

## **Potomac River Capital, LLC**

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### **FORM ADV, PART 2A BROCHURE**

**March 31, 2014**

**This Form ADV, Part 2A (the “Brochure”) provides information about the qualifications and business practices of Potomac River Capital, LLC (“Potomac River” or the “Adviser”), an investment adviser registered with the United States Securities and Exchange Commission (the “SEC”). If you have any questions about the contents of this Brochure, please contact Potomac River via e-mail at [compliance@potomacriverfund.com](mailto:compliance@potomacriverfund.com). The information in this Brochure has not been approved or verified by the SEC or by any state securities authority.**

**Additional information about Potomac River is also available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The searchable IARD/CRD number for Potomac River is 159887.**

**Registration with the SEC or any state securities authority does not imply a certain level of skill or training.**

**This Brochure is neither an offer to sell nor a solicitation of an offer to buy shares or interests in any of the privately offered investment funds advised by Potomac River. An offer of interests in such funds can be made only through the offering materials for the relevant fund and only in jurisdictions in which such an offer would be lawful.**

## **Item 2 – Material Changes**

This Item 2 discusses only specific material changes that are made to this Brochure since the last annual update of the Adviser's Brochure on April 1, 2013. The Adviser hired a senior trader as part of the portfolio management team. The Adviser also hired an individual to serve as Chief Operating Officer, General Counsel, and Chief Compliance Officer. There have been no other material changes since the Adviser's last brochure.

The Adviser has updated its assets under management and made various non-material changes throughout the Brochure to clarify certain services and practices of the firm.

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#### **Item 4 – Advisory Business**

Potomac River Capital, LLC (“Potomac River” or the “Adviser”) is a Delaware limited liability company that has been in the investment management business since April 2007. Potomac River is owned by Mark Spindel, who also serves as the firm’s sole Managing Member, Chief Executive Officer and Chief Investment Officer. The following paragraphs describe Potomac River’s services and fees and how Potomac River tailors its advisory services to your individual needs.

#### **Pooled Investment Vehicles**

Potomac River provides investment advisory services to a group of pooled private investment vehicles known as the Potomac River Funds (sometimes hereafter, the “Funds”). The Potomac River Funds, which are exempt from registration as investment companies under the Investment Company Act of 1940 (“Company Act”), form a “master-feeder” structure to facilitate investment by U.S. and non-U.S. domiciled investors. The Potomac River Funds invest in a global macro strategy focused primarily on opportunities in global interest rates, exchange rates, commodity and equity markets. Individual strategies can be directional and/or relative value. The Potomac River Funds focus investment strategies in G10 markets, but with a wider potential geographic universe. The G10 markets consist of eleven industrial countries: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States.

The Adviser may launch or manage pooled vehicles other than the Funds.

#### **Separate Accounts**

The Adviser offers investment management services to separate accounts (“Separate Accounts”) that generally pursue a global macro based strategy similar to the strategy followed for the Funds. Such Separate Accounts may have terms (e.g., fees, liquidity and portfolio transparency) that differ from those of the Potomac River Funds, and may adhere to unique investment parameters and risk guidelines imposed by the relevant investor. The parameters relating to each Separate Account are determined on a case-by-case basis according to the size, investment strategy and other features of the Separate Account. The Separate Accounts also may impose restrictions on investing in certain securities or other instruments. In addition, there is one Separate Account client for which the Adviser provides only foreign exchange settlement and cash management services.

Investment advisory agreements with Separate Accounts are terminable based on the provisions of the specific agreements. Clients will receive a prorated refund of any fees paid in advance. If Clients pay fees at the end of a quarter in arrears, they will incur a pro rata charge for services rendered prior to the termination of the agreement, which means they will incur advisory fees only in proportion to the number of days in the quarter for which they are a Client.

The Potomac River Funds and the Separate Accounts are collectively referred to in this brochure as “Clients.”

#### **Assets Under Management**

As of December 31, 2013, Potomac River managed \$592,228,000 in Client assets on a discretionary basis. Potomac River does not manage assets on a non-discretionary basis.

## **Item 5 – Fees and Compensation**

### **Management and Performance Fees**

Potomac River's fees vary depending on the nature of the Client. Potomac River does not have one fee schedule that applies to all Clients.

With regard to the Potomac River Funds, the Adviser charges a management fee of 2 percent per annum of the assets under management. These fees are billed quarterly, in advance, at one-fourth the annual rate. In addition, at year-end, the Adviser receives a performance allocation equal to 20% of the net profits of the Funds, subject to a loss carryforward provision (sometimes called a "highwater mark"). In computing the performance allocation, Potomac River includes realized and unrealized capital gains and losses. The Adviser, in its sole discretion, may waive or reduce the management fees paid by certain types of investors in the Funds, including members, principals, eligible employees or affiliates of the Adviser or the Funds' General Partner. For more information about the fees charged to the Potomac River Funds, as well as the terms on which investors may withdraw capital or redeem or transfer their interests in the Funds, please refer to the relevant Fund offering documentation.

Potomac River has entered into "side letter" agreements with investors in the Funds. Under such agreements, an investor may receive benefits not generally available to other investors, such as a payment or rebate from fees earned by the Adviser, preferential liquidity terms, special rights to make future investments in the Funds or other managed accounts, more detailed information regarding portfolio holdings or other rights.

With respect to Separate Accounts, fees are negotiated on a case-by-case basis, depending on the size and nature of the account, and nature of the services provided. Such fees may differ from the fees charged to the Potomac River Funds, and may or may not include an asset-based fee (billed quarterly, in advance) and a performance-based fee, calculated as a percentage of a Client's net profits and subject to a "highwater mark."

Potomac River's investment advisory agreements may contain written authorization permitting its fees to be paid directly from each Client's account. In such cases, Potomac River will send each Client and the qualified custodian that the Client selects for such account an invoice showing the amount of fees due along with the account value on which the fee is based and how the fee was calculated, and Potomac River will deduct its fee directly from such Client's account through the qualified custodian holding such funds and investments. If not debited directly from the account, Potomac River will invoice the Client for payment of fees. Potomac River urges its Clients to review all statements received from their custodians for accuracy.

### **Other Fees and Expenses**

In addition to any asset-based management or performance fees, Clients also are responsible for investment expenses, such as commissions, interest on margin accounts and other indebtedness, borrowing charges on securities sold short, transfer taxes, fees payable to governments or agencies, custodial fees and bank service fees. Please see Item 12 below for more information about the Adviser's brokerage practices.

As explained in the offering documents for the Potomac River Funds, the Funds are responsible for the payment of operating expenses including, but not limited to, administrator, legal, auditing, accounting (including outsourced accounting) and other professional expenses, administrative expenses and directors and officers insurance (if any), communication expenses relating to preparing, printing and distributing financial and other reports, prospectuses and similar documents and other expenses related to the purchase, sale or transmittal of the Funds' assets. The Funds also may pay the Adviser's middle/back office expenses (including trade capture systems) and research expenses (including research-related travel, Bloomberg and similar

subscriptions and data services). Separate Accounts may also be responsible for certain overhead and operating expenses, depending on the particular arrangements with such Clients.

Certain Separate Accounts may be invested in investment vehicles or investment funds managed by third-party asset managers. In such cases, the Separate Account will indirectly incur fees on the underlying investment managers and brokerage and other transaction costs through its underlying investments in third-party funds. Certain Separate Accounts may pay a separate asset based fee for certain reporting, technology, license fees or other expenses paid by the Adviser in connection with such client.

#### **Item 6 – Performance-Based Fees and Side-by-Side Management**

As described in the foregoing section, Potomac River is paid a performance allocation or fee by the Funds and certain Separate Accounts. All of the Adviser's performance fee arrangements are designed to comply with Section 205(a)(1) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 205-3 thereunder.

From time to time, Potomac River may charge clients asset-based management fees only. Furthermore, Potomac River may, in its discretion, manage assets for Clients with higher or lower fees, and different fee structures than those currently in place.

Performance-based fee arrangements create an incentive for Potomac River to recommend investments that may be riskier or more speculative than those it would recommend under a different fee arrangement. In addition, performance fee arrangements may also create an incentive to favor such accounts over other accounts in the allocation of investment opportunities. Potomac River has implemented trade allocation procedures designed to mitigate this conflict of interest.

Finally, because the Adviser's asset-based and performance fees are based on the net asset value of the Client accounts, there is a potential conflict of interest in valuing the assets held in the accounts. The Adviser generally invests in investments that have a market quotation. In addition, the Adviser will follow its valuation policies and utilize third party administrators to provide asset values as appropriate in order to mitigate this risk.

#### **Item 7 – Types of Clients**

Potomac River provides investment advisory services primarily to private funds that are not registered with the SEC as investment companies under the Company Act and to corporations. In addition, Potomac River offers investment advisory services to pension plans, insurance companies, individuals, trusts, estates and charitable organizations.

Certain of the Potomac River Funds may not be available to all U.S. investors, may limit the number of U.S. investors they accept, or may require that any U.S. investors certify that they are a "qualified purchaser" as defined in Section 2(a)(51) of the Company Act and an "accredited investor" as defined by Regulation D promulgated under the Securities Act of 1933. The offering documents for each Fund contain detailed information about the relevant minimum initial and additional investment requirements. A Fund's general partner or board of directors (as applicable), in its sole discretion, may accept either initial or additional subscriptions of a lesser amount as permitted by law.

A minimum investment of \$50 million is required for each investor that wishes to open a Separate Account. This minimum investment has been waived in the past and may be waived in the future at the Adviser's sole discretion.

## **Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss**

### **Methods of Analysis and Investment Strategies**

#### Principal Investment Strategy

In managing Client portfolios, Potomac River employs strategies commonly referred to as “global macro” and “relative value” investing. Potomac River believes its deep understanding of markets, economic policy making and risk management provide a comparative advantage in recognizing trends in G10 economies and then assessing applicable central bank policy and market reaction. Potomac River's flexible investment approach allows for efficiently structured trades, with a strong focus on asymmetric risk-return profile. The pursuit of asymmetric returns is not confined to specific trades; overall portfolio exposure to key macroeconomic and market factors are measured at intraday frequency, and continuously managed and stress-tested through scenario analyses.

#### Third-Party Investments

In addition, for one Separate Account, Potomac River may invest Client assets in third-party investment vehicles. In implementing these investments, Potomac River employs an investment process covering: (a) market review and asset allocation, primarily among fixed-income investment strategies and assets; (b) portfolio manager identification and due diligence; (c) portfolio construction; (d) risk management; and (e) portfolio monitoring. Potomac River allocates assets among portfolio managers in a manner consistent with a Client's investment parameters and liquidity needs.

There can be no assurance that an investment strategy utilized by Potomac River will be successful, that a third-party fund will be available for investment, or that any stated investment objective will be achieved.

### **Risk of Loss**

All investments risk the total loss of capital and Clients should be prepared to bear this loss.

The material risks set forth below are qualified in their entirety by the more detailed risk disclosure in the applicable Fund offering documents or Separate Account documentation. Hereafter, securities, derivatives and other instruments are collectively referred to as “investments.”

#### Market Risks

The profitability of a significant portion of Potomac River's investment program depends to a great extent upon correctly assessing the future course of the price movements of various financial markets and other investments. There can be no assurance that the Adviser will be able to predict these price movements accurately. Although the Adviser may attempt to mitigate market risk through the use of long and short positions or other methods, there is a significant degree of market risk.

#### Futures and Other Derivatives

Potomac River utilizes both exchange-traded and over-the-counter derivatives, including, but not limited to, futures, forwards, swaps, options and contracts for differences as part of its investment approach. Futures may be in respect of interest rates, equities and commodities. These

instruments can be highly volatile and expose investors to a high risk of loss. The low initial margin deposits normally required to establish a position in such instruments permit a high degree of leverage. As a result, depending on the type of instrument, a relatively small movement in the price of a contract may result in a profit or a loss which is high in proportion to the amount of funds actually placed as initial margin and may result in unquantifiable further loss exceeding any margin deposited.

In addition, daily limits on price fluctuations and speculative position limits on exchanges may prevent prompt liquidation of positions resulting in potentially greater losses. Transactions in over-the-counter contracts may involve additional risk as there is no exchange market on which to close out an open position. It may be impossible to liquidate an existing position, to assess the value of a position or to assess the exposure to risk. Contractual asymmetries and inefficiencies can also increase risk, such as break clauses, whereby a counterparty can terminate a transaction on the basis of a certain reduction in net asset value, incorrect collateral calls or delays in collateral recovery.

#### Currency Exposure Risk

Client portfolios may invest in foreign exchange contracts denominated in various currencies. However, Potomac River will value its investments in U.S. dollars. A change in the value of such foreign currencies against the U.S. dollar will result in a corresponding change in the U.S. dollar value of a portfolio's assets denominated in those currencies. Foreign currency exchange rates are determined by forces of supply and demand in foreign exchange markets. These forces are, in turn, affected by international balance of payments and other economic and financial conditions, government intervention, speculation and other factors.

Foreign currency exchange rates may also be affected by affirmative government policies of intervention in the foreign exchange markets, and certain currencies may be affirmatively supported relative to the U.S. dollar by their or other governments. Changes in government policy, including a cessation of currency support intervention, may result in abrupt devaluations of such currencies.

Potomac River may seek to manage a Client portfolio's foreign exchange position to enhance profits or to hedge the foreign exchange exposure. However, the portfolio will necessarily be subject to foreign exchange risks. In addition, prospective Clients whose assets and liabilities are predominantly in other currencies should take into account the potential risk of loss arising from fluctuations in value between the U.S. dollar and the variety of other currencies in which a portfolio may invest.

#### Foreign Exchange Contracts

Potomac River may enter into forward foreign exchange contracts with prime brokers and other foreign exchange counterparties with respect to Client portfolios. A forward foreign exchange contract is a contractually binding obligation to purchase or sell a particular currency at a specified date in the future (in the case of a spot contract, this is always two working days forward from the dealing date). Foreign exchange contracts are not uniform as to the quantity or (in the case of forward foreign exchange contracts) the period within which a currency is to be delivered, and are not traded on exchanges. Rather, they are individually negotiated transactions. Prime brokers and any other foreign exchange counterparty will contract as principal with the Client and will maintain a "bid/ask" spread which will include for its account both an anticipated profit and transaction costs.

Foreign exchange contracts are effected through a trading system known as the interbank market. It is not a market with a specific location but rather a network of participants linked electronically. At present, there is no central clearing system for foreign exchange contracts entered into on this market and accordingly, if Potomac River wishes to 'close out' any such



contract with respect to a Client, it will be reliant upon the agreements of the prime brokers or other relevant foreign exchange counterparty to enter into an appropriate 'offsetting' transaction.

There is no limitation as to daily price moves on the interbank market and prime brokers and other foreign exchange counterparties will not be required to make or continue to make a market in any foreign exchange contracts. In exceptional circumstances, there have been periods during which certain banks have refused to quote prices for foreign exchange contracts or have quoted prices with an unusually wide spread between the price at which the bank is prepared to buy and that at which it is prepared to sell. The imposition by prime brokers or other foreign exchange counterparties of credit restrictions on the dealing facilities which they agree to provide to a Client may subsequently limit any transactions in foreign exchange contracts. Further, effecting foreign exchange contracts may involve somewhat less protection against defaults than trading on commodity or other exchanges, as neither the interbank market nor transactions in foreign exchange contracts effected on it are regulated by any regulatory authority, nor are they guaranteed by an exchange or its clearing house.

Client portfolios will be subject to the risk of the inability or refusal of prime brokers or other foreign exchange counterparty to perform with respect to such contracts. Any such default would eliminate any profit potential and compel the Client to cover its commitments for resale or repurchase, if any, at the then current market price. These events could result in significant losses.

#### Mortgage-Backed Securities and Asset-Backed Securities

Client portfolios may be invested in instruments whose value is derived from mortgage-backed securities and asset-backed securities. The investment characteristics of certain mortgage-backed securities differ from those of traditional fixed-income securities. The major differences include the payment of interest and principal on the securities on a more frequent schedule and the possibility that principal may be prepaid at any time due to prepayments on the underlying mortgage loans or other assets. These differences can result in significantly greater price and yield volatility than is the case with traditional fixed-income securities. In general, "premium" securities will be adversely affected by faster than anticipated prepayments, while "discount" securities will be adversely affected by slower than anticipated prepayments. In some cases, price and yield volatility can be substantial. For example, stripped mortgage-backed securities are created by stripping a pool(s) of mortgage-backed pass-through securities to create an interest-only (IO) security and principal-only (PO) security. While the aggregated risk/reward characteristics of the IO and PO securities will resemble the underlying pass-through security, the price and yield sensitivity of the individual components will be much greater than that of the underlying pass-through security with respect to unanticipated changes in prepayments.

Potomac River may invest Client portfolios in variable rate mortgage-backed securities, including adjustable-rate mortgage securities that are backed by mortgages with variable rates, and CMO derivatives that pay a rate of interest that varies with a specified index. The value of these securities can fluctuate significantly with the level of the specified indices as well as anticipated movements of the indices. The variable rate nature of these securities introduces another risk that must be measured and hedged. It is possible that this variable rate risk may interact in a complex way with the imbedded prepayment risk of the security, making it difficult to hedge the instrument.

Asset-backed securities are subject to interest rate risk and, to a lesser degree, prepayment risk. Asset-backed securities are subject to additional risks in that, unlike mortgage-backed investments, asset-backed securities generally do not have the benefit of a security interest in the related collateral. Each type of asset-backed security also entails unique risks depending on the type of assets involved and the legal structure used. For example, credit card receivables are generally unsecured and the debtors are entitled to the protection of a number of state and federal consumer credit laws, many of which give debtors the right to set off certain amounts owed on the credit cards, thereby reducing the balance due. Asset-backed securities typically experience credit risk. For example, there is an increasing supply of subordinated securities rated

lower than AA (down to B or first loss) and senior securities that may be rated lower than AAA, as well. There is also the possibility that recoveries on repossessed collateral may not, in some cases, be available to support payments on these securities because of the inability to perfect a security interest in such collateral.

### Sovereign Debt Investments

Potomac River may invest in sovereign debt instruments which may be unrated by a nationally recognized statistical rating organization or may be rated below investment grade, and which are subject to greater risk of loss of principal and interest than higher-rated debt securities. Potomac River may invest in debt instruments which rank junior to other outstanding securities and obligations of the issuer, all or a significant portion of which may be secured on substantially all of that issuer's assets.

Potomac River may invest in sovereign debt investments which are not protected by financial covenants or limitations on additional indebtedness. Potomac River may invest in distressed sovereign debt investments which are subject to the significant risk of the issuer's inability to meet principal and interest payments on the obligations (credit risk) and may also be subject to price volatility due to such factors as interest rate sensitivity, market perception of the creditworthiness of the issuer and general market liquidity risk (market risk). Client portfolios will therefore be subject to credit, liquidity and interest rate risks. In addition, evaluating credit risk for sovereign debt investments involves uncertainty because credit rating agencies throughout the world have different standards, making comparison across countries difficult. Also, the market for credit spreads is often inefficient and illiquid, which can make it difficult to accurately calculate discounting spreads for valuing financial instruments.

### Leverage

Client portfolios may utilize a substantial degree of leverage. This results in a portfolio controlling substantially more assets than it has equity. Leverage increases returns to Clients if the portfolio earns a greater return on investments purchased with borrowed funds than the portfolio's cost of borrowing such funds. However, the use of leverage exposes a Client portfolio to additional levels of risk including (i) greater losses from investments than would otherwise have been the case had the portfolio not borrowed to make the investments, (ii) margin calls or interim margin requirements that may force premature liquidations of investment positions and (iii) losses on investments where the investment fails to earn a return that equals or exceeds the Client portfolio's cost of borrowing such funds. In the event of a sudden, precipitous drop in value of the Client portfolio's assets, the Client portfolio might not be able to liquidate assets quickly enough to repay its borrowings, further magnifying the losses incurred by the Client portfolio.

While the use of borrowing can substantially improve the return on invested capital, such use may also increase the adverse impact to which the Client portfolio may be subject. Borrowings will typically be secured by the Client portfolio's securities and other assets. Under certain circumstances, a lender (which may be a broker-dealer or a non-broker-dealer affiliate of the broker-dealer) may demand an increase in the collateral that secures the Client portfolio's obligations and if the Client portfolio were unable to provide additional collateral, the lender could liquidate assets held in the account to satisfy the Client portfolio's obligations to the lender. Liquidation in that manner could have extremely adverse consequences. In addition, the amount of the Client's borrowings and the interest rates on those borrowings, which will fluctuate, will have a significant effect on the Client portfolio's profitability.

### Emerging Markets Risk

Potomac River may but does not generally invest in sovereign issuers which are located in emerging markets. However, emerging markets may affect more developed markets. Emerging markets are subject to particular risks. It should be noted that political risk for many developing countries is a significant factor. In adverse social and political circumstances, governments have

been involved in policies of expropriation, confiscatory taxation, nationalization, intervention in the financial markets and trade settlement and imposition of foreign investment restrictions and exchange controls, and these policies could be repeated in the future.

Generally accepted accounting, auditing and financial reporting practices in emerging markets may be significantly different from those in developed markets. These markets are often less rigorously regulated than more mature markets and, as such, the accuracy of this information may not be as reliable.

Trading volumes in these markets, when compared with more mature markets, can be lower, which could result in lack of liquidity and greater price volatility.

Practices in relation to settlement of financial transactions in emerging markets involve higher risks than those in developed markets, in part because Potomac River would need to use brokers and counterparties which are less well capitalized, and custody, registration and title of assets in some countries may be less reliable.

#### Lack of Diversification

A Client's portfolio may not be diversified among geographic areas or types of investments. Accordingly, the investment portfolio of a Client may be subject to more rapid change in value than would be the case if the Client maintained a wide diversification among types of investments and issuers.

#### Short Sales

Short selling, or the sale of securities not owned by a Client, necessarily involves certain additional risks. Such transactions expose the Client's portfolio to the risk of loss in an amount greater than the initial investment, and such losses can increase rapidly and without effective limit. There is the risk that the securities borrowed by the Client in connection with a short sale would need to be returned to the securities lender on short notice. If such request for return of securities occurs at a time when other short sellers of the subject security are receiving similar requests, a "short squeeze" can occur, wherein the Client might be compelled, at the most disadvantageous time, to replace borrowed securities previously sold short with purchases on the open market, possibly at prices significantly in excess of the proceeds received earlier.

#### Options

Purchasing put and call options, as well as writing such options, are highly specialized activities and entail greater than ordinary investment risks especially when such options are not used as a hedge or are uncovered.

Because option premiums paid or received by the Client will be small in relation to the market value of the investments underlying the options, buying and selling put and call options can result in large amounts of leverage. As a result, the leverage offered by trading in options could cause the Client portfolio's asset value to be subject to more frequent and wider fluctuations than would be the case if the Client did not invest in options.

#### Non-U.S. Derivatives and Securities

Potomac River may invest Client portfolios in non-U.S. derivatives and securities. Investing in securities of non-U.S. governments and companies, which are generally denominated in non-U.S. currencies, and utilization of currency forward contracts and options on currencies involves certain considerations comprising both risks and opportunities not typically associated with investing in securities of United States issuers. These considerations include changes in exchange rates and exchange control regulations, political and social instability, expropriation,

imposition of non-U.S. taxes, less liquid markets and less available information than are generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

#### Repurchase Agreements and Reverse Repurchase Agreements

Potomac River may utilize repurchase agreements in its trading Client portfolios. Under a repurchase agreement, the Client sells an investment to a counterparty and simultaneously agrees to repurchase the investment back from the counterparty at an agreed upon price and date, with the difference between the sale price and the repurchase price establishing the cost of the transaction to the Client. Repurchase agreements essentially constitute a form of borrowing secured by collateral in the form of investments and will have the effect of leveraging the Client's assets. These agreements may be entered into on an overnight, specified term or open-ended basis.

Potomac River may also enter into reverse repurchase agreements with respect to Client portfolios. Under a reverse repurchase agreement, the Client purchases an investment from a counterparty and simultaneously agrees to resell the security back to the counterparty at an agreed upon price and date, with the difference between the purchase price and the resale price establishing the Client's return. Repurchase agreements may be entered into on an overnight, specified term or open-ended basis. If the seller of investments under a reverse repurchase agreement defaults on its obligation to repurchase the underlying investments, as a result of its bankruptcy or otherwise, the Client will seek to dispose of such investments, which action could involve costs or delays. If the seller becomes insolvent and subject to liquidation or reorganization under applicable bankruptcy or other laws, the Client's ability to dispose of the underlying investments may be restricted. If the seller fails to repurchase the investments, the Client's portfolio may suffer a loss to the extent proceeds from the sale of the underlying investments are less than the repurchase price.

#### Lack of Liquidity of Portfolio Assets

Client portfolio assets may include securities and other financial instruments or obligations which are very thinly traded or for which no market exists or which are restricted as to their transferability under applicable securities laws, although this is likely to occur only in extreme market conditions. The sale of any such investments may be possible only at substantial discounts. Further, such investments may be extremely difficult to value with any degree of certainty.

#### Valuation

Although Clients' portfolio assets are generally invested in securities and financial instruments that have readily available market values, there is some risk that in the event of a redemption from a Fund or Separate Account redemption proceeds may be paid out in an amount which could be higher or lower than the value designated by Potomac River. With respect to Potomac River Funds, there is a risk that an investment in the Fund by a new investor (or an additional investment by an existing investor) could dilute the value of such investments.

In addition, the timing of liquidations may also affect the values obtained on liquidation. It is also possible, although highly unlikely, other than in extreme market conditions, that third-party pricing information may not be available for certain positions held in a Client portfolio. Investments to be held in a Client portfolio may trade with bid-ask spreads that may be significant.

#### Regulatory Risk

Investment management and the securities and financial industry generally are subject to a variety of governmental regulations. Changes in governmental regulation applicable to the Funds,

or securities or instruments in which a Client may invest, may negatively affect a Client's returns. It is possible that regulatory action could impose additional direct or indirect costs on the Funds, limit the strategies that the Adviser may pursue or adversely impact the desirability of certain classes of investments or the anticipated return on certain investments.

#### Counterparty and Settlement Risk

To the extent Client portfolios are invested in swaps, derivative or synthetic instruments, or other over-the-counter transactions including forward contracts, or in certain circumstances, non-U.S. securities, a Client portfolio may take a credit risk with regard to parties with whom it trades and may also bear the risk of settlement default. These risks may differ materially from those entailed in exchange-traded transactions which generally are backed by clearing organization guarantees, daily marking-to-market and settlement, and segregation and minimum capital requirements applicable to intermediaries. Transactions entered directly between two counterparties generally do not benefit from such protections and expose the parties to the risk of counterparty default. Any such default by a trading counterparty could result in losses to the Client due to the delay of settlement of a transaction, loss of market gains or, in certain circumstances, loss of a portion or the full amount of the notional value of the transaction.

#### Custody and Prime Brokerage Risk

There are risks involved in dealing with the custodians or prime brokers who settle Client portfolio trades. Under certain circumstances, including certain transactions where a Client's portfolio assets are pledged as collateral for leverage from a non-broker-dealer custodian or a non-broker-dealer affiliate of the prime broker, or where the Client's portfolio assets are held at a non-U.S. prime broker, the securities and other assets deposited with the custodian or broker may not be clearly identified as being assets of the Client's portfolio and hence the Client could be exposed to a credit risk with regard to such parties. In addition, there may be practical or timing problems associated with enforcing the Client's rights to its assets in the case of an insolvency of any such party.

While Potomac River will monitor the prime brokers and custodians utilized for Client portfolios and believes they or their affiliates are each an appropriate custodian, there is no guarantee that any prime broker or custodian that may be used from time to time, will not become insolvent. While both the U.S. Bankruptcy Code and the U.S. Securities Investor Protection Act of 1970 seek to protect customer property in the event of a failure, insolvency or liquidation of a broker-dealer, there is no certainty that, in the event of a failure of a broker-dealer that has custody of Client assets, the Client would not incur losses due to its assets being unavailable for a period of time, ultimately less than full recovery of its assets, or both.

#### Risks of Investing in Underlying Funds

The Funds' ability to invest in other funds (including exchange-traded funds (ETFs)) subjects a Fund to the investment performance (positive or negative) and risks of these underlying funds in direct proportion to a Fund's investment therein. The performance of underlying funds could be adversely affected if other entities that invest in the same underlying funds make relatively large investments or redemptions in such underlying funds. The Funds indirectly bear a portion of the expenses of any funds in which the Funds invest. Because the expenses and costs of a fund are shared by its investors, redemptions by other investors in the fund could result in decreased economies of scale and increased operating expenses for such fund.

Underlying funds, when organized as independent legal entities, may be subject to lawsuits or proceedings by government entities or private parties, and underlying funds pursuing certain strategies may be more prone to lawsuits in connection with their investment activities than underlying funds pursuing strategies where the likelihood of engaging in hostile investment activities is lower. Expenses or liabilities of an underlying fund arising from any such suit would be borne by the underlying fund.

### Limited Withdrawal

Inasmuch as there are substantial restrictions on withdrawals from a Potomac River Fund, holdings in a Fund may constitute a relatively illiquid investment. In some cases, Separate Accounts may likewise be precluded from closing out positions in their accounts, although such Clients always retain their right to terminate their advisory relationship with Potomac River altogether.

### Non-Disclosure of Positions

In an effort to protect the confidentiality of its positions, Potomac River generally will not disclose its positions to Clients on an ongoing basis, although it may permit such disclosure on a select basis to certain Clients if it determines that there are sufficient confidentiality agreements and procedures in place.

The foregoing is not a complete explanation of all risks involved in engaging the Adviser. For additional information investors should carefully review the offering documents for the Potomac River Fund they wish to invest in.

### **Item 9 – Disciplinary Information**

Item 9 is not applicable as Potomac River has no reportable material legal or disciplinary events.

### **Item 10 – Other Financial Industry Activities and Affiliations**

Mark Spindel, the Adviser's founder, Managing Member, Chief Executive Officer and Chief Investment Officer, is also the Managing Member of Potomac River Capital GP, LLC, the general partner of the Potomac River Funds. Thus, the Adviser and the Funds are affiliated entities. Furthermore, Mr. Spindel and other principals, eligible employees and affiliates of the Funds have made substantial investments in the Funds. These relationships may give rise to a conflict of interest, incentivizing the Adviser to maximize the trading profits of the Funds at the expense of the Adviser's other Clients. Although Potomac River has adopted procedures reasonably designed to ensure that all its Clients are treated fairly in relation to one another, taking into consideration each Client's investment objectives and risk factors, there is no guarantee that each Client will be treated in the same manner in each circumstance. In effecting transactions, it may not always be possible or consistent with the investment objectives of the various persons or entities described above and of the Client for the same investment positions to be taken or liquidated at the same time or at the same price.

Potomac River (or its respective members, principals, affiliates and employees) may give advice or take action with respect to a Client that differs from the advice given with respect to other Clients. Moreover, Potomac River (and its respective members, principals, affiliates and employees) may conduct any other business, including any business within the financial industry, whether or not such business is in competition with a Client. With regard to its Separate Accounts, Potomac River may perform a variety of other functions related to investment management, including functions typically performed by a Chief Financial Officer.

Potomac River became registered with the Commodity Futures Trading Commission ("CFTC") as a Commodity Pool Operator ("CPO") and a Commodity Trading Advisor ("CTA") in January 2013. The General Partner became registered with the CFTC as a CPO in January 2013. Potomac River became registered with the Central Bank of Ireland in March 2013.

## **Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **Code of Ethics**

Potomac River has adopted a Code of Ethics for all supervised persons of the firm. Provisions in the Code of Ethics relate to the confidentiality of Client information, a prohibition on insider trading, restrictions on the acceptance of significant gifts, and personal securities trading procedures, among other things. Potomac River's goal is to protect its Clients' interests at all times and to demonstrate its commitment to its fiduciary duties of honesty, good faith, and fair dealing with Clients. All Potomac River employees are expected to adhere strictly to these guidelines and must acknowledge their obligation to comply with the Code of Ethics annually. Potomac River's Code of Ethics also requires that certain employees submit reports of their personal account holdings and securities or other investment transactions to the Chief Compliance Officer or his designee, who reviews these reports on a periodic basis. Clients or prospective clients may request a copy of the firm's Code of Ethics by contacting the Chief Compliance Officer, Daniel O. Hirsch, at (202) 524-8548 or [daniel.hirsch@potomacriverfund.com](mailto:daniel.hirsch@potomacriverfund.com).

### **Participation or Interest in Client Transactions**

From time to time, the Adviser may recommend that Separate Accounts invest in the Potomac River Funds. Because this practice may present a conflict of interest, the Client will be fully apprised of the relationship and compensation arrangements between the Adviser and the Funds before any such investment is made. Disclosure also will be made of the fact that the Adviser's related party serves as general partner to some of the Funds.

### **Personal Trading**

The Adviser's supervised persons are permitted to invest in one or more of the Potomac River Funds and may do so on terms that may be more favorable than those offered to outside investors. While this practice may present a conflict of interest, Potomac River believes it also aligns the Adviser's interests with those of the Fund investors. Such investments must be approved by the Adviser's Chief Compliance Officer or Managing Member.

Supervised persons also are generally permitted to buy and sell for their own accounts the same investments that are bought and sold for Client accounts. Subject to the restrictions described below, personal trading can occur at or around the time trades are placed for Clients. This situation presents a potential conflict between the supervised persons' interests and the interests of Clients. In order to address this potential conflict, Potomac River's Code of Ethics requires personal trades to be precleared by the Adviser's Chief Compliance Officer or Managing Member. Approval to trade will be granted unless there is a reasonable likelihood that the personal trade will disadvantage one or more Clients. Potomac River's personal trading restrictions do not apply with regard to transactions in the following securities because they are securities which are generally not bought and sold for Client accounts: equity securities listed on a national securities exchange (e.g., NYSE, NASDAQ), direct obligations of the U.S. Government, bankers' acceptances, bank certificates of deposit, commercial paper, high-quality short-term debt instruments (including repurchase agreements), shares issued by registered open-end investment companies (including money market funds), shares issued by unit investment trusts that are invested exclusively in one or more open-end funds, and investments in 529 plans.

## **Item 12 – Brokerage Practices**

### **Selecting Brokerage Firms**

Potomac River has full discretion to select the brokers and dealers who effect securities transactions and the futures commission merchants who effect commodities transactions on behalf of the Funds. In the case of Separate Accounts, the extent of Potomac River's discretion

depends on the terms of the agreement with each Client. In selecting broker-dealers to execute Client trades, Potomac River endeavors to obtain “best execution,” which may be defined as effecting trades in such a way as to maximize the value of Client assets. Among the many factors Potomac River considers are commission rates, prices, the quality, accuracy and efficiency of trade executions, the size and complexity of a particular transaction, the creditworthiness of the broker-dealer, the level of service provided and access to inventory. Potomac River does not consider Client referrals in selecting which firms execute trades for Clients.

Potomac River permits Separate Accounts to direct that all trading on their behalf be effected through a particular broker-dealer. In such cases, Potomac River's ability to negotiate the commission rates charged to the account may be limited or eliminated. As a result, a directed account may pay higher or lower commissions, receive more or less favorable net prices or pay higher or lower administrative costs than it would if the Adviser were authorized to select the broker-dealer. In addition, directed trades may cost a Client more because such trades will not be eligible to participate in bundled transactions (described below) and shall be effected after bundled trades are effected for the Funds and other Clients who have authorized the Adviser to select the broker-dealer. Notwithstanding the foregoing, the securities and other instruments traded by the Adviser tend to be of the most liquid in the market so the difference in price among broker-dealers and futures commission merchants is generally negligible, and sometimes, zero.

### **Soft Dollars**

“Soft dollars” refers to the receipt by an investment adviser of products and services that brokers provide, without making any separate cash payments for such products or services, based on the volume of commission revenues generated from transactions placed with those brokers on behalf of the Adviser's clients. The products and services available from brokers include both internally generated items (such as research reports prepared by the broker's employees) and items acquired by the broker from third parties (such as quotation equipment). Section 28(e) of the Securities Exchange Act of 1934, as amended, provides a “safe harbor” to investment advisers who use soft dollars generated by their client accounts to obtain investment research and brokerage services that provide lawful and appropriate assistance to the investment manager in the performance of investment decision-making responsibilities.

As noted above, the Funds and certain other Clients are responsible for paying the Adviser's middle/back office expenses, such as trade capture systems and research expenses, including research-related travel. Because Clients are otherwise responsible for paying Potomac River's research costs, Potomac River does not deem the occasional receipt of research from broker-dealers to pose a conflict of interest. Nevertheless, Potomac River has adopted policies and procedures reasonably designed to ensure that the receipt of any research or other benefit from a broker-dealer either qualifies for the safe harbor afforded by Section 28(e) of the Exchange Act, or has been authorized by Clients. Although Potomac River has a practice of not committing a specific amount of portfolio business to any broker-dealer for research or other soft-dollar benefits, the Adviser does, from time to time receive research (most of it unsolicited) from broker-dealers who effect trades for Client accounts. This research includes information on the economy, the financial markets, broad industry and security groups and individual securities issuers.

It is unlikely that these benefits may influence the Adviser to select one broker over another to perform services for Client accounts. Nevertheless, the Adviser will attempt to assure either (i) that the fees and costs for services that brokers offering these benefits provide are not materially greater than services performed by brokers not offering such benefits or (ii) that Client accounts also will benefit from those services.

The research so received may be used to service all of the Adviser's accounts, not just those whose transaction compensation may have paid for it, and Potomac River does not seek to allocate soft-dollar benefits to accounts in proportion to the trading that may generate the benefits. However, such research products and services are provided to all investment advisers who utilize these firms, and they are not necessarily considered to be paid for with soft dollars.



## **Trade Order and Aggregation**

To ensure that accounts of all Clients are treated fairly in the event the Adviser places orders for the same security or instrument for more than one account at or about the same time, the Adviser may combine orders placed on behalf of Clients, including advisory accounts in which Potomac River or its eligible employees have an interest, for the purpose of negotiating brokerage commissions or obtaining a more favorable price. When appropriate, securities or other instruments purchased or sold may be allocated in terms of amount to a Client according to the proportion that the size of the order placed by that account bears to the aggregate size of orders contemporaneously placed by the other accounts, subject to de minimis exceptions. All participating accounts will pay or receive an average price when orders executed on the same day are combined. Although the aggregation of trade orders is expected to benefit Clients overall, aggregation may, in any circumstance, disadvantage a particular Client. There may be circumstances in which the Adviser determines not to aggregate Client trade orders that otherwise could have been aggregated or in which aggregation is not feasible. As a general matter, the Adviser will place trades as to which it has the authority to select the broker-dealer before it places trades with broker-dealers selected by the Client.

Investment opportunities of limited availability that are suitable for more than one Client will be allocated in a manner that Potomac River determines to be fair and equitable under the circumstances to all Clients.

### **Item 13 – Review of Accounts**

Portfolio accounts are subject to ongoing performance monitoring and risk management review by the Chief Risk Officer and his team and the Chief Investment Officer.

Investors in the Funds generally receive unaudited written performance reports at least monthly, and audited financial statements within 120 days of the end of the fiscal year. Additional periodic reports, including market updates, investment commentary and performance reviews may be supplied as agreed between the Adviser and the Fund investor(s).

The Adviser provides the Separate Accounts with unaudited written portfolio reports on a quarterly basis or more frequently, if the Client requests. Other reports may also be provided, depending on the arrangement between the Separate Account and Potomac River.

### **Item 14 – Client Referrals and Other Compensation**

In certain circumstances, Potomac River will compensate unaffiliated third parties who solicit clients, where such third parties believe that their clients would benefit from Potomac River's investment management services. Any such arrangement with a third party will be pursuant to a written solicitation agreement as required by Rule 206(4)-3(a)(1)(iii) under the Advisers Act. Rule 206(4)-3 requires that the solicitor provide potential clients with a current copy of Potomac River's Form ADV, Part 2 and the written disclosure document required by Rule 206(4)-3(b).

Potomac River may pay third parties a portion of the management fees and/or performance fees earned in respect of investors introduced by such third parties. Potomac River currently pays one third party with respect to solicitations that occurred prior to December 31, 2013. Such fee sharing will not increase the fees charged by Potomac River to a Client. The payment of fees may cause a solicitor to recommend Potomac River over another adviser that does not pay solicitation fees.

### **Item 15 – Custody**

Potomac River does not have physical custody of Clients' funds or investments. Clients' funds and investments are held with a bank, broker-dealer, or other independent "qualified custodian" (as defined in the SEC's custody rule). Custodians for the Potomac River Funds are selected by

the Adviser. Custodians for the Separate Accounts are typically selected by the Client, sometimes with input from the Adviser, but may be selected by the Adviser if the Client so requests.

Although Potomac River does not have physical possession of any Client assets, Potomac River may be deemed to have technical custody of the Funds' assets pursuant to Advisers Act Rule 206(4)-2, because Mark Spindel, the Managing Member of the Adviser is also the Managing Member of the General Partner of certain of the Funds. In accordance with Rule 206(4)-2, the Funds are audited on an annual basis, in accordance with generally accepted accounting principles, by an independent public accountant that is registered with, and subject to regular inspection by the Public Company Accounting Oversight Board. Audited financial statements are distributed to all Fund investors, in accordance with the Rule.

With regard to the Separate Accounts, the qualified custodians provide account statements directly to Clients at their address of record, at least quarterly. Clients are urged to carefully review these statements and to compare them with any account statements they may receive from Potomac River. Clients should also notify Potomac River if they do not receive statements from their custodian.

#### **Item 16 – Investment Discretion**

As explained in Item 4 above, Potomac River generally has discretion to determine the investments and amount thereof to be bought or sold for the Potomac River Funds and the Separate Accounts.

The activities the Adviser engages in on behalf of the Potomac River Funds will be subject to the investment objectives, policies, and restrictions of each Fund and the control of the respective Funds' Boards of Directors or General Partner (as the case may be), while such activities engaged in by the Adviser on behalf of a Separate Account are subject to the investment objectives set forth in the respective investment management agreement or similar provisions contained within governing documents. On a case-by-case basis, owners of the Separate Accounts may negotiate certain risk, investment and operating guidelines that the Adviser will adhere to when exercising its discretionary authority.

#### **Item 17 – Voting Client Securities**

Because Potomac River generally does not invest in individual equities, the issue of proxy voting on behalf of Clients does not typically arise. In the event that such a vote is necessary, Potomac River will either determine how to vote the proxy in Clients' best interest, or will engage a third-party proxy advisory service to do so.

#### **Item 18 – Financial Information**

This Item is not applicable to Potomac River's business.