

# Scoria Capital Partners LP

## Part 2A of Form ADV

### The Brochure

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This brochure provides information about the qualifications and business practices of Scoria Capital Partners LP (“Scoria”). If you have any questions about the contents of this brochure, please contact us at 203-930-7953. 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 Scoria is also available on the SEC’s website at: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## Material Changes

As this is Scoria’s first Disclosure Brochure, there are no material changes.

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## Advisory Business

Scoria is a Delaware limited partnership organized in June 2013 and is owned primarily by Lawrence J. Sapanski, the Chief Investment Officer (“CIO”). Scoria provides investment advisory services on a discretionary basis to private pooled investment vehicles organized as domestic or foreign private investment vehicles. Currently Scoria serves as the investment manager to three private pooled investment vehicles (each a “Fund” and collectively “Funds”) that are structured as a “master-feeder.”

Scoria Partners LP and Scoria Offshore Fund Ltd., (each a “Feeder Fund” and collectively, “Feeder Funds”) invest substantially all of their assets in Scoria Partners Master Fund Ltd. (“Master Fund,” and together with the Feeder Funds, the “Fund”). Scoria then manages the Master Fund in accordance with its investment objectives, strategies, restrictions, and guidelines and does not tailor investment decisions to any particular Fund investor (each an “Investor”). Investors invest through one of the Feeder Funds and have no opportunity to select or evaluate any Master Fund investments or strategies. Scoria selects all Master Fund investments and strategies. Since Scoria does not provide individualized advice to Investors, Investors should consider whether the Fund meets their investment objectives and risk tolerance prior to investing. Information about each Fund can be found in its confidential offering documents.

At January 31, 2014 Scoria advises on \$67.9 million of capital on a discretionary basis on behalf of the three Funds.

## Fees and Compensation

Scoria receives compensation from the Funds comprised of fees based on a percentage of assets under management and performance-based compensation in the form of an incentive allocation from the Master Fund to Scoria. The management fee is paid by the Master Fund quarterly in advance. The incentive allocation is based on realized and unrealized gains and is paid annually or upon a Fund investor's withdrawal of capital, subject to a high water mark. Scoria's fee schedule is omitted because this brochure is only being delivered to qualified purchasers, as defined in the Investment Company Act of 1940 and the rules thereunder. Scoria, in its sole discretion, may reduce, waive or calculate differently the management fee or incentive allocation with respect to one or more Investors (including employees or affiliates of Scoria). The management fee and incentive allocation are deducted directly from the Master Fund.

### Expenses

Each Feeder Fund is responsible for paying its operating expenses — primarily its *pro rata* share of the operating expenses incurred by the Master Fund — including: legal, auditing, accounting and other professional expenses (for example, accounting and tax advisory fees, tax compliance and filings related costs, legal fees charged in negotiating prime brokerage, ISDA Master Agreements and related custody and segregation agreements, repurchase agreements or other trading or financing agreements); administration expenses and fees including, but not limited to, the provision of any investment/management related reporting; research expenses (including research-related and due diligence travel); investment expenses such as commissions, ticket charges, prime brokerage fees, give up fees, borrow costs, interest on margin accounts and other indebtedness and similar charges, as well as the expenses incurred by Sector Specialists in connection with trading the Master Fund's account; order management systems; custodial fees; bank and wire service and transaction fees; regulatory reporting costs (including, for example, Schedule 13D, 13F, 13G and Form PF filing costs and expenses, as well as EDGAR formatting and filing costs); and other expenses and legal fees related to the purchase, sale and maintenance of the Fund's assets as determined by the Scoria (including, but not limited to, withholding, income and other taxes). The Feeder Fund's operating expenses will also include Scoria's errors and omissions insurance and other costs associated with the Feeder Fund's business, such as the costs and expenses associated with issuing new interests as well as revising the Feeder Fund's offering and operative documents.

In general, the Feeder Funds will bear their *pro rata* share of the Master Fund's costs and expenses determined in accordance with the relative capitalizations of the Feeder Funds. However, if a certain Master Fund cost or expense relates solely to one Feeder Fund, Scoria may, but is under no obligation to, allocate such cost or expense solely to the particular Feeder Fund.

**The Feeder Funds will invest substantially all of its assets through a “master-feeder” fund structure in the Master Fund. Each Feeder Fund that invests in the Master Fund indirectly will bear the administrative and other expenses of the Master Fund *pro rata* based on its ownership interest in the Master Fund. Virtually all expenses, including the Management Fee and the Incentive Allocation, will be incurred at the Master Fund level itself.**

## **Performance Based Fees and Side-by-Side Management**

Scoria receives performance-based compensation in the form of an incentive allocation equal to a percentage of net profits (including both realized and unrealized gains and losses), allocable to each Investor's capital account, paid at the Master Fund level, subject to a high water mark.

Scoria's ability to earn performance-based compensation aligns the interests of Scoria and the Funds in some ways, but the arrangements also pose potential conflicts of interest. Scoria may have an incentive to invest the Funds' capital more speculatively than would otherwise be prudent in an effort to generate outsized returns. Also, incentive allocations for the Funds are based on realized and unrealized gains and losses, so Scoria could have an incentive to overvalue the Funds' holdings.

## **Types of Clients**

Scoria provides investment advice exclusively to the Funds. In order to invest, Investors must satisfy certain eligibility and suitability requirements which are described in more detail in the relevant Feeder Fund's confidential offering documents.

The minimum initial and subsequent investments in the Feeder Funds are \$5,000,000 and \$1,000,000, respectively, subject to Scoria's determination to accept a lesser amount.

## **Methods of Analysis, Investment Strategies and Risk of Loss**

### **Methods of Analysis**

The CIO will allocate the Funds' capital among sector-specific portfolios ("Sector Portfolios"), each of which is managed by a single portfolio manager ("Sector Specialist"), and the Best Ideas Portfolio ("BIP"), which is managed by the CIO (who also manages certain Sector Portfolios) with input from all of the Sector Specialists. In managing their respective Sector Portfolios, each Sector Specialist implements a process-driven, bottom-up/top-down investment strategy that focuses on both microeconomic, stock-specific factors and market-wide macroeconomic effects. The CIO invests the BIP in the "best risk-adjusted/return opportunity ideas" developed by the CIO, in active and formal collaboration with the Sector Specialists, implementing a similar process-driven investment strategy. While the BIP will be a "stock-specific" portfolio, macroeconomic factors will at times override other considerations in the CIO's trading decisions for the BIP.

The Sector Portfolios will use moderate leverage and are intended to have relatively low to standard volatility. In an attempt to reduce correlation, the Sector Portfolios will not hold overlapping portfolio positions (diversification being one of the objectives of the Sector Portfolio structure), and will be subject to formal risk parameters and trading limitations — e.g., issuer concentration, capitalization of portfolio companies, limits on illiquid positions, leverage restrictions, etc. — established (and which may be changed at any time) by the CIO.

The BIP will invest under the direct management of the CIO in "best risk-adjusted/return opportunity ideas" developed by the CIO in active and formal collaboration with the Sector Specialists. These ideas will be presented to Scoria's "Investment Committee" on Scoria's formal idea template. The ideas will be reviewed at the weekly Investment Committee meetings, and the

CIO, Investment Committee and presenting Sector Specialist will discuss the potential risks and rewards of the proposed investment idea. The CIO will make the ultimate investment decisions on behalf of the BIP. Once the BIP invests in an idea, the CIO, in collaboration the Investment Committee and the presenting Sector Specialist, will continue to monitor the investment using the Investment Checklist.

Scoria will often utilize market directional leverage (as opposed to the leverage typically used in relative value strategies to acquire large but substantially offsetting positions) in implementing its strategies, and the Fund's gross market exposure will typically exceed its net asset value capping out at approximately 3 times the Fund's net asset value. Scoria will modulate the Fund's gross market exposure from time to time in response to changing market conditions, macroeconomic factors, volatility and risk.

### Investment Strategies

Initially, the Sector Portfolios will implement the following strategies. Over time, Scoria expects that not only will these strategies themselves change and develop significantly, but also that new Sector Portfolios and strategies will be added to (and others eliminated from) the Fund's portfolio.

- Long/short equity;
- Event-driven, including merger arbitrage;
- Global macro, including fixed income and commodity components; and
- Index-based.

#### *Long/Short Equity*

Long/short equity strategies involve investing and trading long and/or short positions in equity securities in U.S. and international sectors and sub-sectors, including, without limitation, the financial, health care, industrial and cyclical, consumer and retail, telecommunication, media and technology, energy and insurance sectors.

#### *Event-Driven*

Event-driven strategies involve investing in opportunities created by transactional events, such as spin-offs, mergers and acquisitions, bankruptcy reorganizations, recapitalizations and share buybacks, as well as merger arbitrage strategies — that is, investing in the securities of publicly-traded companies involved in prospective mergers or corporate combinations, acquisitions, cash tender offers, exchange offers or corporate recapitalizations, with the intent to profit from the difference between the price of such securities at the inception of the investment and the price of such securities in expectation of or upon actual consummation of particular events.

#### *Global Macro*

Global macro strategies seek to analyze shifts in macroeconomic trends and attempt to capitalize on directional opportunities across a broad spectrum of markets, asset classes and financial instruments. Scoria's Global Macro strategy may include components of fixed income and commodities strategies.

Scoria's commodities trading will opportunistically employ a wide range of volatility, directional, relative value, hybrid and other strategies.

Among the commodities markets in which the Fund may trade are: energy products (including heating oil, light crude oil, natural gas and unleaded gasoline); precious metals (including platinum, silver, gold and palladium); base metals (including copper, zinc, tin and lead); agriculturals (including wheat, soybeans, soybean oil, live hogs, hog bellies, live cattle and corn); and the so-called “softs” (including cocoa, coffee, cotton and sugar).

#### *Index-Based*

Scoria’s index-based strategies may involve trading publicly-traded equity securities, equity indices and exchange-traded funds in an effort to track additions, deletions, upweights, downweights and rebalancings in G20 and other major market indices.

Investing in securities involves risk of loss that Investors should be prepared to bear.

### **Certain Strategy Risks**

#### **Evolving Strategies; New Strategies**

Scoria’s investment approaches are continually evolving, and Scoria may add new trading strategies, Sector Portfolios and Sector Specialists at any time. Scoria may allocate Master Fund capital to develop and incubate new strategies, even if Scoria has limited experience in such strategies. Scoria anticipates that it will add additional, and terminate existing, Sector Portfolios and strategies on an ongoing basis. There can be no assurance that Scoria will be successful in implementing the strategies which Scoria may from time to time develop and implement for the Master Fund, or that the Funds will not suffer losses during the development or incubation stage of a strategy

#### **Importance of Market Judgment**

Scoria’s strategies are by no means wholly quantitative or systematic; the market judgment and discretion of Scoria’s personnel are fundamental to the implementation of its investment strategies. Generally, the greater the importance of subjective factors to a trading strategy, the more unpredictable its results.

#### **Model Risk**

Certain of Scoria’s strategies require the use of quantitative valuation models that it will develop over time, as well as valuation models developed by third parties and licensed to Scoria. As market dynamics shift over time (due to changed market conditions and participants, among other factors), a previously highly successful model often becomes outdated or inaccurate, perhaps without Scoria recognizing that fact before substantial losses are incurred. It is an inherent feature even of successful quantitative models that they must be continuously updated. There can be no assurance that Scoria will be successful in developing and maintaining effective quantitative models. Furthermore, the changing nature of these models implies that the past results of any given quantitative strategy may not be representative of its future performance.

#### **Hedging**

Scoria is not obligated to enter into any hedging transactions. Scoria will not, in general, attempt to hedge all market or other risks inherent in the Master Fund’s positions and will hedge certain risks only partially, if at all. Specifically, Scoria may choose not to hedge certain risks or

determine that hedging is economically unattractive — either in respect of particular positions or in respect of the Master Fund’s overall portfolio. The Master Fund’s portfolio composition will commonly result in various directional market risks remaining unhedged. Although Scoria may rely on diversification to control such risks to the extent that Scoria believes it is desirable to do so, the Master Fund is not subject to any formal diversification policies.

If Scoria attempts to enter into hedging transactions with the intention of reducing or controlling risk, these hedging transactions, even if successful in achieving their objective, will likely reduce the Fund’s returns. Furthermore, hedging strategies may be ineffective in controlling risk, due to unexpected non-correlation (or even positive correlation) between the hedging instrument and the position being hedged, increasing rather than reducing both risks and losses.

To the extent that Scoria hedges, its hedging positions generally will not be static but rather will be adjusted continually based on Scoria’s assessment of market conditions, as well as the expected degree of non-correlation between the hedges and the portfolio being hedged. The success of any of Scoria’s hedging strategies will depend on Scoria’s ability to implement such strategies efficiently and cost-effectively, as well as on the accuracy of Scoria’s ongoing subjective judgments concerning the hedging positions to be acquired by the Master Fund.

#### **No Assurance of Portfolio Diversification**

While the CIO will establish formal diversification policies for each Sector Portfolio, these policies may be changed from time to time, and Scoria will not be restricted as to the percentage of the Master Fund’s assets that may be allocated to any particular Sector Portfolio. In addition, Scoria may concentrate the Master Fund’s portfolio in the BIP, a “best ideas” portfolio not subject to any formal diversification policies. If the market moves against a concentrated position in any Sector Portfolio or the BIP, significant losses could result — substantially in excess of those that would have been incurred had the Master Fund’s trading been more diversified. This lack of diversification will be pronounced until Sector Portfolios are formally added to each of the major market sectors over time.

#### **Portfolio Leverage**

The Master Fund will use leverage, both through its borrowings and through the significant degree of leverage typically embedded in the derivative instruments in its portfolio. Losses incurred on the Master Fund’s leveraged investments increase in direct proportion to the degree of leverage employed.

Although Scoria expects that the Master Fund’s gross market exposure will generally not exceed 3 times its Net Asset Value, there are no formal limitations on the leverage which the Master Fund may employ. From time to time the portfolios may be significantly more leveraged — either purposefully or because of market conditions beyond the control of Scoria.

The Master Fund will incur interest expense on the borrowings used to leverage its positions. If the gains (if any) earned by the Master Fund’s portfolio fail to cover such costs, the Master Fund will incur losses.

The Master Fund typically will obtain its leverage from securities brokers and dealers, which leverage typically will be secured by the Master Fund's securities and other assets. Brokers and dealers could liquidate assets held in the account to discharge the Master Fund's loan from the counterparty. Liquidation in that manner could have extremely adverse consequences for the Master Fund. Tightening of credit by lenders and counterparties may have a material adverse impact on the Master Fund and its operations.

### **Reliance on Corporate Management and Financial Reporting**

Many of the Master Fund's strategies will rely on the financial information made available by the issuers to which the Master Fund has exposure. Scoria will have no ability independently to verify the financial information disseminated by the issuers in which the Master Fund invests, and will depend upon the integrity of both the management of these issuers and the financial reporting process in general. Recent events have demonstrated the material losses that investors such as the Master Fund can incur as a result of corporate mismanagement, fraud and accounting irregularities. Equity securities prices are particularly vulnerable to instances of corporate mismanagement and fraud.

### **Uncertain Value of Investments**

Scoria has broad discretion to invest the Master Fund's capital and will do so in certain cases in instruments which have an uncertain fair value.

There is a risk that an Investor who makes a withdrawal will be paid an amount less than such Investor would otherwise be paid if the actual value of the Fund's investments is higher than the value determined by Scoria. Conversely, there is a risk that such Investor might, in effect, be overpaid if the actual value of such investment is lower than the value determined by Scoria.

The Master Fund may acquire a significant position in a given instrument — a position sufficiently large that the Master Fund is unable to transact freely in such instrument, due to practical, contractual, legal or regulatory restrictions. The value of such position may be materially less than it would have been in the absence of such restrictions.

The actual timing of a position's liquidation may materially affect the values obtained on such liquidation, irrespective of the "fair value" of such position.

Scoria, its affiliates and the fund administrator are entitled to rely, without independent investigation, upon pricing information and valuations furnished by third parties, including pricing services.

The prices which dealers and counterparties quote for certain positions may differ materially from the prices at which such dealers and counterparties would be prepared actually to execute transactions in such positions.

### **Volatility**

The prices of numerous instruments traded by the Master Fund have been subject to periods of excessive volatility in the past, and such periods can be expected to recur. Price movements are influenced by many unpredictable factors.



Although volatility can create profit opportunities for the Master Fund, it can also create the specific risk that historical or theoretical pricing relationships will be disrupted, causing what should otherwise be comparatively low risk positions to incur potentially substantial losses.

The financial markets experienced increased volatility in 2008–2010, which may recur in the future. On the other hand, in 2012 the equity markets experienced unusually low volatility, causing many arbitrage and similar strategies (which focus on profiting from the mispricings created in part by market volatility) to incur major losses.

### **Stagnant Markets**

Although volatility is one indication of market risk, certain of the investment strategies employed by the Master Fund rely for their profitability on market volatility contributing to the mispricings that they are designed to identify. In periods of trendless, stagnant markets and/or deflation, such strategies have materially diminished prospects for profitability.

### **Declining Equity Markets**

Although the Master Fund will take both long and short positions, the Master Fund's profit potential may be diminished during market cycles in which there is a general decline in equity instrument price levels.

### **Relative Value and Event-Driven Investments**

The Master Fund will pursue certain relative value strategies, taking highly leveraged long positions in securities believed to be undervalued and short positions in securities believed to be overvalued. In the event that the perceived valuations underlying the Master Fund's trading positions were to fail to converge toward, or were to diverge further from, Scoria's expectations, the Master Fund could incur substantial losses. Market disruptions and uncertainty can also cause substantial losses if relative value positions are forced to be prematurely terminated due to severe price changes.

Due to the leverage required to give relative value positions a profit potential generally consistent with the Master Fund's investment objectives, the Master Fund will be subject in its relative value trading to the risk of "credit squeezes."

### **Trade Execution Risk**

Many of the trading techniques used by the Fund will require the rapid and efficient execution of transactions. Inability to execute or inefficient executions can eliminate the small pricing differentials on which Scoria will seek to capitalize in implementing certain of its strategies and may materially adversely affect the profitability of such strategies.

### **The Costs of Frequent Trading**

Certain strategies employed will require frequent trading, resulting in substantial brokerage commissions and other transaction fees and expenses. The brokerage and commission expenses of the Master Fund, as a percentage of its Net Asset Value, generally will exceed those of many other private investment funds. These expenses must be offset by investment gains in order for the Funds to be profitable.

## **Rising Interest Rates**

Global interest rates are currently at or close to historical lows. In the event that interest rates increase — particularly if they do so suddenly — a number of the Master Fund’s outstanding positions could incur substantial losses, and the ongoing profit potential of certain of the strategies materially decrease.

## **Short Sales**

Short selling — the sale of securities not owned by the Master Fund— involves certain additional risks not applicable to other trading strategies. Short selling exposes the Master Fund to the risk of potentially unlimited losses.

Securities borrowed by the Master Fund in connection with a short sale need to be returned to the securities lender on short notice if so requested. If such a request occurs at a time when other short sellers of the same security are receiving similar requests, a “short squeeze” can occur, in which the Master Fund might be compelled, at a very disadvantageous time, to replace borrowed securities previously sold short with purchases on the open market, likely at prices significantly in excess of the proceeds received from the earlier short sales.

## **Exchange-Rate Risks**

Investments denominated in a foreign currency will be subject to the risk that the value of a particular currency will change in relation to one or more other currencies (primarily the U.S. dollar in which the investments generally will be denominated). Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in the values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments.

The Master Fund may enter into currency forward contracts (agreements to exchange one currency for another at a future date) to manage currency exchange rate risks, to protect against adverse changes in exchange rates and to facilitate transactions in non-U.S. securities. Currency forward contracts involve a risk of loss if Scoria fails to predict accurately the direction of currency exchange rates. For example, the Master Fund may experience a loss if it increases its exposure to a particular currency and that currency’s value in relation to the U.S. dollar subsequently falls in value against the U.S. dollar. In addition, forward contracts are not guaranteed by an exchange or clearinghouse, and may involve substantial credit risks.

## **Possible Positive Correlation with Stocks and Bonds**

One of the goals in incorporating a non-traditional investment such as an Interest into a portfolio is to provide a potentially valuable element of diversification. However, there can be no assurance, particularly during periods of market disruption and stress, that the performance of the Funds will, in fact, experience a low level of correlation with a traditional portfolio of stocks and bonds. In 2008–2009, many hedge funds incurred losses generally comparable to the decline in the S&P 500 Stock Index. The Master Fund’s concentration on equity and equity-linked markets may increase the likelihood of such correlation.

It appears that during periods when market liquidity contracts, both alternative and traditional investment strategies tend to incur losses. Periods of illiquidity can be expected to recur from time

to time, and during such periods the potential diversification benefits of an investment in the Master Fund may not be realized. On the contrary, the Master Fund's performance may be highly correlated with the performance of traditional portfolio holdings.

### **Instruments and Markets Traded**

There are no material limitations on the instruments (financial, currencies, commodities, etc.) or the markets (developed or developing) in which the Partnership may trade. The CIO and the Sector Specialists currently trade in a wide range of different sectors as well as markets and may trade in any others in the future, subject to any legal restrictions on doing so.

### **Risks of Certain Instruments Traded**

#### **Common Stocks**

The Master Fund will invest a substantial amount of its capital in long and short positions in common stock. Common stock prices are directly affected by issuer-specific events, as well as general market conditions. In addition, in many countries investing in common stocks is subject to greater regulatory and self-regulatory scrutiny than investing in debt or other financial instruments.

#### **Equity-Linked Instruments and Related Options**

A number of the financial instruments to be traded by the Master Fund are referenced to underlying equities but also incorporate other components — duration, strike price, premiums, etc. — which can result in the Master Fund's positions being unprofitable even though Scoria may have correctly assessed the market value of the underlying equity instrument.

Scoria may trade in put and call options, which involve qualitatively different risks than owning or selling short the underlying common stock. Because option premiums paid or received by an investor are small in relation to the market value of the investments underlying the options, trading put and call options is highly leveraged.

A number of traders as a matter of policy will not sell “naked” options — *i.e.*, options on common stocks not already owned by the trader in question — due to the risk of the value of such options spiking dramatically due to changes in stock prices, market volatility and/or interest rates. Scoria, however, will from time to time sell “naked” options.

#### **Derivatives**

The Master Fund will use derivative financial instruments, including, without limitation, warrants, options, swaps, convertible securities, notional principal contracts, contracts for differences, forward contracts and futures contracts as well as options on such futures contracts. The use of derivative instruments — both for speculation and for hedging purposes — involves a variety of material risks, including the extremely high degree of leverage often embedded in such instruments as well as the possibility of material and prolonged deviations between the theoretical and realizable value of a derivative. The market in derivative instruments is also typically materially less liquid than the market in the underlying reference asset. Such risks (and other risks that may not be anticipated) may make it difficult as well as economically non-viable to the Master Fund to close out derivative positions in order either to realize gains or to limit losses.

Many of the derivatives to be traded by the Master Fund are principal-to-principal or “over-the-counter” contracts between the Master Fund and third parties entered into privately, rather than on an exchange. As a result, the Master Fund will not be afforded the regulatory and financial protections of an exchange or its clearinghouse (or of the government regulator that oversees such exchange and clearinghouse). OTC contracts subject the Master Fund to credit risk with regard to the third parties with which it trades and the Master Fund will also bear the risk of counterparty non-performance under such contracts. Furthermore, in privately negotiated transactions, the risk of the negotiated price deviating materially from fair value is substantial, particularly when there is no active market available from which to derive benchmark prices.

Many derivatives are valued on the basis of dealers’ pricing of these instruments. However, the price at which dealers value a particular derivative and the price which the same dealers would be willing to pay for such derivative should the Master Fund wish or be forced to sell such position may be materially different. Such differences can result in an overstatement of the Master Fund’s Net Asset Value and may have a material adverse effect upon the Master Fund in situations in which the Master Fund is required to sell derivative instruments.

The Master Fund’s use of derivatives for hedging purposes will involve certain additional risks, including: (i) imperfect correlation between price movements in the asset on which the derivative is based and price movements in such derivative; and (ii) possible impediments to effective portfolio management or the ability to meet short-term obligations because of the percentage of the Master Fund’s assets segregated to secure its obligations under derivatives contracts

The terms of the Master Fund’s derivative contracts generally will allow the counterparty to the Master Fund to terminate such contracts under numerous circumstances, including as a result of certain levels of Net Asset Value declines (whether as a result of performance, withdrawals or a combination of the two), increases in the Master Fund’s mark-to-market exposure to such counterparty and the Master Fund’s suspension of the calculation of Net Asset Value and/or withdrawals. If a derivative contract is terminated prematurely, the Master Fund is likely to incur material losses.

By requiring that many derivatives be cleared on exchanges, the Dodd Frank Wall Street Reform and Consumer Protection Act (**the “Reform Act”**) may significantly disrupt the Partnership’s use of derivatives — at least for the foreseeable future.

### **Swap Agreements**

Among the various derivative transactions the Partnership may enter into are swap agreements and options on swap agreements (“swaptions”). These agreements can be individually negotiated and structured to include exposure to a variety of different types of investments, asset classes or market factors. The Master Fund, for instance, may enter into swap agreements with respect to interest rates, credit defaults, currencies, securities, indices of securities and other assets and/or other components of risk or return. Depending on their structure, swap agreements may increase or decrease the Master Fund’s market exposure.

Whether the Master Fund’s use of swap agreements or swaptions will be successful will depend on Scoria’s selection and negotiation of such transactions for the Master Fund. Swap transactions may be highly illiquid and may increase or decrease the volatility of the Partnership’s portfolio.

Moreover, the Master Fund bears the risk of loss of the amount expected to be received under a swap agreement in the event of the default or insolvency of its counterparty. The Master Fund will also bear the risk of loss related to swap agreements, for example, due to breaches of such agreements or the failure of the Master Fund to post or maintain required collateral. Many swap markets are relatively new and still developing. The Reform Act, as well as possible additional government regulation or other developments in the swap markets could adversely affect the Master Fund's swaps trading and result in material losses.

The Reform Act has required comprehensive regulation of swap agreements among many market participants, and may significantly disrupt the Master Fund's use of swaps — at least for the foreseeable future.

### **Futures Contracts**

The Master Fund will trade futures contracts and commodity options. Trading in futures contracts and options is a highly specialized activity and may entail greater than ordinary investment risks.

Futures positions may become illiquid because certain commodity exchanges limit fluctuations in certain futures contract prices during a single day by regulations referred to as “daily price fluctuation limits” or “daily limits.” During a single trading day no trades may be executed at prices beyond the daily limits. Once the price of a particular futures contract has increased or decreased by an amount equal to the daily limit, positions in that contract can neither be taken nor liquidated. This could prevent Scoria from promptly liquidating unfavorable positions and subject the Master Fund to substantial losses. In addition, Scoria may not be able to execute futures contract trades at favorable prices if little trading in the contracts involved is taking place. It also is possible that an exchange or the Commodity Futures Trading Commission (the “CFTC”) may suspend trading, order immediate liquidation and settlement or order that trading in a particular contract be conducted for liquidation only.

The low initial margin deposits normally required for futures positions (typically between 2% and 15% of the face value of a futures contract) permit an extremely high degree of leverage. Accordingly, a relatively small price movement may result in immediate and substantial losses to the Master Fund. Like other leveraged investments, a futures trade may result in losses in excess of the amount invested.

The bankruptcies of certain futures brokers have demonstrated that a significant portion of customer funds on deposit with CFTC-regulated futures brokers are, as a matter of practice, maintained in “unregulated” rather than “regulated” accounts at the futures broker. The futures brokers do not have to maintain “net capital” with respect to amounts on deposit in unregulated accounts. However, amounts in unregulated accounts are not subject to “customer protection” in the event of the futures broker's bankruptcy — in which case such amounts become simply unsecured debts of the futures broker.

While Scoria will, as a matter of policy, attempt to ensure that the Master Fund's assets are maintained in regulated accounts (or at a custodian other than a futures broker), this may not always be the case (*e.g.*, because of error, interim processing transfers, intentional misconduct of futures broker personnel, etc.).

## **Commodities**

The Master Fund may implement a wide range of strategies in the commodities markets. Among the commodities markets in which the Master Fund may trade are energy commodities, precious metals, base metals, agriculturals and “soft” commodities — *e.g.*, sugar, cotton and cocoa. Commodities trading is subject to risks — destruction, loss, industry-specific regulation (*e.g.*, pollution control regulation), operating failures, labor relations, etc. — that are not typically directly applicable to financial instrument trading.

Commodity price movements are influenced by many unpredictable factors and are, in particular, subject to dramatic price movements as the result of political and/or weather events (*e.g.*, Middle East political unrest and Hurricane Katrina), as well as due to factors such as market sentiment, inflation rates (real and perceived), interest rate movements and general economic and political conditions.

In certain market conditions, Scoria may have a significantly reduced likelihood of being able to capitalize on commodity price movements. For example, in “whipsaw” markets in which commodity price trends appear to develop, but then frequently reverse, Scoria’s commodity strategies are likely to be unprofitable.

The restrictions on “insider trading” such as those under the federal securities laws are generally not applicable to the commodities markets. Consequently, the Master Fund may often be trading in these markets at a material informational disadvantage to other market participants with better market access and/or information sources.

## **Currency Markets**

The Master Fund will trade currencies and foreign exchange. Such transactions involve a significant degree of risk. The markets in which foreign exchange transactions are effected are volatile and specialized. Significant changes, including changes in liquidity and prices, can occur in such markets within very short periods of time, often within minutes. Foreign exchange trading risks include, but are not limited to, exchange rate risk, maturity gaps, interest rate risk and potential governmental interference through regulation of the local exchange markets, foreign investment or particular transactions in the native or foreign currencies. Foreign exchange transactions can result in the Master Fund’s returns being substantially better or worse than they would have been had the Master Fund not entered into such transactions.

## **Preferred Stock**

Preferred stock generally has a preference as to dividends and upon the event of liquidation over an issuer’s common stock, but it ranks junior to debt securities in an issuer’s capital structure. Preferred stock generally pays dividends in cash (or additional shares of preferred stock) at a defined rate, but unlike interest payments on debt securities, preferred stock dividends are payable only if declared by the issuer’s board of directors. Dividends on preferred stock may be cumulative, meaning that, in the event the issuer fails to make one or more dividend payments on the preferred stock, no dividends may be paid on the issuer’s common stock until all unpaid preferred stock dividends have been paid. Preferred stock may also be subject to optional or mandatory redemption provisions.

## **Energy Sector and Utility Industry Related Risks**

The Master Fund will invest in the global energy markets, including in utility companies. Accordingly, the Master Fund faces the risk that earnings and dividends of energy companies will be greatly affected by changes in the prices and supplies of oil, natural gas and other energy fuels. Prices and supplies can fluctuate significantly over short periods due to a variety of factors, including but not limited to changes in international politics, policies of the Organization of the Petroleum Exporting Countries (“OPEC”), relationships among OPEC members and between OPEC and oil-importing nations, energy conservation, the regulatory environment, government tax policies and the economic growth and stability of key energy-consuming countries.

The risks associated with certain energy and utility companies include those involving the construction, operation and licensing of nuclear power plants, including the risk of nuclear accident. Oil and gas companies are subject to the risk of, among other things, production disruptions, spills and the costs and negative publicity associated therewith. The market value of the stock of utility companies also may be adversely affected by inadequate rate increases from regulatory agencies. Other risks of electric and gas utilities include their sensitivity to changes in interest rates, their continuing requirements for raising additional capital and their obligation to comply with environmental and other governmental mandates.

A number of major private investment funds incurred material losses in energy trading during the periods surrounding Hurricane Katrina and the Deepwater Horizon oil spill. In the first quarter of 2011, the unrest in the Middle East and the Japanese earthquake and tsunami also created unusual volatility in the energy markets, causing material losses to certain trades. There can be no assurance that the Master Fund itself might not, from time to time, incur similar losses.

## **Small to Medium Capitalization Companies**

Scoria may invest a portion of the Master Fund’s capital in the securities of companies with small to medium market capitalizations. Although Scoria believes that these securities may provide significant potential for appreciation, such securities, particularly smaller-capitalization stocks, often involve higher risks than do investments in the securities of larger-capitalization companies. Smaller-capitalization stocks are often more volatile and more illiquid than large-capitalization stocks.

## **High Growth Company-Related Risks**

The Master Fund may invest in high growth companies, which may allocate, or may have allocated, greater than usual amounts to research and product development. The securities of such companies may experience above-average price movements associated with the perceived prospects of success of their research and development programs. In addition, companies in which the Master Fund invests could be adversely affected by the lack of commercial acceptance of a new product or products or by technological change and obsolescence. Many of these companies may participate in undeveloped or limited markets, have limited products, rely on proprietary technology that may be difficult to protect from competitors, have no proven profit-making history, operate at a loss or with substantial variations in operating results from period to period, have limited access to capital and/or be in the developmental stages of their businesses.

## **Financial Services Sector Investments**

The Master Fund may invest in financial services companies. The financial services industry is vulnerable to a number of factors, including: extensive government regulation, rapid business changes, general economic conditions, significant competition and value fluctuations. Many financial services companies suffered substantial losses as a result of the events of 2007–2009 due to heavy losses in proprietary trading. The ongoing volatility in the credit and other market sectors continues to pose significant financial challenges and risks to financial services companies. Extensive and changing governmental regulation of financial services companies can, among other things, both increase costs and make it difficult to pass such increased costs on to consumers. Far-reaching revisions to the regulation of the financial services industry have recently been adopted in the Reform Act which could further affect the profitability of companies in that sector. On the other hand, in certain cases, deregulation of financial service companies has resulted in increased competition and reduced profitability.

Investment in the financial services sector may expose the Master Fund to systemic risk in the financial system. Moreover, the prices of stocks and bonds issued by many financial services companies have historically been more closely correlated with changes in interest rates than the prices of other stocks.

## **Credit Default Swaps**

The Master Fund may purchase and sell credit derivatives contracts — primarily credit default swaps — both for hedging and speculative purposes. The typical credit default swap contract generally requires the seller to pay to the buyer, in the event that a particular reference entity experiences specified credit events, a specified notional amount in exchange for securities issued by such reference entity. In return, the buyer agrees to make periodic payments equal to a fixed percentage of the notional amount of the contract. The Master Fund may also purchase or sell credit default swaps on a basket of reference entities as part of a synthetic collateralized debt obligation transaction. Credit default swaps, and collateralized debt obligations referenced to them, will be subject to additional regulation under the Reform Act in the near future.

As a seller of credit default swaps, the Master Fund will incur leveraged exposure to the credit of the reference entity and is subject to many of the same risks it would incur if it were holding debt securities issued by the reference entity. However, the Master Fund would not have any legal recourse against the reference entity and would not benefit from any collateral securing the reference entity's debt obligations. In addition, the credit default swap buyer is likely to have broad discretion to select which of the reference entity's debt obligations to deliver to the Master Fund following a credit event and would likely choose the obligations with the lowest market value in order to maximize the payment obligations of the Master Fund.

As a buyer of credit default swaps, in circumstances in which the Master Fund did not own the debt securities that are deliverable under a credit default swap, the Master Fund would be exposed to the risk that deliverable securities would not be available in the market, or would be available only at unfavorable prices, as would be the case in a so-called "short squeeze."

As a buyer or a seller of credit default swaps, the Master Fund takes credit risk with respect to its counterparties. Credit default swaps generally trade on the basis of theoretical pricing and valuation models, which may not accurately value such swap positions when established or when subsequently traded or unwound under actual market conditions.



In certain instances of issuer defaults or restructurings, it has been unclear under the standard industry documentation for credit default swaps whether or not a “credit event” triggering the seller’s payment obligation had occurred.

The market in credit default swaps may be substantially curtailed by the Reform Act and the regulations promulgated thereunder.

### **Special Situations**

The Master Fund may invest in companies involved in (or the target of) acquisition attempts or tender offers as well as companies involved in work-outs, liquidations, spin-offs, reorganizations, bankruptcies or other catalytic changes or similar transactions. In any such “special situation,” there exists the risk that the contemplated transaction will not be consummated, will take considerably longer than anticipated and/or will result in a distribution of cash or a new security the value of which is less than the purchase price to the Master Fund of the security or other financial instrument in respect of which such distribution is received. Similarly, if an anticipated transaction does not in fact occur, the Master Fund may be required to sell its investment at a substantial loss. There is typically substantial uncertainty concerning whether a special situation event will be consummated as well as to the outcome of such consummation.

### **Non-U.S. Markets**

Investing in non-U.S. securities involves certain considerations not typically associated with investing in the securities of U.S. issuers. These considerations include changes in exchange rates and exchange control regulations, political and social instability, expropriation, imposition of punitive and retroactive taxes, less market liquidity and less available issuer-specific information than is 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, geo-political risk, and greater price volatility.

### **Emerging Markets**

Investing in emerging market debt or equity involves certain risks and special considerations not typically associated with investing in other more established economies or securities markets. Such risks may include: (i) the risk of nationalization or expropriation of assets or confiscatory taxation; (ii) social, economic and political uncertainty including war; (iii) dependence on exports and the corresponding importance of international trade; (iv) price fluctuations, less liquidity and the smaller capitalization of the securities markets; (v) currency exchange rate fluctuations; (vi) rates of inflation (including hyperinflation); (vii) controls on foreign investment and limitations on repatriation of invested capital and on the Master Fund’s ability to exchange local currencies for U.S. dollars; (viii) governmental involvement in and control over the economies; (ix) governmental decisions to discontinue support of economic reform programs generally and to impose centrally planned economies; (x) differences in auditing and financial reporting standards which may result in the unavailability of material information about issuers; (xi) less extensive regulation of the securities markets; (xii) longer settlement periods for securities transactions in emerging markets; (xiii) less developed corporate laws regarding fiduciary duties of officers and directors and the protection of investors; and (xiv) certain considerations regarding the maintenance of Master Fund portfolio securities and cash with non-U.S. sub-custodians and securities depositories.

## **Disciplinary Information**

Scoria and its employees have not been involved in any legal or disciplinary events in the past 10 years that would be material to a client's evaluation of Scoria or its personnel.

## **Other Financial Industry Activities and Affiliations**

Scoria is registered as a commodity pool operator.

Scoria and its employees do not have any affiliations or other relationships or arrangements with other financial services companies that are material to Scoria's advisory business.

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

Scoria has adopted a written code of ethics ("Code") that sets forth a standard of business conduct and compliance with federal securities laws by all of its employees. The Code contains policies and procedures intended to ensure that personal securities trading by Scoria employees is conducted in such a manner as to avoid actual or potential conflicts of interest or any abuse of an individual's position of trust and responsibility. Among other things, the Code requires Scoria and its employees to act in clients' best interests, abide by all applicable regulations, and avoid even the appearance of insider trading. More specifically, the Code prohibits an employee from purchasing (or selling) any exchange-traded fund or any single-name equity security (or any derivative security thereof). The Code also prohibits an employee from participating in a private placement without the prior written approval of the Chief Compliance Officer, and requires periodic reporting of employees' personal securities transactions and holdings. In addition, the Code requires prompt internal reporting of violations of the Code.

Scoria's restrictions on personal securities trading apply to employees, as well as employees' family members living in the same household. A copy of Scoria's code of ethics is available upon request.

## **Brokerage Practices**

Scoria is authorized to determine the broker or dealer to be used for each securities transaction on behalf of the Master Fund. In selecting brokers and negotiating commission rates, Scoria will take into account the financial stability and reputation of brokerage firms, the brokerage, research and other services provided by such brokers, and referrals of investors, although the Master Fund may not, in any particular instance, be the direct or indirect beneficiary of the services provided. In selecting brokers or dealers to execute transactions, Scoria need not solicit competitive bids and does not have an obligation to seek the lowest available commission cost, although Scoria will make a good faith determination that the amount of commissions paid is reasonable in light of the products or services provided by a broker. Commission rates are generally negotiable and selecting brokers on the basis of considerations that are not limited to the applicable commission rates may result in higher transaction costs than would otherwise be obtainable.

## Soft Dollars

Scoria will utilize “soft dollars” to pay only for research and brokerage products or services that it believes satisfy the definition of “research” or “brokerage” under Section 28(e). Section 28(e) is a “safe harbor” that permits an investment manager to use commissions or “soft dollars” to obtain certain research and brokerage services in connection with the investment decision-making process. Under Section 28(e), research obtained with “soft dollar” credits generated by the Master Fund may be used by Scoria to service accounts other than the Master Fund. Where a product or service provides both research and non-research assistance to Scoria, a portion of the cost of the product or service, based upon a reasonable allocation between the two types of uses, may be paid for with “soft dollars.”

Scoria’s use of soft dollars presents a potential conflict of interest because Scoria is effectively using Fund assets to pay for research that Scoria might be able to generate internally or would otherwise have to purchase. This conflict of interest could motivate Scoria to allocate trades to research providers, even if those providers were not offering the best available execution. Scoria considers the amount and nature of research services provided by broker-dealers, as well as the extent to which such services are relied upon, and attempts to allocate a portion of the brokerage business of the Funds on the basis of that consideration. In addition, broker-dealers sometimes suggest a level of business that they would like to receive in return for the various services they provide. Actual brokerage business received by any broker-dealer may be less than the suggested allocations, but can (and often does) exceed the suggestions, because total brokerage is allocated on the basis of all the considerations described above. A broker-dealer is not excluded from receiving business because it has not been identified as providing research services.

Scoria may engage non-discretionary third-party consultants for the use of proprietary software, research or other services. Any compensation to such persons based on the success of their ideas and certain operating expenses related to such relationships may be paid directly by the Funds or with “soft dollars.”

Research and brokerage services obtained by the use of commissions arising from the Master Fund’s portfolio transactions may be used by Scoria in its other investment activities. The Master Fund may not necessarily, in any particular instance, be the direct or indirect beneficiary of the research or brokerage services provided in consideration of the “soft dollars” generated by the Master Fund’s trading.

The Master Fund may (but is not obligated to) enter into arrangements under which certain direct expenses of the Master Fund may be paid for with “soft dollar” credits from brokers. For the avoidance of doubt, the Master Fund’s brokers may pay expenses on the Master Fund’s behalf that are billed to the Master Fund. Scoria will enter into such arrangements where it believes it is administratively or operationally expedient to do so or where they are more favorable to the Master Fund than an arrangement under which the Master Fund pays for the products or services in question with cash. However, such arrangements make it more difficult for Investors to evaluate the cost structure of the Master Fund because the costs of such products or services are not broken out separately.

In some cases, at the end of a calendar year, certain brokers may provide a cash refund of unused “soft dollar” credits. In this event Scoria will credit the refund to the Feeder Funds *pro rata* in accordance with their respective Net Asset Values.

### Referrals

Brokers may introduce investors or potential investors in the Feeder Funds to Scoria (and those brokerage firms may in turn compensate their employees as a result). However, in selecting broker-dealers, Scoria does not take into consideration referrals from a broker-dealer or other third party.

### Directed Brokerage

Investors cannot direct brokerage through a specific broker-dealer.

### Aggregated Trades

Trades are placed through the Master Fund so there is no aggregation of trades for multiple accounts.

## **Review of Accounts**

The Funds are monitored on an ongoing basis by the Investment Committee, headed by the CIO. The Investment Committee conducts formal meetings weekly to assess new idea submissions and review existing positions. In addition, accounts are reviewed as needed based on company specific or macro trends.

Investors receive monthly, unaudited capital account statements from Scoria. Such statements detail the Investor’s capital account information including the capital account’s beginning and ending equity, and the capital account’s performance for that period. Additionally, each Investor will receive the audited financial statements of the Funds within 120 days of the Funds’ fiscal year end.

## **Client Referrals and Other Compensation**

Scoria does not compensate any related persons or third parties for Investor referrals.

Other than the previously described “soft dollars” (see **Brokerage Practices** above) that Scoria may receive from broker-dealers, Scoria does not receive any other economic benefits from non-clients in connection with the provision of investment advice to clients.

## **Custody**

Under Rule 206(4)-2 of the Investment Advisers Act of 1940, Scoria is deemed to have custody of the securities and other assets of each Fund even though Scoria does not physically hold the securities and other assets, and such securities and assets are not held or registered in Scoria’s name. Scoria is exempt from many of the provisions of Rule 206(4)-2 because each Fund is audited in accordance with U.S. generally accepted accounting principles on an annual basis 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 each Investor within 120 days of the end of each fiscal year.

## **Investment Discretion**

Scoria has full discretionary authority over each of the Funds pursuant to a grant of authority in each Fund's governing documents. Investors in the Funds cannot place restrictions on Scoria's investment discretion.

## **Voting Client Securities**

In accordance with its fiduciary duty to clients and Rule 206(4)-6 under the Investment Advisers Act of 1940, Scoria has adopted and implemented written policies and procedures governing the voting of client securities. All proxies that Scoria receives will be treated in accordance with these policies and procedures.

Scoria's authority to vote proxies for the Funds is established by the Funds governing documents. Scoria's general policy is to vote proxy proposals, amendments, consents or resolutions relating to client securities, including interests in private investment funds, if any (**collectively, "proxies"**), in a manner that serves the best interests of the Master Fund, as determined by Scoria, and taking into account relevant factors, including, but not limited to: the impact on the value of the securities; the anticipated costs and benefits associated with the proposal; the effect on liquidity; and customary industry and business practices. In addition, the proxy voting policy includes guidelines if a material conflict of interest arises between Scoria, its employees, and/or its Funds to ensure that any material conflict is resolved in the best interest of the Funds.

A copy of Scoria's proxy voting policies and procedures, as well as specific information about how Scoria has voted in the past, is available upon written request.

## **Financial Information**

Scoria has never filed for bankruptcy and is not aware of any financial condition that is expected to impair its ability to meet contractual commitments to clients.