agency. However, in certain cases, such securities are collateralized by loans guaranteed by the U.S. Small Business Administration (“SBA”). The SBA is an independent agency of the United States.
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- The SBA guarantees the payment of principal and interest on portions of loans made by private lenders to certain small businesses. The loans are generally commercial loans such as working capital loans and equipment loans. The SBA is authorized to issue from time to time, through its fiscal and transfer agent, SBA-guaranteed participation certificates evidencing fractional undivided interests in pools of these SBA-guaranteed portions of loans made by private lenders. The SBA’s guarantee of such certificates, and its guarantee of a portion of the underlying loan, are backed by the full faith and credit of the United States.
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- Asset-Backed Securities will be considered Puerto Rico Asset-Backed Securities when the securitization vehicle is organized under the laws of Puerto Rico, or regardless of where organized, when a majority of the underlying assets are obligations of Puerto Rico Residents.

Methods of Analysis, Investment Strategies

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- *Preferred Stock.* Preferred stock generally has priority over common stock with respect to payment of dividends and upon liquidation, but does not have the seniority of a debt instrument in an issuer's capital structure in terms of claims to corporate income and liquidation payments. Preferred stock may have a fixed dividend rate and may not participate in any profits of the issuer above such dividend rate, in which case it is referred to as "non-participating," or it may participate in some or all of the profits of the issuer, in which case it is referred to as "participating." Preferred stock may be perpetual, with no mandatory redemption date, or issued with a mandatory redemption date. It may also be callable or redeemable at the option of the issuer after a certain period of time. Issuers of preferred stock are not required to pay dividends on the preferred stock, even if they have sufficient funds to pay dividends, although they are usually prohibited from paying dividends on their common stock unless all or some preferred dividends have been paid. Preferred dividends may be "cumulative" or "non-cumulative." If dividends are cumulative and they are not declared and paid at their regularly scheduled time, such dividends must generally be paid when the issuer is liquidated, before any assets may be distributed to holders of the issuer's common stock. If dividends are non-cumulative, they never have to be paid if they are not declared. (However, as mentioned above, the issuer may be prohibited from paying dividends on their common stock unless all or some preferred dividends have been paid.) Holders of preferred stock do not have the right to precipitate bankruptcy filings or collection activities in the event of missed dividend payments. Preferred stock may be convertible into common stock of the issuer or into some other security, or it may be non-convertible. Holders of preferred stock usually have no voting rights, except in cases where preferred dividends have been unpaid for a certain period, in which case holders of preferred stock usually have the right to elect certain representatives to the board of directors of the issuer.
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- *Trust Preferred Securities.* Trust preferred securities are securities issued by banks or bank holding companies through a special purpose trust organized by the bank or bank holding company. The trust issues the trust preferred securities and invests the proceeds in a subordinated debenture of the bank or bank holding company that has identical terms. The trust preferred securities are payable solely from payments made by the bank or bank holding company with respect to the subordinated debentures. Trust preferred securities and the underlying debentures usually provide that the issuer may suspend the payment of interest on such securities for a period of time, and pay such interest at the end of the suspension period.
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- *Corporate Obligations.* Corporate obligations are debt obligations or similar securities issued by or on behalf of corporations. See "Appendix D – Certain Other Types of Investments."
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- *Common Stock.* Holders of the common stock issued by a corporation own the corporation and are in most cases entitled to elect its directors. Upon the liquidation of a corporation, owners of common stock are entitled to the assets of the corporation after the payment of all creditors and preferred stockholders. Holders of shares of common stock are entitled to receive whatever dividends are declared on such shares.
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Methods of Analysis, Investment Strategies



Commodity-related securities. Commodity-related securities consist primarily of derivative instruments such as swap agreements, futures, options on futures, commodity index-linked notes and commodity options that provide exposure to the investment returns of the commodities futures markets. Commodities are assets that have tangible properties, such as oil, metals, and agricultural products. The derivative instruments in which the Fund primarily intends to invest are instruments linked to certain commodity indices and instruments linked to the value of a particular commodity or commodity futures contract, or a subset of commodities or commodity futures contracts. These instruments may specify exposure to commodity futures with different roll dates, reset dates or contract months than those specified by a particular commodity index. As a result, these commodity-linked derivatives may deviate from the returns of any particular commodity index. The Fund may also invest in leveraged or unleveraged commodity index-linked notes, which are derivative debt instruments with principal or coupon payments linked to the performance of commodity indices. The value of these notes will rise or fall in response to changes in the underlying commodity or related index of investment.

Methods of Analysis, Investment Strategies



- **OTHER INVESTMENT PRACTICES**

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- Certain of the other investment practices in which the Fund may engage are described below.

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- **When-Issued Securities and Delayed Delivery Transactions**

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- The purchase of securities on a when-issued or delayed delivery basis involves the risk that, as a result of an increase in yields available in the marketplace, the value of the securities purchased will decline prior to the settlement date. The sale of securities for delayed delivery involves the risk that the prices available in the market on the delivery date may be greater than those obtained in the sale transaction. At the time the Fund enters into a transaction on a when-issued or delayed delivery basis, it will segregate with the Custodian (as defined herein) cash or liquid instruments with a value not less than the value of the when-issued or delayed delivery securities. The value of these assets will be monitored daily to ensure that their marked-to-market value will at all times exceed the corresponding obligations of the Fund. There is always a risk that the securities may not be delivered, and the Fund may incur a loss.

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- **Short-Term Temporary Investments**

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- Subject to the requirements of the Commissioner's Ruling, if, in the opinion of the Investment Adviser, no suitable investments are available, or if the Investment Adviser believes unusual circumstances warrant a defensive posture, the Fund may temporarily commit all or any portion of its assets to short-term instruments. Such instruments may include commercial paper, bank certificates of deposit, bankers' acceptances and reverse repurchase agreements secured by any of the foregoing.

Methods of Analysis, Investment Strategies

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- **Dollar Rolls and Repurchase Agreements**

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- The Fund may enter into dollar rolls, in which the Fund sells mortgage-backed or other securities for delivery in the current month and simultaneously contracts to purchase substantially similar securities on a specified future date. In the case of dollar rolls involving mortgage-backed securities, the mortgage-backed securities that are purchased will be of the same type and will have the same interest rate as those sold, but will be supported by different pools of mortgages. The Fund forgoes principal and interest paid during the roll period on the securities sold in a dollar roll, but the Fund is compensated by the difference between the current sales price and the lower price for the future purchase as well as by any interest earned on the proceeds of the securities sold. The Fund could also be compensated through the receipt of fee income equivalent to a lower forward price.

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- The Fund may also enter into repurchase agreements in which a member bank of the Federal Reserve System or a securities dealer who is a member of a national securities exchange purchases portfolio securities from the Fund, coupled with an agreement to resell them to the Fund at a specific date and price.

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- Dollar rolls and repurchase agreements will generally be considered to be leverage and accordingly, will be subject to the Fund's limitations on leverage, which will restrict the aggregate of such transactions to 80% of the Fund's total assets.

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- The market value of securities sold under repurchase agreements typically is greater than the proceeds of the sale, and accordingly, the market value of the securities sold is likely to be greater than the value of the securities in which the Fund invests those proceeds. Repurchase agreements involve the risk that the buyer of the securities sold by the Fund might be unable to deliver them when the Fund seeks to repurchase such securities. In the event the buyer of securities under a Reverse Repurchase Agreement files for bankruptcy or becomes insolvent, such buyer or its trustee or receiver may receive an extension of time to determine whether to enforce the Fund's obligation to repurchase the securities, and the Fund's use of the proceeds of the Reverse Repurchase Agreement may effectively be restricted pending such decision.

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- **Reverse Repurchase Agreements**

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- The Fund may use Reverse Repurchase Agreements, which consist of transactions in which the Fund purchases securities from a member bank of the Federal Reserve System or a securities dealer who is a member of a national securities exchange or is a market-maker in U.S. Government Securities and simultaneously commits to resell the securities to such original seller at an agreed-upon date and price reflecting a market rate of interest unrelated to the coupon rate or maturity of the purchased securities. Reverse Repurchase Agreements carry certain risks not associated with direct investments in securities, including possible declines in the market value of the underlying securities and delays and costs to the Fund if the other party to the Reverse Repurchase Agreement becomes bankrupt.

Methods of Analysis, Investment Strategies



- **Other Practices**
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- *Call Rights.* The Fund may purchase a Puerto Rico Security or other Municipal Obligation issuer's right to call all or a portion of such obligation for mandatory tender for purchase (a "Call Right"). A holder of a Call Right may exercise such right to require a mandatory tender for the purchase of related obligations, subject to certain conditions. A Call Right that is not exercised prior to the maturity of the related obligation will expire without value. The economic effect of holding both a Call Right and the related obligation is identical to holding an obligation as a non-callable security.
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- *Options and Futures.* The Fund may use securities options (both exchange-traded and over-the-counter) to attempt to enhance income and may also attempt to reduce the overall risk of its investments (i.e., hedge) by using securities options, financial futures contracts and other interest rate protection transactions such as swap agreements. See Appendix E to this private placement memorandum, for a more complete discussion of the Fund's types of derivative and related income strategies and the risks thereof.
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- *Short Sales.* The Fund may engage in short sales of securities "against the box" to defer realization of gains or losses for tax or other purposes. A short sale "against the box" occurs when the Fund owns an equal amount of the securities sold short or owns securities convertible into or exchangeable, without payment of any further consideration, for securities of the same issue as, and equal amount to, the securities sold short.
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- *Securities Lending.* The Fund may also lend securities from its portfolio to broker-dealers, banks, financial institutions, and institutional borrowers of securities and receive collateral in the form of cash or U.S. Government obligations, subject to procedures adopted by the Board of Directors.

Risk Factors

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- **RISK FACTORS**

- The principal risks of investing in the Shares are described below. **Any of these risks may cause you to lose money.**

- ***Lack of Operating History.*** The Fund is a newly organized investment company with no previous operating history.

- ***Liquidity and Restrictions on the Transfer of the Shares.*** The Shares have not been registered with the U.S. Securities and Exchange Commission under the Securities Act of 1933, and the Fund has not been registered under the Investment Company Act of 1940. The Shares may be offered, sold or otherwise transferred exclusively to individuals whose principal residence is in Puerto Rico, or to corporations and other business organizations whose principal office and principal place of business are in Puerto Rico, who in either case meet certain net worth, income or other requirements applicable to “accredited investors” and “qualified clients” under federal securities laws and who are: (i) familiar with the use of high levels of leverage and derivatives; (ii) sufficiently knowledgeable and experienced in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Fund; (iii) financially capable of bearing the economic risks of an investment in the Fund; (iv) willing to assume a high level of risk in order to seek a high return; and (v) owners of sufficient liquid assets to be capable of bearing the risk of losing their entire investment in the Fund (referred to herein as “Qualified Investors”). See **“OFFERING LIMITED TO PUERTO RICO RESIDENTS THAT ARE QUALIFIED INVESTORS; RESTRICTIONS ON TRANSFER.”**

- Prior to the initial sale or subsequent transfer of the Shares, each purchaser will be required to represent in writing to the Fund that the above conditions to purchase are satisfied. Appendix C to this private placement memorandum contains, in letter form, the substance of the representations that must be made prior to the purchase and delivery of such Shares. Shareholders who cease to be residents of Puerto Rico (as described above) will no longer have available the tax benefits associated with an investment in the Shares, will have an obligation to liquidate their Shares as soon as it becomes economically feasible to do so and will be required to agree not to purchase additional Shares while they are not residents of Puerto Rico.

- The Shares are a new issue of securities. Therefore, prior to this offering there has been no market for the Shares. There can be no assurance that a secondary for the market will develop.

- Since you will only be able to redeem your Shares twice a month upon at least a 10-Business Day prior written notice, the liquidity of such Shares will be limited. In addition, the redemption price of the Shares will be equal to the net asset value of such Shares determined as of the valuation date immediately preceding such redemption date, which may be lower than the net asset value of such Shares on the date on which you give notice of redemption.

Risk Factors

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- **Management Risk.** The Fund is subject to management risk since it is an actively managed portfolio. The Investment Adviser will apply investment techniques and risk analyses in making investment decisions for the Fund, but there can be no guarantee that those decisions will produce the desired results.
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- **Risks Related to the Use of High Level of Leverage.** The Fund may raise additional cash to invest by entering into repurchase agreements, borrowing money from banks and other lenders, and other forms of leverage, in an aggregate amount representing not more than 80% of the value of the Fund's total assets immediately after such incurrence. This means that for every dollar invested by the Fund's shareholders, the Fund could borrow or incur other forms of leverage in an amount of up to four dollars.
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- Use of leverage is a speculative investment technique and involves increased risk for Shareholders to a greater extent than in a non-leveraged fund. These include the possibility of higher volatility of the Fund's yield and net asset value and in the market value of the Shares. In addition, changes in short-term, medium-term and long-term interest rates and in their relationship to each other could negatively impact the Fund's yield, net asset value and the market price of the Shares.
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- **The effects of high leverage may cause a Shareholder to lose some or all amounts invested in the Fund.**
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- If the Fund is able to realize a higher net return on the assets purchased with the proceeds of the leverage than the interest and other costs of the leverage, the effect of the leverage will be to cause the Shareholders to realize higher current net investment income than if the Fund were not leveraged. There can be no assurance, however, that the Fund will be able to realize such a net return. Short-term, medium-term, and long-term interest rates change from time to time, as does their relationship to each other (*i.e.*, the slope of the yield curve), depending upon such factors as supply and demand forces, monetary and tax policies, and investor expectations. Changes in any or all of such factors could cause the relationship between short-term, medium-term, and long-term rates to change (*i.e.*, to flatten or to invert the slope of the yield curve) so that short-term and medium-term rates may substantially increase relative to the long-term obligations in which the Fund may be invested. To the extent that the interest and other costs of leverage approach the net return on that portion of the Fund's assets purchased with the proceeds of the leverage, the benefit of leverage to the Shareholders will be reduced. Should the interest and other costs of leverage exceed the yield or return on the Fund's assets purchased with the proceeds of the leverage, the Fund's leveraged capital structure would result in a lower yield or return to the Shareholders than if the Fund were not so leveraged and, therefore, the amount available for distribution to Shareholders will be reduced.
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- Payments on repurchase agreements and other leverage incurred by the Fund may be indexed to equity or other indices unrelated to the assets held by the Fund. While the Fund may enter into hedging transactions to minimize the risks inherent in those transactions, there is no assurance that those transactions will be successful. Moreover, any decline in the value of the Fund's assets will be borne entirely by the Shareholders. Accordingly, the effect of leverage in a declining market would be a greater decrease in the net asset value of the Fund's Shares than if the Fund were not leveraged and could adversely affect the Fund's ability to make dividend payments and other distributions on the Shares. Any such decrease may be reflected in a greater decline in the market price of the Shares. If the current investment income of the Fund were not sufficient to meet interest requirements on its leverage, it could become necessary for the Fund to liquidate certain of its investments, thereby reducing net assets and therefore, the net asset value of the Shares. Such liquidations would also cause the Fund to incur transaction costs.
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Risk Factors



- The incurrence of leverage entails certain costs and expenses. These costs and expenses are borne by the Fund. Ongoing expenses associated with the incurrence of leverage are reflected as a reduction in the investment income that otherwise would be available for distribution to Shareholders
- **Risks Related to the Use of Derivative Instruments.** The Fund may invest without restriction in certain instruments that are or may be considered derivatives. Derivative instruments, because of their increased volatility and potential leveraging effect, may adversely affect the Fund. Such investments may also be leveraged, thereby magnifying the risk of loss. If the Fund invests in derivative instruments, it could lose more than the principal amount invested. For example, utilization of options and futures transactions involves the risk of imperfect correlation in movements in the price of such options and futures and the movements in the price of the securities or interest rates, which are the subject of the hedge. Municipal derivatives may also be subject to the same risks as floating rate municipal obligations generally, as well as risks of adverse tax determinations, or in the case of municipal derivatives used for hedging purposes, risks similar to those for other hedging strategies. The Fund may use a variety of derivative instruments to attempt to hedge its portfolio of assets against interest rate risk. Successful use of most derivative instruments depends upon the Investment Adviser's ability to predict movements of the overall securities and interest rate markets. There can be no assurance that any particular hedging strategy will succeed, or that the Fund will employ such strategies with respect to all or any portion of its portfolio.
- **Risks Related to the Use of Hedging Strategies.** The Fund may use a variety of derivative instruments including securities options, financial futures contracts, options on futures contracts and other interest rate protection transactions such as swap agreements, to attempt to hedge its portfolio of assets and enhance its return. Successful use of most derivative instruments depends upon the Investment Adviser's ability to predict movements of the overall securities and interest rate markets. There can be no assurance that any particular hedging strategy will succeed, or that the Fund will employ such strategy with respect to all or any portion of its portfolio. Some of the derivative strategies that the Fund may use to enhance its return are riskier than its hedging transactions and have speculative characteristics. Such strategies do not attempt to limit the Fund's risk of loss.
- **Risks Related to the Use of Swaps and other Transactions with Counterparties.** The Fund will engage in swap and other financial transactions directly with other counterparties. This subjects the Fund to the credit risk that a counterparty will default on an obligation to the Fund. Such a risk contrasts with transactions done through exchange markets, wherein credit risk is reduced through the collection of variation margin and through the interposition of a clearing organization as the guarantor of all transactions. Clearing organizations transform the credit risk of individual counterparties into the more remote risk of the failure of the clearing organization.
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- **Interest Rate Risk.** The value of fixed income securities such as those in which the Fund may invest generally can be expected to fall when interest rates rise and to rise when interest rates fall. Interest rate risk is the risk that interest rates will rise and that, as a result, the value of the Fund's investments will fall. The Fund is subject to interest rate risk. *This risk may be particularly acute in the current market environment given the fact that market interest rates are at historically low levels.* Prices of longer term fixed income securities generally change more in response to interest rate changes than prices of shorter term fixed income securities. Because the Fund will invest primarily in long term fixed income securities, the net asset value and market price per Share of its common stock will fluctuate more in response to changes in market interest rates than if the Fund invested primarily in shorter term fixed income securities. In addition, during periods of rising interest rates, the average life of certain types of securities may be extended because of the right of the issuer to defer payments or make slower than expected principal payments. This may lock in a below market interest rate, increase the security's duration (its sensitivity to interest rate changes) and reduce the value of the security. This is known as extension risk. The Fund is subject to extension risk. Conversely, during periods of declining interest rates, the issuer of a security may exercise its option to prepay principal earlier than scheduled in order to refinance at lower interest rates, forcing the Fund to reinvest in lower yielding securities. This is known as prepayment risk. The Fund is subject to prepayment risk. This tendency of issuers to refinance debt with high interest rates during periods of declining interest rates may reduce the positive effect of declining interest rates on the market value of the Fund's securities. Finally, the Fund's use of leverage by the issuance of preferred stock, debt securities and other instruments, as discussed below, may increase the risks described above.
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Risk Factors



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- **Credit Risk.** Credit risk is the risk that debt securities or preferred stock in the Fund's portfolio will decline in price or fail to make dividend or interest payments when due because the issuer of the security experiences a decline in its financial condition. The risk is greater in the case of securities that are rated below investment grade. The Fund may invest without restriction in preferred stock, subordinated debt, trust preferred securities and other securities that are rated below investment grade or that are not rated at the time of purchase. These securities are or may be of lower credit quality and pose or may pose greater credit risk (risk of loss of income and principal) to the Fund than investment grade securities. They involve substantial risk of loss, are considered highly speculative with respect to the issuer's ability to pay dividends and any required redemption or liquidation payments and are more susceptible to default or decline in market value due to adverse economic and business developments than more highly rated securities. The market value of speculative securities is also more sensitive to changes in interest rates than the market value of more highly rated securities, and may be adversely affected by negative perceptions of the market for speculative securities. These securities may also be substantially less liquid (they may have a more limited secondary market and may therefore be more difficult to sell) than more highly rated securities. A decline in the financial condition of certain issuers of fixed income securities may also result in such issuers seeking protection from creditors under bankruptcy, insolvency, and other laws affecting the rights and remedies of creditors, or in creditors seeking such protection on behalf of the issuer. This may result in delays and costs to the Fund.
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- **Risks of Preferred Stock.** Investments in preferred stock present certain special risks. One of them is that the issuers of preferred stock are not legally required to pay dividends when scheduled, even if they have sufficient funds to do so, and therefore these securities have greater payment risk than other securities in which the Fund may invest. In the case of cumulative preferred stock, missed dividends only have to be paid upon the liquidation of the company, and only after payment of the company's creditors. In the case of non-cumulative preferred stock, missed dividends never have to be paid. (However, the issuer is normally prohibited from paying dividends on its common stock unless all or some of its preferred dividends have been paid.) Preferred stock is subordinated in right of payment to all other creditors of the issuer, and therefore is subject to greater credit risk than debt instruments. Also, holders of preferred stock usually have no voting rights, except in very limited circumstances. Shares of preferred stock may be substantially less liquid (they may have a more limited secondary market and may therefore be more difficult to sell) than other securities in which the Fund could invest, such as U.S. government securities. Shares of preferred stock are usually redeemable at the option of the issuer. As with any fixed income security, a redemption may negatively impact the return of the security to the holder. The Fund may invest without limitation in preferred stock.
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Risk Factors



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- **Risks Related to Fixed Income Securities Generally.** The yield on fixed income securities such as those in which the Fund may invest depends on a variety of factors, including general market conditions for such securities, the financial condition of the issuer, the size of the particular offering, and the maturity, credit quality, rating, redemption rights, and other terms of the security. Generally, the longer the maturity of those securities, the higher its yield and the greater the changes in its yield, both up and down. The market value of fixed income securities normally will vary inversely with changes in interest rates. Such changes in the market value of the Fund's investments, and hence in the Fund's net asset value, may affect the price of the Shares. The unique characteristics of certain types of securities may also make them more or less sensitive to changes in interest rates.
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- **Political Risk.** Political or regulatory developments in Puerto Rico and in the United States could adversely affect the tax status of dividends and interest paid on the Fund's securities. These developments could also cause the value of the Fund's investments to fall.
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- **Geographic Concentration Risk.** The Fund is exposed to certain risks resulting from the reduced geographic diversification of its portfolio. Under the Act as currently in effect, at least 20% of the Fund's assets must be invested in securities of Puerto Rico issuers. Consequently, the Fund in general may be more susceptible to economic, political, regulatory or other factors adversely affecting issuers in Puerto Rico than an investment company that is not concentrated in Puerto Rico issuers. The securities issued by the Government of the Commonwealth of Puerto Rico and its instrumentalities, and the securities issued by several Puerto Rico financial institutions, have been downgraded over the past few years as a result of several factors, many are currently rated in the lowest tranche of the investment grade categories, and some are rated below investment grade. Also, the Fund's ability to achieve its investment objective and to comply with applicable law depends on the availability of Puerto Rico obligations. If those obligations are unavailable or are only available at a price unreasonably above their market value or at interest rates inconsistent with the Fund's investment objective, the Fund's performance will be adversely affected.
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- **Non-Diversification Risk.** The Puerto Rico portion of the Fund's total assets will be invested in obligations of a limited number of Puerto Rico issuers. Consequently, the Fund's net asset value and its yield may increase or decrease more than that of a more diversified investment company as a result of changes in the market's assessment of the financial condition and prospects of such Puerto Rico issuers. The Fund will also be more susceptible to any single economic, political, or regulatory occurrence in Puerto Rico than a more widely diversified fund.
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Risk Factors



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- ***Risks Related to Repurchase and Reverse Repurchase Agreements.*** The Fund may engage in repurchase agreements, which are transactions in which the Fund sells a security to a counterparty and agrees to buy it back at a specified time and price in a specified currency. Repurchase agreements involve the risk that the buyer of the securities sold by the Fund might be unable to deliver the securities when the Fund seeks to repurchase them and may be unable to replace the securities or only at a higher cost. If the buyer of securities under a repurchase agreement files for bankruptcy or becomes insolvent, the buyer may receive an extension of time to determine whether to enforce the Fund's obligation to repurchase the securities, and the Fund's use of the proceeds of the repurchase agreement may be severely restricted during that extension period. The Fund may also engage in reverse repurchase agreements, which are transactions in which the Fund purchases a security from a counterparty and agrees to sell it back at a specified time and price in a specified currency. If a reverse repurchase agreement counterparty defaults, the Fund may suffer time delays and incur costs or possible losses in connection with the disposition of the securities underlying the reverse repurchase agreement. In the event of a default, instead of the contractual fixed rate of return, the rate of return to the Fund will depend on intervening fluctuations of the market values of the underlying securities and the accrued interest thereon. In such an event, the Fund would have rights against the counterparty for breach of contract with respect to any losses resulting from those market fluctuations.
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- ***Risks Related to Municipal Obligations.*** Certain of the municipal obligations in which the Fund may invest present their own distinct risks. These risks may depend, among other things, on the financial situation of the government issuer, or in the case of industrial development bonds and similar securities, on that of the entity supplying the revenues that are intended to repay the obligations. It is also possible that, as a result of litigation or other conditions, the power or ability of issuers or those other entities to meet their obligations for the repayment of principal and payment of interest may be materially and adversely affected.
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- ***Risks Related to Mortgage-Backed Securities.*** Mortgage-backed securities have many of the risks of traditional debt securities but, in general, differ from investments in traditional debt securities in that, among other things, principal may be prepaid at any time due to prepayments by the obligors on the underlying obligations. As a result, the Fund may receive principal repayments on these securities earlier or later than anticipated by the Fund. In the event of prepayments that are received earlier than anticipated, the Fund may be required to reinvest such prepayments at rates that are lower than the anticipated yield of the prepaid obligation. The rate of prepayments is influenced by a variety of economic, geographic, demographic and other factors, including, among others, prevailing mortgage interest rates, local and regional economic conditions and home owner mobility. Generally, prepayments will increase during periods of declining interest rates and decrease during periods of rising interest rates. The decrease in the rate of prepayments during periods of rising interest rates results in the extension of the duration of mortgage-backed securities, which makes them more sensitive to changes in interest rates and more likely to decline in value (this is known as extension risk). Since a substantial portion of the assets of the Fund may be invested in mortgage-backed securities, the Fund may be subject to these risks and other risks related to such securities to a significant degree, which might cause the market value of the Fund's investments to fluctuate more than otherwise would be the case. In addition, mortgage-backed or other securities issued or guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation or a Federal Home Loan Bank are supported only by the credit of these entities and are not supported by the full faith and credit of the United States.

Risk Factors



- **Risks Related to CMO Securities.** Collateralized mortgage obligations or “CMOs” exhibit similar risks to those of mortgage-backed securities, but also present certain special risks. CMO classes may be specially structured in a manner that provides a variety of investment characteristics, such as yield, effective maturity and interest rate sensitivity. As market conditions change, however, particularly during periods of rapid or unanticipated changes in interest rates, the ability of a CMO class to provide the anticipated investment characteristics and performance may be significantly reduced. These changes may result in volatility in the market value, and, in some instances, reduced liquidity of the CMO class. Recently, default rates on many CMO’s have increased, and their value and liquidity has been negatively affected by conditions in the economy and the housing market.
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- **Risks Related to Asset-Backed Securities.** Asset-backed securities present risks similar to those of mortgage-backed securities. However, in the case of many asset-backed securities, the prepayment rates on the underlying assets have historically been less influenced by market interest rate fluctuations and, therefore, have been more stable. The frequent absence of a government guarantee creates greater exposure to the credit risk on the underlying obligations and, depending on the structure, the credit risk of the sponsor of such obligations.
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- **Risks Related to Illiquid Securities.** Illiquid securities are securities that cannot be sold within a reasonable period of time, not exceeding seven days, in the ordinary course of business at approximately the amount that the Fund has valued the securities. There presently are a limited number of participants in the market for certain Puerto Rico securities or other securities or assets that the Fund may own. That and other factors may cause certain securities to have periods of illiquidity. Illiquid securities include, among other things, securities subject to legal or contractual restrictions on resale that hinder the marketability of the securities. There are no limitations on the Fund’s investment in illiquid securities. The Fund may also continue to hold, without limitation, securities or other assets that become illiquid after the Fund invests in them. To the extent the Fund owns illiquid securities or other illiquid assets, the Fund may not be able to sell them easily, particularly at a time when it is advisable to do so to avoid losses. Certain of the securities in which the Fund intends to invest, such as shares of preferred stock, may be substantially less liquid than other types of securities in which the Fund may invest. Illiquid securities may trade at a discount from comparable, more liquid investments.

Risk Factors



- **Valuation Risk.** There may be few or no dealers making a market in certain securities owned by the Fund, particularly securities of certain Puerto Rico issuers. Dealers making a market in those securities may not be willing to provide quotations on a regular basis to the Fund's Investment Adviser. It may therefore be particularly difficult to value those securities. When market quotations for securities held by the Fund are not readily available from any such independent dealers, the Fund's administrator will be responsible for obtaining quotations for such securities from various sources. When market quotations are not readily available or are deemed to be unreliable, the Fund will value its investments at fair value, as determined in good faith pursuant to policies and procedures approved by the Fund's Board of Directors. Fair value pricing may require subjective determinations about the value of a security or other asset. As a result, there can be no assurance that fair value pricing will result in adjustments to the prices of securities or other assets, or that fair value pricing will reflect actual market value, and it is possible that the fair value determined for a security or other asset will be materially different from quoted or public prices, from the prices used by others for the same security or other assets or from the value that actually could be or is realized upon the sale of that security or other asset.
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- **Risks Related to Securities Lending.** Securities lending involves the risk that there may be delay in recovery of securities or even loss of rights in the collateral, among other things, should the borrower of the securities fail financially or become insolvent.
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- **Risks Related to Changes in Applicable Law.** Legislation affecting Puerto Rico Securities, assets other than Puerto Rico Securities, Puerto Rico and U.S. investment companies, taxes and other matters related to the business of the Fund is continually being considered by the Puerto Rico Legislature and the U.S. Congress. Moreover, the determinations made and the waivers and rulings granted by the Office of the Commissioner of Financial Institutions (the "Commissioner of Financial Institutions") to the Fund do not constitute a precedent binding on the Commissioner of Financial Institutions. There can be no assurance that legislation enacted or regulations promulgated after the date hereof will not have an adverse effect on the operations of the Fund, the economic value of the Shares, or the tax consequences of the acquisition or redemption of Shares.

Risk Factors



- **Impact of federal “conduit arrangement” rules on source of income of dividends.** Regulations issued under Section 937(b) of the United States Internal Revenue Code addressing “conduit arrangements” may impact the source of income for U.S. tax purposes of dividends distributed by an investment company that invests in securities that generate income from sources within the United States. Under the rules set forth in these final regulations, income that is otherwise treated as income from sources within Puerto Rico under the general source of income rules is treated as income from sources outside Puerto Rico and not excludable from gross income under Section 933 of the U.S. Code if it consists of income derived in a “conduit arrangement.” Based on the current language of the final regulations and the guidance offered therein, in the opinion of O’Neill & Borges LLC, counsel to the Fund, it is more likely than not that an investment in the Shares will not be considered the type of transaction intended to be covered by these rules. Consequently, in the opinion of O’Neill & Borges LLC, counsel to the Fund, it is more likely than not that dividends on the Shares will be treated as income from sources within Puerto Rico. Puerto Rico Individuals should note that the United States Internal Revenue Service may reach a different conclusion as to the applicability of the “conduit arrangement” rules to the Fund. Accordingly, Puerto Rico Individuals may want to seek the advice of their own tax advisors.
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- **Foreign investment risk.** Although the Fund does not currently intend to invest a substantial portion of its assets in foreign securities, the Investment Adviser has the ability to do so without seeking the consent of the Fund’s shareholders. To the extent the Fund invests in foreign securities, the fund's performance will be influenced by political, social and economic factors affecting such investments. Special risks associated with investments in foreign issuers include exposure to currency fluctuations, less liquidity, less developed or less efficient trading markets, lack of comprehensive company information, political and economic instability and differing auditing and legal standards. Funds that invest in securities traded principally in securities markets outside the United States are subject to additional and more varied risks, as the value of foreign securities may change more rapidly and extremely than the value of U.S. securities. The securities markets of many foreign countries are relatively small, with a limited number of companies representing a small number of industries. Additionally, issuers of foreign securities may not be subject to the same degree of regulation as U.S. issuers. Reporting, accounting and auditing standards of foreign countries differ, in some cases significantly, from U.S. standards. There are generally higher commission rates on foreign portfolio transactions, transfer taxes, higher custodial costs and the possibility that foreign taxes will be charged on dividends and interest payable on foreign securities, some or all of which may not be reclaimable. Also, for lesser-developed countries, nationalization, expropriation or confiscatory taxation, adverse changes in investment or exchange control regulations (which may include suspension of the ability to transfer currency or assets from a country), political changes or diplomatic developments could adversely affect a fund’s investments. In the event of nationalization, expropriation or other confiscation, the Fund could lose its entire investment in a foreign security. Some of the foreign risks are also applicable to funds that invest a material portion of their assets in securities of foreign issuers traded in the U.S. Investments denominated in foreign currencies are subject to the risk that such currencies will decline in value relative to the U.S. dollar and affect the value of these investments held by the Fund. To the extent the Fund's investments are concentrated in a limited number of foreign countries, the Fund's performance could be more volatile than that of more geographically diversified funds.

Risk Factors



- **Emerging market risk.** Although the Fund does not currently intend to invest a substantial portion of its assets in emerging markets, the Investment Adviser has the ability to do so without seeking the consent of the Fund's shareholders. To the extent the Fund invests in such markets, it will be affected by risks that are particular to those markets. Emerging markets are typically those of poorer or less developed countries, which exhibit lower levels of economic or capital market development, and higher levels of share price and currency volatility. Emerging markets tend to be more volatile and less liquid than the markets of more mature economies, and generally have less diverse and less mature economic structures and less stable political systems than those of developed countries. The securities of issuers located or doing substantial business in emerging markets are often subject to rapid and large changes in price. In particular, emerging markets may have relatively unstable governments, present the risk of sudden adverse government or regulatory action and even nationalization of businesses, restrictions on foreign ownership or prohibitions of repatriation of assets, and may have less protection of property rights than more developed countries. In adverse social and political circumstances, governments in emerging markets have been involved in policies of expropriation, confiscatory taxation, nationalization, intervention in the securities market and trade settlement, and imposition of foreign investment restrictions and exchange controls, and these could be repeated in the future. In addition to withholding taxes on investment income, some emerging markets may impose capital gains taxes on foreign investors. The economies of emerging market countries may be based predominantly on only a few industries and may be highly vulnerable to changes in local or global trade conditions, and may suffer from extreme debt burdens or volatile inflation rates. Local securities markets may trade a small number of securities and may be unable to respond effectively to increases in trading volume, potentially making prompt liquidation of substantial holdings difficult. Transaction settlement and dividend collection procedures also may be less reliable in emerging markets than in developed markets. Emerging market securities may present market, credit, currency, liquidity, legal, political and other risks that are greater than, or in addition to, the risks of investing in developed foreign countries. These risks include: high currency exchange-rate fluctuations; increased risk of default (including both government and private issuers); greater social, economic and political uncertainty and instability (including the risk of war); more substantial governmental involvement in the economy; less governmental supervision and regulation of the securities markets and participants in those markets; controls on foreign investment and limitations on repatriation of invested capital and on a fund's ability to exchange local currencies for U.S. dollars; unavailability of currency hedging techniques in certain emerging market countries; the fact that companies in emerging market countries may be newly organized, smaller and less seasoned; the difference in, or lack of, auditing and financial reporting standards, which may result in the unavailability of material information about issuers; different clearance and settlement procedures, which may be unable to keep pace with the volume of securities transactions or otherwise make it difficult to engage in such transactions; difficulties in obtaining and/or enforcing legal judgments in foreign jurisdictions; and significantly smaller market capitalizations of emerging market issuers. Compared to mature markets, some emerging markets may have a low level of regulation, enforcement of regulations and monitoring of investors' activities. Those activities may include practices such as trading on material non-public information by certain categories of investor.

Risk Factors



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- **Foreign currency risk.** Although the Fund does not currently intend to invest a substantial portion of its assets in securities issued in foreign currencies, the Investment Adviser has the ability to do so without seeking the consent of the Fund's shareholders. To the extent the Fund invests in such securities, it will be subject to currency risk. Currency risk is the risk that fluctuations in exchange rates may adversely affect the U.S. dollar value of a fund's investments. Currency risk includes both the risk that currencies in which a fund's investments are traded, or currencies in which a fund has taken an active investment position, will decline in value relative to the U.S. dollar and, in the case of hedging positions, that the U.S. dollar will decline in value relative to the currency being hedged. Currency rates in foreign countries may fluctuate significantly over short periods of time for a number of reasons, including the forces of supply and demand in the foreign exchange markets, actual or perceived changes in interest rates and intervention (or the failure to intervene) by U.S. or foreign governments or central banks or by currency controls or political developments in the U.S. or abroad. Certain funds may engage in proxy hedging of currencies by entering into derivative transactions with respect to a currency whose value is expected to correlate to the value of a currency the fund owns or wants to own. This presents the risk that the two currencies may not move in relation to one another as expected. In that case, the fund could lose money on its investment and also lose money on the position designed to act as a proxy hedge. Certain funds may also take active currency positions and may cross-hedge currency exposure represented by their securities into another foreign currency. This may result in a fund's currency exposure being substantially different than that suggested by its securities investments. Foreign currencies are also subject to risks caused by inflation, interest rates, budget deficits and low savings rates, political factors and government intervention and controls. Derivative foreign currency transactions (such as futures, forwards and swaps) may also involve leveraging risk, in addition to currency risk. Leverage may disproportionately increase a fund's portfolio losses and reduce opportunities for gain when currency rates are changing.
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- **Sovereign debt risk.** Sovereign debt refers to debt obligations issued or guaranteed by governments or their agencies and instrumentalities. Although the Fund does not currently intend to invest a substantial portion of its assets in sovereign debt securities, the Investment Adviser has the ability to do so without seeking the consent of the Fund's shareholders. To the extent the Fund invests in sovereign debt securities, the Fund's performance will be influenced by political, social and economic factors affecting such investments. Investments in sovereign debt may involve special risks. The governmental entity that controls the repayment of sovereign debt may not be able or willing to repay the principal or interest when due in accordance with the terms of such debt. A governmental entity's willingness or ability to repay principal and interest due in a timely manner may be affected by, among other factors, its cash flow situation, the extent of its foreign reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the governmental entity's policy towards the international monetary bodies, any constraints placed on it by inclusion in a common monetary policy, or any other constraints to which a governmental entity might be subject. Governmental entities may also be dependent on expected disbursements from foreign governments, multilateral agencies and others foreign entities to reduce principal and interest arrears on their debt. The commitment on the part of these governments, agencies and others to make such disbursements may be conditioned on a governmental entity's implementation of economic reforms or economic performance and the timely service of such debtor's obligations. Failure to implement such reforms, achieve such levels of economic performance or repay principal or interest when due may result in the cancellation of such third parties' commitments to lend funds to the governmental entity, which may further impair such debtor's ability or willingness to service its debt on a timely basis.
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- Sovereign debt holders may also be affected by additional constraints relating to sovereign issuers which may include (i) the restructuring of such debt (including the reduction of outstanding principal and interest and or rescheduling of repayment terms) without the consent of the impacted Fund(s) (e.g. pursuant to legislative actions unilaterally taken by the sovereign issuer and/or decisions made by a qualified majority of the lenders); and (ii) the limited legal recourses available against the sovereign issuer in case of failure of, or delay in, repayment (for example there may be no bankruptcy proceedings available by which sovereign debt on which a government entity has defaulted may be recovered).

Risk Factors



- **Credit default swap risk.** The use of credit default swaps may carry a higher risk than investing in securities directly. A credit default swap allows the transfer of default risk on a security, in effect providing insurance to the buyer of the swap with respect to such security. In a typical credit default swap transaction, the buyer pays the seller an agreed upon premium in exchange for the seller's agreement to pay to the buyer the face amount of the security (or other agreed upon amount) in the event that there is a specified "credit event" such as a decline in the credit quality of the security. If the credit event does not occur the buyer pays all the required premiums and the swap terminates at maturity with no further payments. The risk of the buyer is therefore limited to the value of the premiums paid, and the risk of the seller is limited to the value of the underlying asset minus premiums received. The market for credit default swaps may sometimes be more illiquid than bond markets.
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- **General.** The Fund's investments may be adversely affected by the performance of U.S., Puerto Rico, and foreign investment securities markets, which may be influenced by a number of factors, including the level of interest rates, the rate of inflation, politics, fiscal policy, and current events. Because the Fund invests in investment securities, the net asset value of the Shares may fluctuate due to market conditions and you may experience a decline in the value of your investment in the Shares and lose money.
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Disciplinary Information



There are no legal or disciplinary events to be disclosed

Other Financial Industry Activities and Affiliations

a There are no other financial industry activities and affiliations to be disclosed

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

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X² Capital will adopt the CFA code of ethics and Standards of Professional Conduct. The code is published in the following URL:

<http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n14.1>

Personal trading & participation in client accounts is strictly prohibited

Brokerage Practices

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X² Capital uses an open platform architecture where it conducts open market operations in a deutsche auction like style in order to ensure best execution for clients

The firm receives research from all its counterparties and uses that research for the benefit of clients

X² Capital will from time to time execute equity transactions through Bloomberg trade book which will net commissions paid to the monthly dues of the Bloomberg Terminal

X² Capital does not receive client referrals nor directs brokerage

Review of client accounts

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X² Capital does not review client accounts

Clients will receive a monthly report from their custodian showing the value of their investment

Client Referrals and Other Compensation



Not applicable

Custody



X² Capital does not hold assets in custody

Investment Discretion

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X² Capital will have full discretion over the management of the X² Alternative Dividend Alpha Fund, with such discretion limited to the investment policy and objectives as set and disclosed in the offering private placement memorandum

Voting Client Securities

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X² Capital will vote on behalf of its client, the X² Alternative Dividend Alpha Fund, and it will always carry the funds interest above its own interest.

The client may obtain full information about the voting executed by the advisor at any time it request such information

Financial Information



Not applicable

Requirements for State-Registered Advisers



Not applicable