
PART 2A OF FORM ADV: FIRM BROCHURE

AAG CAPITAL MARKETS LLC

February 2014

AAG Capital Markets LLC
848 Brickell Avenue
Suite 1120
Miami, Florida 33131
Tel: 305-504-8777
Fax: 305-504-8747
Website: www.acap.aero

This brochure (this "Brochure") provides information about the qualifications and business practices of AAG Capital Markets LLC (the "Investment Adviser," "we," "us," and similar terms). If you have any questions about the contents of this Brochure, please contact us at 305-504-8777 or info@acap.aero. The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority.

The Investment Adviser is a newly formed adviser and expects to register as an investment adviser with the SEC. Registration with the SEC or with any state securities authority does not imply a certain level of skill or training.

Additional information about the Investment Adviser also is available on the SEC's website at www.adviserinfo.sec.gov.

ITEM 2

MATERIAL CHANGES

This Brochure is the first supplement to our initial Form ADV Part 2A, which was submitted with our application for registration with the SEC. We do not have any material changes to report since that initial brochure. In the future, if our Brochure - when amended in conjunction with our annual update - contains material changes from our last annual update, we are required to identify and discuss those changes.

ITEM 3 **TABLE OF CONTENTS**

ITEM 1 COVER PAGE.....	i
ITEM 2 MATERIAL CHANGES	ii
ITEM 3 TABLE OF CONTENTS.....	iii
ITEM 4 ADVISORY BUSINESS	1
A. <u>General Description of Advisory Firm</u>	1
1. <i>AAG Capital Markets LLC</i>	1
2. <i>AAG Aviation Advisers LLC</i>	1
B. <u>Description of Advisory Services</u>	1
1. <i>Advisory Services</i>	1
2. <i>Investment Strategies and Types of Investments</i>	2
C. <u>Availability of Customized Services for Individual Clients</u>	3
D. <u>Wrap Fee Programs</u>	3
E. <u>Assets Under Management</u>	4
ITEM 5 FEES AND COMPENSATION	5
A. <u>Advisory Fees and Compensation</u>	5
B. <u>Payment of Fees</u>	5
C. <u>Additional Fees and Expenses</u>	5
D. <u>Additional Compensation and Conflicts of Interest</u>	6
ITEM 6 PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT.....	7
ITEM 7 TYPES OF CLIENTS	8
ITEM 8 METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS.....	9
A. <u>Methods of Analysis and Investment Strategies</u>	9
B. <u>Material, Significant or Unusual Risks Relating to Investment Strategies</u>	10
C. <u>Risks Associated With Particular Types of Securities</u>	14
ITEM 9 DISCIPLINARY INFORMATION	25
ITEM 10 OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS	26
A. <u>Broker-Dealer Registration Status</u>	26
B. <u>Futures Commission Merchant, Commodity Pool Operator or Commodity Trading Adviser Registration Status</u>	26
C. <u>Material Relationships or Arrangements with Industry Participants</u>	26
D. <u>Material Conflicts of Interest Relating to Other Investment Advisers</u>	26
ITEM 11 CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING.....	27

A. <u>Code of Ethics</u>	27
B. <u>Securities in which the Investment Adviser or a Related Person Has a Material Financial Interest</u>	27
1. <i>Cross Trades</i>	27
2. <i>Principal Transactions</i>	28
C. <u>Investing in Securities that the Investment Adviser or a Related Person Recommends to Clients</u>	28
D. <u>Conflicts of Interest Created by Contemporaneous Trading</u>	28
ITEM 12 BROKERAGE PRACTICES.....	30
A. <u>Factors Considered in Selecting or Recommending Broker-Dealers for Client Transactions</u>	30
1. <i>Research and Other Soft Dollar Benefits</i>	30
2. <i>Brokerage for Client Referrals</i>	31
3. <i>Directed Brokerage</i>	32
B. <u>Order Aggregation</u>	32
ITEM 13 REVIEW OF ACCOUNTS.....	33
A. <u>Frequency and Nature of Review of Client Accounts or Financial Plans</u>	33
B. <u>Factors Prompting Review of Client Accounts Other than a Periodic Review</u>	33
C. <u>Content and Frequency of Account Reports to Clients</u>	33
ITEM 14 CLIENT REFERRALS AND OTHER COMPENSATION.....	34
A. <u>Economic Benefits for Providing Services to Clients</u>	34
B. <u>Compensation to Non-Supervised Persons for Client Referrals</u>	34
ITEM 15 CUSTODY.....	35
ITEM 16 INVESTMENT DISCRETION.....	36
ITEM 17 VOTING CLIENT SECURITIES.....	37
A. <u>Policies and Procedures Relating to Voting Client Securities</u>	37
ITEM 18 FINANCIAL INFORMATION.....	38

ITEM 4 ADVISORY BUSINESS

A. General Description of Advisory Firm.

1. *AAG Capital Markets LLC.*

AAG Capital Markets LLC (the "Investment Adviser" "we," and "us"), is a Delaware limited liability company that was formed in 2013.

We only have one office, which is located in Miami, Florida.

We are a wholly-owned subsidiary of Apollo Aviation Holdings Limited ("AAHL"), a Bermuda holding company which also owns Apollo Aviation Fund Management, LLC and Apollo Aviation Management Limited, both of which are specialty managers of aviation assets. AAHL is ultimately co-owned by Mr. William D. Hoffman and Mr. Robert G. Korn, its founders (the "Principals"), and Sciens International Investments and Holdings S.A.

2. *AAG Aviation Advisers LLC.*

Our registration on Form ADV also covers *AAG Aviation Advisers LLC* (the "Fund General Partner"), a limited liability company organized under the laws of the state of Delaware. The Fund General Partner is an affiliate of the Investment Manager and it serves or may serve as the general partner of pooled investment vehicles that are U.S. or offshore partnerships. The Fund General Partner's facilities and personnel are provided by the Investment Adviser.

The Principals also control the Fund General Partner.

B. Description of Advisory Services.

This Brochure generally includes information about us and our relationships with our clients. While much of this Brochure applies to all such clients, certain information included herein applies to specific clients only.

1. *Advisory Services.*

Upon or soon after the effectiveness of our registration as an investment adviser, we will serve as the investment adviser, with discretionary trading authority, to private pooled investment vehicles, the securities of which are offered to investors on a private placement basis (each, a "Fund" and collectively, the "Funds"). The Funds include:

- (1) AAG Aviation Fund LP, a Delaware limited liability partnership (the "Domestic Fund");
- (2) AAG Aviation Offshore Fund Ltd., a Cayman Islands exempted company (the "Offshore Fund", and together with the Domestic Fund, the "Feeder Funds");
- (3) AAG Aviation Intermediate Fund LP, a Cayman Islands exempted limited partnership (the "Intermediate Fund"); and

- (4) AAG Aviation Master Fund LP, a Cayman Islands exempted limited partnership (the "Master Fund"), which serves as the master fund into which the Domestic Fund and the Intermediate Fund invest substantially all of their assets through a "master feeder" structure.

The Fund General Partner serves as the general partner of the Domestic Fund, the Intermediate Fund and the Master Fund. In addition, we expect that the Funds listed above will be modified in the months following the effectiveness of our registration as an investment adviser, including by the creation of a Japanese Yen-denominated investment mechanism.

We will update the information contained herein on, among other topics, our investment strategy, instruments and securities universe, and the attendant risks at an appropriate time.

This Brochure does not constitute an offer to sell or solicitation of an offer to buy any securities. The securities of the Funds are offered and sold on a private placement basis under exemptions promulgated under the Securities Act of 1933 and other applicable state, federal or non-U.S. laws. Significant suitability requirements apply to prospective investors in the Funds, including requirements that they be "accredited investors" as defined in Regulation D, "qualified purchasers" as defined in the Investment Company Act, or non-"U.S. Persons" as defined in Regulation S. Persons reviewing this Brochure should not construe this as an offer to sell or a solicitation of an offer to buy the securities of any of the Funds described herein. Any such offer or solicitation will be made only by means of a confidential private placement memorandum.

2. Investment Strategies and Types of Investments.

Our investment focus will be on sourcing, buying, trading and managing aviation related securities and understanding their structures. We will also seek to identify and exploit market inefficiencies and trading opportunities.

Investments we make for clients may include all types of aviation, aerospace and general macro-economic benchmark securities, including fixed income instruments, particularly equipment trust certificates and enhanced equipment trust certificates ("ETCs") and enhanced equipment trust certificates ("EETCs"), equity securities, currencies, loans or derivatives, including notes, bonds, bank obligations, trade claims, swaps, including credit default swaps, and other notional principal contracts, equity indices, exchange-traded funds ("ETFs"), contracts based on indices, contracts that transfer risks, such as total return swaps, futures, options and forward contracts, which may be held for investment or hedging purposes. Investments in financial instruments may be made both on exchanges and over-the-counter, and through private placements.

Our investment strategies include the following:

- Investment Grade Trading. This strategy focuses on mid to high grade fixed income securities and derivatives, issued or backed by companies and assets in the aviation sector. These securities include ETCs and EETCs, backed by high quality assets, whose credit ratings are equal to or higher than Baa3 by Moody's or BBB by S&P or Fitch.
- High Yield Trading. This strategy focuses on high yield fixed income instruments and derivatives issued or backed by companies and assets, including ETCs and EETCs,

whose credit ratings are below Baa3 as rated by Moody's or BBB as rated by S&P or Fitch.

- Equities. This strategy incorporates equity instruments of listed companies and utilizes a variety of products, including common stock, convertible bonds, and convertible preferred and equity derivatives. The trading strategies in which the clients may engage include new issues, relative value such as long-short, directional trading, carry trades, correlation trades and others.
- Currency and Rates. This strategy will seek to maximize gains, measured in U.S. Dollars, through participating in the global currency, interest rate, equity and fixed income markets through the hedge trading of spot, forward, swap and option contracts on currencies, exchange-traded futures and interest rates and over-the-counter derivative instruments relating to currency and interest rate exposures.
- Event Oriented Strategies. This strategy will seek to capitalize on announced and anticipated events that are expected to impact the price of a certain instrument. Such events may include company specific mergers, acquisitions, restructurings, liquidations, bankruptcies, grounding of fleets, as well as macro-economic events such as interest rate movements, economic indicator announcements, political unrest and terror attacks. Following a detailed analysis of an event or potential event, we may structure transactions designed to capitalize on the anticipated price movement by entering into long or short positions.

* * *

The descriptions set forth in this Brochure of specific advisory services that we offer to our clients, and investment strategies pursued and investments made by us on behalf of our clients, should not be understood to limit in any way our investment activities. We may offer any advisory services, engage in any investment strategy and make any investment, including any not described in this Brochure, that we consider appropriate, subject to each client's investment objectives and guidelines. The investment strategies we pursue are speculative and entail substantial risks. Clients should be prepared to bear a substantial loss of capital. There can be no assurance that the investment objectives of any client will be achieved.

C. Availability of Customized Services for Individual Clients.

Our investment decisions and advice with respect to each Fund will be subject to each Fund's investment objectives and guidelines, as set forth in its respective offering documents.

The Investment Adviser in its role as investment adviser to Funds and/or the Fund General Partner, in its role as the general partner of certain Funds that are partnerships, may from time to time in the future agree to supplements, clarifications, or variations of the terms of a Fund's offering, subscription, or organizational documents in "side letters" or similar agreements.

D. Wrap Fee Programs.

We do not currently participate in any Wrap Fee Programs.

E. Assets Under Management.

We do not currently have any client assets under management but we expect to have, within 120 days of when our initial registration becomes effective, client assets under management sufficient to allow us to remain eligible for registration with the SEC.

ITEM 5

FEES AND COMPENSATION

A. Advisory Fees and Compensation.

The fees applicable to each Fund are set forth in detail in each Fund's offering documents. These fees can vary in amount and in methodology from product to product and therefore may not lend themselves to a single summary in this Brochure; prospective investors are therefore urged to carefully review the offering documents and to raise any questions with us. In addition, we only deliver this Brochure to qualified purchasers as defined in section 2(a)(51)(A) of the Investment Company Act of 1940.

B. Payment of Fees.

Fees and compensation paid to the Investment Adviser or its affiliates by clients are generally deducted from the assets of such clients. As discussed above, Management Fees are generally deducted on a quarterly basis and Performance Compensation is generally deducted on an annual basis.

C. Additional Fees and Expenses.

In general, each client bears its own expenses, including, without limitation, the Management Fee; the Performance Compensation; investment expenses, whether or not such investments are consummated (such as brokerage commissions, expenses relating to short sales, clearing and settlement charges, custodial fees, bank service fees and interest expenses); investment-related travel expenses (which are travel expenses related to the purchase, sale or transmittal of, or due diligence regarding, the client's investments, whether or not such investments are consummated, incurred by the Investment Adviser); professional fees (including, without limitation, expenses of consultants, investment bankers, attorneys, accountants and other experts) relating to investments; fees and expenses relating to software tools, programs or other technology utilized in managing the client (including, without limitation, third-party software licensing, implementation, data management and recovery services and custom development costs); research and market data (including, without limitation, any computer hardware and connectivity hardware (*e.g.*, telephone and fiber optic lines) incorporated into the cost of obtaining such research and market data); order management systems; administrative expenses (including, without limitation, fees and expenses of the client's administrator); the cost of directors and officers and errors and omissions liability insurance for the directors, the Investment Adviser and the Fund General Partner; legal fees and related expenses; external accounting and valuation expenses (including, without limitation, the cost of accounting software packages); audit and tax preparation expenses; fees of the members of the board of directors of the client who are not associated with the Investment Adviser; costs of providing electronic access to client reports and information and printing and mailing reports and notices; entity-level taxes; corporate licensing; regulatory expenses (including, without limitation, filing preparation and fees, including for filings required to be made by the Investment Adviser); organizational expenses; expenses incurred in connection with the offering and sale of securities of the client and other similar expenses related to the client (other than any fees payable to any placement agent, which will be paid by the Investment Adviser indirectly by reducing the Management Fees owed to the Investment Adviser); indemnification expenses; and extraordinary expenses.

D. Additional Compensation and Conflicts of Interest.

Neither the Investment Adviser nor any of its supervised persons accepts compensation (*e.g.*, brokerage commissions) for the sale of securities or other investment products.

ITEM 6
PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT

We and our affiliates accept performance-based compensation from every client (other than clients that are not assessed performance-based compensation because it is assessed through another entity in a single master-feeder or similar structure). As a result, we and our affiliates do not face certain conflicts of interest that may arise when an investment adviser accepts performance-based fees from some clients, but not from other clients.

ITEM 7
TYPES OF CLIENTS

We provide investment advice to the Funds, as described above.

ITEM 8

METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

A. Methods of Analysis and Investment Strategies.

The descriptions set forth in this Brochure of specific advisory services that we offer to clients, and investment strategies pursued and investments made by us on behalf of its clients, should not be understood to limit in any way our investment activities. We may offer any advisory services, engage in any investment strategy and make any investment, including any not described in this Brochure, that we consider appropriate, subject to each client's investment objectives and guidelines. The investment strategies we pursue are speculative and entail substantial risks. Clients should be prepared to bear a substantial loss of capital. There can be no assurance that the investment objectives of any client will be achieved.

Our investment focus will be on sourcing, buying, trading and managing aviation related securities and understanding their structures. We believe that there are ample investment opportunities due to the cyclical nature of the aviation industry and the wide spreads that these instruments have typically enjoyed.

We will seek to identify and exploit market inefficiencies and trading opportunities. We believe we can achieve this by capitalizing upon our deep understanding of aviation asset values and extensive knowledge of business cycles within the aviation industry.

In general, our objective is to achieve superior risk-adjusted returns on an ongoing basis through the adoption of a multi-step approach to selecting and actively managing the securities for a client's portfolio. In pursuing this investment objective, we expect to utilize multiple investment vehicles and allocate risk capacity to investment strategies based on our view of existing and potential investment opportunities in the aviation-related securities industry. Prior to investing in specific securities, asset and credit analyses will first be undertaken. This will consist of research of the underlying asset values and structures, where applicable. We will employ a number of risk controls that are designed to limit a client's exposure to excessive risks. We will then seek to capitalize upon market inefficiencies and identify arbitrage opportunities through sourcing, trading and managing aviation-related securities for the a client's portfolio.

Investments may include all types of aviation, aerospace and general macro-economic benchmark securities, including fixed income instruments, particularly ETCs and EETCs, equity securities, currencies, loans or derivatives, including notes, bonds, bank obligations, trade claims, swaps, including credit default swaps, and other notional principal contracts, equity indices, ETFs, contracts based on indices, contracts that transfer risks, such as total return swaps, futures, options and forward contracts, which may be held for investment or hedging purposes. Investments in financial instruments may be made both on exchanges and over-the-counter, and through private placements.

Our investment strategies are described, at a summary level, in Item 4.

The main risks to be considered in the management of a client's portfolio will include: (i) market risk, including political and regulatory risk, market liquidity risk and credit market availability risk; (ii) individual positions risk, such as credit risk of issuers, liquidity risk, counterparty risk, correlation and sensitivity risk; (iii) portfolio risk, such as correlation and sensitivity risk, company and asset concentration risk, liquidity risk and current marks risk; (iv)

industry specific risk, such as macro and micro level risks; and (v) global economic risk, such as macro and micro level risks. The risks identified herein are examples of some, but not all, possible risks.

We will seek to control portfolio risks through the sizing and dynamic hedging of positions based on a regular evaluation of each investment's risk and by managing the amount of risk associated with each investment. We will gather real-time data regarding market movements, investment movements and any other market intelligence. Frequent mark-to-market portfolio monitoring will help us monitor the investments. Additionally, we will develop and use proprietary statistical models to help identify and hedge systemic portfolio risk, as well as individual position specific risk.

We will not attempt to hedge all market or other risks inherent in a client's positions. Specifically, we may choose not to hedge, or may deem it economically unattractive to hedge, certain risks, including risks related to changes in interest rates, exchange rates, equity prices, volatility, credit spreads and liquidity as well as buy-in-risk on short positions, either in respect of particular positions or in respect of a client's overall portfolio.

B. Material, Significant or Unusual Risks Relating to Investment Strategies.

The following risk factors do not purport to be a complete list or explanation of the risks involved in an investment in the clients advised by us. These risk factors include only those risks we believe to be material, significant or unusual and relate to particular significant investment strategies or methods of analysis employed by us.

Risk of Loss. No guarantee or representation is made that a client's investment program, including, without limitation, a client's investment objective, diversification strategies or risk monitoring goals, will be successful. Investment results may vary substantially over time. No assurance can be made that profits will be achieved or that substantial or complete losses will not be incurred. Past investment results are not necessarily indicative of their future performance.

General Economic and Market Conditions. Success will be affected by general economic and market conditions, such as interest rates, availability of credit, credit defaults, inflation rates, economic uncertainty, changes in laws (including laws relating to taxation of a client's investments), trade barriers, currency exchange controls, and national and international political circumstances (including wars, terrorist acts or security operations). These factors may affect the level and volatility of the prices and the liquidity of a client's investments. Volatility or illiquidity could impair a client's profitability or result in losses. A client may maintain substantial trading positions that can be adversely affected by the level of volatility in the financial markets.

Current Economic Conditions in European Countries. Certain European countries, including Greece, Ireland, Italy, Portugal and Spain, are currently experiencing varying degrees of financial distress. Risks from the debt crisis in Europe could result in a disruption of the financial markets, which could have a detrimental impact on global economic conditions. Recently, contagion fears have expanded to Spain and Italy, and credit spreads widened further in European peripheral countries and European banks. There remains considerable uncertainty as to future developments in the European debt crisis and the impact on global financial markets. A significant deterioration of the European debt crisis could result in material

reductions in the value of sovereign debt and other asset classes, disruptions in capital markets, widening of credit spreads, loss of investor confidence in the financial services industry, a slowdown in global economic activity, and other adverse developments that could negatively impact performance .

Capital Structure Arbitrage. The success of a capital structure arbitrage strategy depends upon the Investment Adviser's ability to identify and exploit the relationships between movements in different securities within an issuer's capital structure (including, bank debt, convertible and non-convertible senior and subordinated debt and preferred and common stock). Identification and exploitation of these opportunities involve uncertainty. There can be no assurance that the Investment Adviser will be able to locate investment opportunities or to correctly exploit price discrepancies. A reduction in the pricing inefficiency of the markets in which a client will seek to invest will reduce the scope for the client's investment strategies. In the event that the perceived mispricings underlying the client's positions fail to materialize, these investment strategies could be unsuccessful or result in losses.

Short Selling. The success of a short selling investment strategy depends upon the Investment Adviser's ability to identify and sell short securities that are overvalued. A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying Security could theoretically increase without limit, thus increasing the cost of buying those securities to cover the short position. There can be no assurance that a client will be able to maintain the ability to borrow securities sold short. In such cases, the client can be "bought in" (*i.e.*, forced to repurchase securities in the open market to return to the lender). There also can be no assurance that the securities necessary to cover a short position will be available for purchase at or near prices quoted in the market. Purchasing Securities to close out a short position can itself cause the price of the securities to rise further, thereby exacerbating the loss. Short strategies can also be implemented synthetically through various instruments and be used with respect to indices or in the over-the-counter market and with respect to futures and other instruments. In some cases of synthetic short sales, there is no floating supply of an underlying instrument with which to cover or close out a short position and a client may be entirely dependent on the willingness of over-the-counter market makers to quote prices at which the synthetic short position may be unwound. There can be no assurance that such market makers will be willing to make such quotes. Short strategies can also be implemented on a leveraged basis. Lastly, even though the client secures a "good borrow" of the security sold short at the time of execution, the lending institution may recall the lent security at any time, thereby forcing that client to purchase the security at the then-prevailing market price, which may be higher than the price at which such security was originally sold short.

Short-Term Market Considerations. The Investment Adviser's trading decisions may be made on the basis of short-term market considerations, and the portfolio turnover rate could result in significant trading-related expenses.

Leverage and Borrowing.

Leverage for Investment Purposes. The use of leverage will allow clients to make additional investments, thereby increasing their exposure to assets, such that their total assets may be greater than their capital. However, leverage will also magnify the volatility of changes in the value of a client's portfolio. The effect of the use of leverage by clients in a market that moves adversely to their investments could result in substantial losses to clients, which would be greater than if clients were not leveraged.

Borrowing for Cash Management Purposes. Clients have the authority to borrow for cash management purposes, such as to satisfy redemption requests. The rates at and terms on which clients can borrow will affect the operating results of clients.

Collateral. The instruments and borrowings utilized by clients to leverage investments may be collateralized by all or a portion of a client's portfolio. Accordingly, clients may pledge their securities in order to borrow or otherwise obtain leverage for investment or other purposes. Should the securities pledged to brokers to secure a client's margin accounts decline in value, clients could be subject to a "margin call", pursuant to which clients must either deposit additional funds or securities with the broker or suffer mandatory liquidation of the pledged securities to compensate for the decline in value. The banks and dealers that provide financing to clients can apply essentially discretionary margin, "haircut", and financing and collateral valuation policies. Changes by counterparties in any of the foregoing may result in large margin calls, loss of financing and forced liquidations of positions at disadvantageous prices. Lenders that provide other types of asset-based or secured financing to clients may have similar rights. There can be no assurance that clients will be able to secure or maintain adequate financing.

Costs. Borrowings will be subject to interest, transaction and other costs, and other types of leverage also involve transaction and other costs. Any such costs may or may not be recovered by the return on a client's portfolio.

Lending of Portfolio Securities. The Funds may lend securities on a collateralized and an uncollateralized basis from their portfolio to creditworthy securities firms and financial institutions. While a securities loan is outstanding, clients will continue to receive the equivalent of the interest or dividends paid by the issuer on the securities, as well as interest on the investment of the collateral or a fee from the borrower. The risks in lending securities, as with other extensions of secured credit, if any, consist of possible delay in receiving additional collateral, if any, or in recovery of the securities or possible loss of rights in the collateral, if any, should the borrower fail financially.

Diversification and Concentration. The Investment Adviser may select investments that are concentrated in a limited number or types of Securities. In addition, a client's portfolio may become significantly concentrated in securities related to a single or a limited number of issuers, industries, sectors, strategies, countries or geographic regions. This limited diversification may result in the concentration of risk, which, in turn, could expose clients to losses disproportionate to market movements in general if there are disproportionately greater adverse price movements in such securities.

Hedging Transactions. The Funds may utilize securities for risk management purposes in order to: (i) protect against possible changes in the market value of a client's investment portfolio resulting from fluctuations in the markets and changes in interest rates; (ii) protect a client's unrealized gains in the value of its investment portfolio; (iii) facilitate the sale of any securities; (iv) enhance or preserve returns, spreads or gains on any security in a client's portfolio; (v) hedge against a directional trade; (vi) hedge the interest rate, credit or currency exchange rate on any of a client's securities; (vii) protect against any increase in the price of any securities clients anticipate purchasing at a later date; or (viii) act for any other reason that the Investment Adviser deems appropriate. The Funds will not be required to hedge any particular risk in connection with a particular transaction or their portfolio generally. The Investment Adviser may be unable to anticipate the occurrence of a particular risk and,

therefore, may be unable to attempt to hedge against it. While clients may enter into hedging transactions to seek to reduce risk, such transactions may result in a poorer overall performance for clients than if they had not engaged in any such hedging transaction. Moreover, the portfolio will always be exposed to certain risks that cannot be hedged.

Discretion of the Investment Adviser; New Strategies and Techniques. While the Investment Adviser will generally seek to employ the representative investment strategies and techniques discussed herein, the Investment Adviser (subject to the policies and control of the board of directors, as applicable) has considerable discretion in the types of securities clients may trade and has the right to modify the investment strategies and techniques of clients without the consent of the client's investors. New investment strategies and techniques may not be thoroughly tested in the market before being employed and may have operational or theoretical shortcomings which could result in unsuccessful trades and, ultimately, losses to clients. In addition, any new investment strategy or technique may be more speculative than earlier investment strategies and techniques and may involve material and as-yet-unanticipated risks.

Fundamental Analysis. Certain trading decisions made by the Investment Adviser may be based on fundamental analysis. Data on which fundamental analysis relies may be inaccurate or may be generally available to other market participants. To the extent that any such data are inaccurate or that other market participants have developed, based on such data, trading strategies similar to a client's trading strategies, clients may not be able to realize their investment goals. In addition, fundamental market information is subject to interpretation. To the extent that the Investment Adviser misinterprets the meaning of certain data, clients may incur losses.

Small and Medium-Capitalization Companies. Investments in securities of smaller-capitalization companies involve higher risks in some respects than do investments in securities of larger "blue-chip" companies. For example, prices of securities of small-capitalization and even medium-capitalization companies are often more volatile than prices of securities of large-capitalization companies and may not be based on standard pricing models that are applicable to securities of large-capitalization companies. Furthermore, the risk of bankruptcy or insolvency of many smaller companies (with the attendant losses to investors) may be higher than for larger, "blue-chip" companies. Finally, due to thin trading in the securities of some small-capitalization companies, an investment in those companies may be illiquid.

Non-U.S. Investments. Investing in the securities of companies (and, from time to time, governments) outside of the United States involves certain considerations not usually associated with investing in securities of U.S. companies or the U.S. government, including political and economic considerations, such as greater risks of expropriation, nationalization, confiscatory taxation, imposition of withholding or other taxes on interest, dividends, capital gains, other income or gross sale or disposition proceeds, limitations on the removal of assets and general social, political and economic instability; the relatively small size of the securities markets in such countries and the low volume of trading, resulting in potential lack of liquidity and in price volatility; the evolving and unsophisticated laws and regulations applicable to the securities and financial services industries of certain countries; fluctuations in the rate of exchange between currencies and costs associated with currency conversion; and certain government policies that may restrict a client's investment opportunities. In addition, accounting and financial reporting standards that prevail outside of the U.S. generally are not as high as U.S. standards and, consequently, less information is typically available concerning

companies located outside of the U.S. than for those located in the U.S. As a result, clients may be unable to structure their transactions to achieve the intended results or to mitigate all risks associated with such markets. It may also be difficult to enforce a client's rights in such markets. For example, securities traded on non-U.S. exchanges and the non-U.S. persons that trade these instruments are not subject to the jurisdiction of the SEC or the CFTC or the securities and commodities laws and regulations of the U.S. Accordingly, the protections accorded to clients under such laws and regulations are unavailable for transactions on non-U.S. exchanges and with non-U.S. counterparties.

Non-U.S. Exchanges. The Funds may trade on exchanges or markets located outside the U.S. Trading on such exchanges or markets is not regulated by the SEC and the CFTC and may, therefore, be subject to more risks than trading on U.S. exchanges, such as the risks of exchange controls, expropriation, burdensome taxation, moratoria and political or diplomatic events. Risks in investments in on-U.S. securities may also include reduced and less reliable information about issuers and markets, less stringent accounting standards, illiquidity of securities and markets, higher brokerage commissions and custody fees.

C. Risks Associated With Particular Types of Securities.

We do not recommend a particular type of investment instrument to clients, but rather, we recommend and invest in multiple investment instruments. Given the broad discretion we have in managing client portfolios, any one or more of the risks listed in the previous section may be incurred by our clients.

However, because it may be useful in understanding our investment program, set forth below is a non-exclusive list of certain risks related to securities and other instruments that may be utilized within a client's portfolio:

Debt Securities Generally. Debt securities of all types of issuers may have speculative characteristics, regardless of whether they are rated. The issuers of such instruments (including sovereign issuers) may face significant ongoing uncertainties and exposure to adverse conditions that may undermine the issuer's ability to make timely payment of interest and principal in accordance with the terms of the obligations.

Interest Rate Risk. Changes in interest rates can affect the value of a client's investments in fixed-income instruments. Increases in interest rates may cause the value of a client's debt investments to decline. The Funds may experience increased interest rate risk to the extent it invests, if at all, in lower-rated instruments, debt instruments with longer maturities, debt instruments paying no interest (such as zero-coupon debt instruments) or debt instruments paying non-cash interest in the form of other debt instruments.

Prepayment Risk. The frequency at which prepayments (including voluntary prepayments by the obligors and accelerations due to defaults) occur on debt instruments will be affected by a variety of factors including the prevailing level of interest rates and spreads as well as economic, demographic, tax, social, legal and other factors. Generally, obligors tend to prepay their fixed rate obligations when prevailing interest rates fall below the coupon rates on their obligations. Similarly, floating rate issuers and borrowers tend to prepay their obligations when spreads narrow.

In general, "premium" securities (securities whose market values exceed their principal or par amounts) are adversely affected by faster than anticipated prepayments, and "discount" securities (securities whose principal or par amounts exceed their market values) are adversely affected by slower than anticipated prepayments. Since many fixed rate obligations will be discount instruments when interest rates and/or spreads are high, and will be premium instruments when interest rates and/or spreads are low, such debt instruments may be adversely affected by changes in prepayments in any interest rate environment.

The adverse effects of prepayments may impact a client's portfolio in two ways. First, particular investments may experience outright losses, as in the case of an interest-only instrument in an environment of faster actual or anticipated prepayments. Second, particular investments may underperform relative to hedges that the Investment Adviser may have constructed for these investments, resulting in a loss to a client's overall portfolio. In particular, prepayments (at par) may limit the potential upside of many instruments to their principal or par amounts, whereas their corresponding hedges often have the potential for unlimited loss.

Zero-Coupon and Deferred Interest Bonds. Zero-coupon bonds and deferred interest bonds are debt obligations issued at a significant discount from face value. The original discount approximates the total amount of interest the bonds will accrue and compound over the period until maturity or the first interest accrual date at a rate of interest reflecting the market rate of the security at the time of issuance. While zero-coupon bonds do not require the periodic payment of interest, deferred interest bonds generally provide for a period of delay before the regular payment of interest begins. Such investments experience greater volatility in market value due to changes in interest rates than debt obligations that provide for regular payments of interest.

High-Yield. Bonds or other fixed-income securities that are "higher yielding" (including non-investment grade) debt securities are generally not exchange traded and, as a result, these securities trade in the over-the-counter marketplace, which is less transparent and has wider bid/ask spreads than the exchange-traded marketplace. High-yield securities face ongoing uncertainties and exposure to adverse business, financial or economic conditions, which could lead to the issuer's inability to meet timely interest and principal payments. High-yield securities are generally more volatile and may or may not be subordinated to certain other outstanding securities and obligations of the issuer, which may be secured by substantially all of the issuer's assets. High-yield securities may also not be protected by financial covenants or limitations on additional indebtedness. The market values of certain of these lower-rated and unrated debt securities tend to reflect individual corporate developments to a greater extent than do higher-rated securities, which react primarily to fluctuations in the general level of interest rates, and tend to be more sensitive to economic conditions than are higher-rated securities. Companies that issue such securities may be highly leveraged and may not have available to them more traditional methods of financing. In addition, clients may invest in bonds of issuers that do not have publicly traded equity securities, making it more difficult to hedge the risks associated with such investments.

The Funds may invest in obligations of issuers that are generally trading at significantly higher yields than had been historically typical of the applicable issuer's obligations. Such investments may include debt obligations that have a heightened

probability of being in covenant or payment default in the future or that are currently in default and are generally considered speculative. The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid only after lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments. Typically such workout or bankruptcy proceedings result only in partial recovery of cash payments or an exchange of the defaulted security for other debt or equity securities of the issuer or its affiliates, which may in turn be illiquid or speculative.

Corporate Debt. Bonds, notes and debentures issued by corporations may pay fixed, variable or floating rates of interest, and may include zero-coupon obligations. Corporate debt instruments may be subject to credit ratings downgrades. Other instruments may have the lowest quality ratings or may be unrated. In addition, clients may be paid interest in kind in connection with their investments in corporate debt and related financial instruments (e.g., the principal owed to clients in connection with a debt investment may be increased by the amount of interest due on such debt investment). Such investments may experience greater market value volatility than debt obligations that provide for regular payments of interest in cash and, in the event of a default, clients may experience substantial losses.

Mezzanine Debt. Mezzanine debt is typically junior to the obligations of a company to senior creditors, trade creditors and employees. The ability of clients to influence a company's affairs, especially during periods of financial distress or following an insolvency, will be substantially less than that of senior creditors. Mezzanine debt instruments are often issued in connection with leveraged acquisitions or recapitalizations in which the issuers incur a substantially higher amount of indebtedness than the level at which they had previously operated. Default rates for mezzanine debt instruments have historically been higher than for investment-grade instruments. In the event of the insolvency of a portfolio company of clients or similar event, a client's debt investment therein will be subject to fraudulent conveyance, subordination and preference laws.

Stressed Debt. Stressed issuers are issuers that are not yet deemed distressed or bankrupt and whose debt securities are trading at a discount to par, but not yet at distressed levels. An example would be an issuer that is in technical default of its credit agreement, or undergoing strategic or operational changes, which results in market pricing uncertainty. The market prices of stressed and distressed instruments are highly volatile, and the spread between the bid and the ask prices of such instruments is often unusually wide.

Non-Performing Nature of Debt. Certain debt instruments may be non-performing or in default. Furthermore, the obligor or relevant guarantor may also be in bankruptcy or liquidation. There can be no assurance as to the amount and timing of payments, if any, with respect to such debt instruments.

Troubled Origination. When financial institutions or other entities that are insolvent or in serious financial difficulty originate debt, the standards by which such instruments were originated, the recourse to the selling institution, or the standards by which such instruments are being serviced or operated may be adversely affected.

Repurchase and Reverse Repurchase Agreements. In a reverse repurchase transaction, clients "buy" securities issued from a broker-dealer or financial institution, subject to the obligation of the broker-dealer or financial institution to repurchase such securities at the price paid by clients, plus interest at a negotiated rate. The use of repurchase and reverse repurchase agreements by clients involves certain risks. For example, if the seller of securities to a client under a reverse repurchase agreement defaults on its obligation to repurchase the underlying securities, as a result of its bankruptcy or otherwise, the client will seek to dispose of such securities, which action could involve costs or delays. If the seller becomes insolvent and subject to liquidation or reorganization under applicable bankruptcy or other laws, a client's ability to dispose of the underlying securities may be restricted. It is possible, in a bankruptcy or liquidation scenario, that the client may not be able to substantiate its interest in the underlying securities. Finally, if a seller defaults on its obligation to repurchase securities under a reverse repurchase agreement, the client may suffer a loss to the extent that it is forced to liquidate its position in the market, and proceeds from the sale of the underlying securities are less than the repurchase price agreed to by the defaulting seller. Similar elements of risk arise in the event of the bankruptcy or insolvency of the buyer.

Derivative Instruments Generally. Certain swaps, options and other derivative instruments may be subject to various types of risks, including market risk, liquidity risk, the risk of non-performance by the counterparty, including risks relating to the financial soundness and creditworthiness of the counterparty, legal risk and operations risk. Derivatives traded over-the-counter may not have an authoritative source of valuation and the models used to value such derivatives is subject to change. Special risks may apply in the future that cannot be determined at this time with respect to certain other derivative instruments that are not presently contemplated for use or that are currently not available. The regulatory and tax environment for derivative instruments in which clients may participate is evolving, and changes in the regulation or taxation of such securities may have a material adverse effect on clients.

Call Options. The seller (writer) of a call option which is covered (*i.e.*, the writer holds the underlying security) assumes the risk of a decline in the market price of the underlying security below the purchase price of the underlying security less the premium received, and gives up the opportunity for gain on the underlying security above the exercise price of the option. The seller of an uncovered call option assumes the risk of a theoretically unlimited increase in the market price of the underlying security above the exercise price of the option. The securities necessary to satisfy the exercise of an uncovered call option may be unavailable for purchase, except at much higher prices, thereby reducing or eliminating the value of the premium. Purchasing securities to cover the exercise of an uncovered call option can cause the price of the securities to increase, thereby exacerbating the loss. The buyer of a call option assumes the risk of losing its entire premium investment in the call option.

Put Options. The seller (writer) of a put option which is covered (*i.e.*, the writer has a short position in the underlying security) assumes the risk of an increase in the market price of the underlying security above the sales price (in establishing the short position) of the underlying security plus the premium received, and gives up the opportunity for gain on the underlying security if the market price falls below the exercise price of the option. The seller of an uncovered put option assumes the risk of a decline in the market price of the underlying security below the exercise price of the

option. The buyer of a put option assumes the risk of losing its entire investment in the put option.

Index or Index Options. The value of an index or index option fluctuates with changes in the market values of the securities included in the index. Because the value of an index or index option depends upon movements in the level of the index rather than the price of a particular security, whether clients will realize appreciation or depreciation from the purchase or writing of options on indices depends upon movements in the level of instrument prices in the security market generally or, in the case of certain indices, in an industry or market segment, rather than movements in the price of particular securities.

Index Futures. The price of index futures contracts may not correlate perfectly with the movement in the underlying index because of certain market distortions. First, all participants in the futures market are subject to margin deposit and maintenance requirements. Rather than meeting additional margin deposit requirements, shareholders may close futures contracts through offsetting transactions that would distort the normal relationship between the index and futures markets. Second, from the point of view of speculators, the deposit requirements in the futures market are less onerous than margin requirements in the securities market. Therefore, increased participation by speculators in the futures market also may cause price distortions. Successful use of index futures contracts by clients also is subject to the Investment Adviser's ability to correctly predict movements in the direction of the market.

Swaps. Whether a client's use of swap agreements or swaptions will be successful will depend on the Investment Adviser's ability to select appropriate transactions for clients. Swap agreements and options on swap agreements ("swaptions") can be individually negotiated and structured to include exposure to a variety of different types of investments, asset classes or market factors. Depending on their structure, swap agreements may increase or decrease the holder's exposure to, for example, equity securities, long-term or short-term interest rates, non-U.S. currency values, credit spreads or other factors. Swap agreements can take many different forms and are known by a variety of names. Swap transactions may be highly illiquid and may increase or decrease the volatility of a client's portfolio. Moreover, clients bear 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 Funds will also bear the risk of loss related to swap agreements, for example, for breaches of such agreements or the failure of clients to post or maintain required collateral. It is possible that developments in the swap markets, including potential government regulation, could adversely affect a client's ability to terminate swap transactions or to realize amounts to be received under such transactions.

Credit Default Swaps. Credit default swaps can be used to implement the Investment Adviser's view that a particular credit, or group of credits, will experience credit improvement or deterioration. In the case of expected credit improvement, clients may sell credit default protection in which they receive a premium to take on the risk. In such an instance, the obligation of clients to make payments upon the occurrence of a credit event creates leveraged exposure to the credit risk of the referenced entity. The Funds may also buy credit default protection with respect to a referenced entity if, in the Investment Adviser's judgment, there is a high likelihood of

credit deterioration. In such instance, clients will pay a premium regardless of whether there is a credit event. The credit default swap market in high-yield securities is comparatively new and rapidly evolving compared to the credit default swap market for more seasoned and liquid investment-grade securities, creating the risk that the newer markets will be less liquid, and making it potentially more difficult to exit or enter into a particular transaction.

Futures Contracts. The value of futures contracts depends upon the price of the securities, such as commodities, underlying them. The prices of futures contracts are highly volatile, and price movements of futures contracts can be influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, as well as national and international political and economic events and policies. In addition, investments in futures contracts are also subject to the risk of the failure of any of the exchanges on which a client's positions trade or of its clearing houses or counterparties. Futures positions may be 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". Under such 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 unless traders are willing to effect trades at or within the limit. This could prevent clients from promptly liquidating unfavorable positions and subject clients to substantial losses or prevent them from entering into desired trades. Also, low margin or premiums normally required in such trading may provide a large amount of leverage, and a relatively small change in the price of a security or contract can produce a disproportionately larger profit or loss. In extraordinary circumstances, a futures exchange or the CFTC could suspend trading in a particular futures contract, or order liquidation or settlement of all open positions in such contract.

Forward Contracts. Banking authorities generally do not regulate trading in forward contracts. The principals who deal in the forward contract market are not required to continue to make markets in such contracts. There have been periods during which certain participants in forward markets have refused to quote prices for forward contracts or have quoted prices with an unusually wide spread between the price at which they were prepared to buy and that at which they were prepared to sell. The imposition of credit controls or price risk limitations by governmental authorities may limit such forward trading to less than that which the Investment Adviser would otherwise recommend, to the possible detriment of clients. In its forward trading, clients will be subject to the risk of the failure of, or the inability or refusal to perform with respect to its forward contracts by, the principals with which clients trade. Fund assets on deposit with such principals will also generally not be protected by the same segregation requirements imposed on certain regulated brokers in respect of customer funds on deposit with them. The Investment Adviser may order trades for clients in such markets through agents. Accordingly, the insolvency or bankruptcy of such parties could also subject clients to the risk of loss.

Failure to Enter into Offsetting Trade. To the extent clients invest in a futures contract or option long, unless an offsetting trade is made, clients would be required to take physical delivery of the commodity underlying the future or option. To the extent

the Investment Adviser fails to enter into such offsetting trade prior to the expiration of the contract, clients may suffer a loss since neither clients nor the Investment Adviser have the operational capacity to accept physical delivery of commodities.

ABS Generally. The investment characteristics of asset-backed securities ("ABS") differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, usually monthly, and that the principal may be prepaid at any time because the underlying loans or other assets generally may be prepaid at any time.

ABS are not secured by an interest in the related collateral. Credit card receivables, for example, are generally unsecured and the debtors are entitled to the protection of a number of state and federal consumer loan laws, many of which give such debtors the right to set off certain amounts owed on the credit cards, thereby reducing the balance due. Most issuers of ABS backed by automobile receivables permit the servicers to retain possession of the underlying obligations. If the servicer were to sell these obligations to another party, there is a risk that the purchaser would acquire an interest superior to that of the holders of the related ABS. In addition, because of the large number of vehicles involved in a typical issuance and technical requirements under state laws, the trustee for the holders of the ABS may not have a proper security interest in all of the obligations backing such ABS. Therefore, there is a possibility that recoveries on repossessed collateral may not, in some cases, be available to support payments on these securities. The risk of investing in ABS is ultimately dependent upon payment of consumer loans by the debtor.

The collateral supporting ABS is of shorter maturity than certain other types of loans and is less likely to experience substantial prepayments. ABS are often backed by pools of any variety of assets, including, for example, leases, mobile home loans and aircraft leases, which represent the obligations of a number of different parties and use credit enhancement techniques such as letters of credit, guarantees or preference rights. The value of an ABS is affected by changes in the market's perception of the asset backing the security and the creditworthiness of the servicing agent for the loan pool, the originator of the loans or the financial institution providing any credit enhancement, as well as by the expiration or removal of any credit enhancement.

ETCs and EETCs. An ETC generally represents an interest in the assets of one or more pass-through trusts which hold equipment notes, typically issued by an airline or other company that owns aircraft, secured by a pool of aircraft (and may also include related assets such as engines or spare parts) which may be owned by the airline outright, owned by the airline subject to a mortgage or other financing, or even scheduled for delivery to the airline. An EETC is an ETC which is senior to all other debt obligations of the ETC obligor or issuer. The Fund may invest in EETCs or ETCs, or may make direct investments in equipment notes.

Because payments on ETCs and EETCs depend on payments on underlying equipment notes, the performance of ETCs and EETCs, like the performance of equipment notes, depend on the financial and operating condition of the obligor on the underlying equipment notes. Accordingly the risks of investing in ETCs and EETCs, as well as direct investments in equipment notes, include risks associated with investments in the airline industry, such as high competition, difficulty in controlling labor costs and pension obligations, seasonal and changing demand for air travel, fuel costs and operating expenses (including security),

regulatory and legal oversight as well as challenges related to doing business globally, insurance costs, the risk of accidents and the risk of hostile acts.

Moreover, the value of the aircraft securing underlying equipment notes is typically based on appraisals that are based on assumptions and methodologies which differ among appraisers, and may in some cases be prepared without physical inspection of the related aircraft. This may result in valuations that are materially different among different appraisal firms. Because appraisals are only estimates of value, they should not be relied upon as a measure of realizable value. The proceeds realized upon a sale of an aircraft may be less than its appraised value.

In addition, if a default occurs under an indenture for the underlying equipment notes, the holder of the notes or the trustee for the ETC or EETC may not be the party which controls remedies, in which case it will not have rights to participate in directing the exercise of remedies. Holders of equipment notes may not realize the full amount of the outstanding principal balance. For any holder of an ETC or a EETC, the equipment notes might, in the exercise of remedies, be sold for less than their outstanding principal amount, in which case holders of ETCs or EETCs may suffer a material loss, and such investors will not have recourse against the obligors on the equipment notes for any shortfall.

Finally, while under normal market conditions there is a secondary market for resale of many issues of equipment notes, ETC or EETC, the liquidity of the secondary market may vary from time to time. At certain times, particularly under stressed market conditions, the secondary market may not be sufficiently liquid to allow for the sale, or the sale at reasonable prices, of equipment notes, ETC or EETC owned by clients.

Currencies. A principal risk in trading currencies is the rapid fluctuation in the market prices of currency contracts. Prices of currency contracts traded by clients are affected generally by relative interest rates, which in turn are influenced by a wide variety of complex and difficult to predict factors such as money supply and demand, balance of payments, inflation levels, fiscal policy, and political and economic events. In addition, governments from time to time intervene, directly and by regulation, in these markets, with the specific effect, or intention, of influencing prices which may, together with other factors, cause all of such markets to move rapidly in the same direction because of, among other things, interest rate fluctuations.

Structured Notes. Structured notes, variable rate mortgage-backed and asset-backed securities each have rates of interest that vary based on a designated floating rate formula or index. The value of these investments is closely tied to the absolute levels of such rates or indices, or the market's perception of anticipated changes in those rates or indices. The movements in specific indices or interest rates may be difficult or impossible to hedge.

When-Issued and Forward Commitment Securities. The purchase of securities on a "when-issued" basis involves a commitment by a client to purchase or sell securities at a future date (typically one or two months later). No income accrues on securities that have been purchased on a when-issued basis prior to delivery to the client. When-issued securities may be sold prior to the settlement date. If a client disposes of the right to acquire a when-issued security prior to its acquisition, it may incur a gain or loss. In addition, there is a risk that securities purchased on a when-issued basis may not be delivered to the client. In such cases, the client may incur a loss.

Distressed Obligations. The obligations of issuers in weak financial condition, experiencing poor operating results, having substantial capital needs or negative net worth, facing special competitive or product obsolescence problems (including companies involved in bankruptcy or other reorganization and liquidation proceedings) are likely to be particularly risky investments although they also may offer the potential for correspondingly high returns. Among the risks inherent in investments in troubled entities is the risk that it frequently may be difficult to obtain information as to the true condition of such issuers. Such investments may also be adversely affected by laws relating to, among other things, fraudulent transfers and other voidable transfers or payments, lender liability and the bankruptcy court's power to disallow, reduce, subordinate, recharacterize debt as equity or disenfranchise particular claims. Such companies' obligations may be considered speculative, and the ability of such companies to pay their debts on schedule could be affected by adverse interest rate movements, changes in the general economic climate, economic factors affecting a particular industry or specific developments within such companies. In addition, there is no minimum credit standard that is a prerequisite to a client's investments in any security. Obligations in which clients invest may be less than investment grade. The level of analytical sophistication, both financial and legal, necessary for successful investment in companies experiencing significant business and financial difficulties is unusually high. There is no assurance that the value of the assets collateralizing a client's investments will be sufficient or that prospects for a successful reorganization or similar action will become available. In any reorganization or liquidation proceeding relating to a company in which clients invest, clients may lose their entire investment, may be required to accept cash or securities with a value less than their original investment and/or may be required to accept payment over an extended period of time. Under such circumstances, the returns generated from a client's investments may not compensate the investors adequately for the risks assumed. In addition, under certain circumstances, payments and distributions may be disgorged if any such payment is later determined to have been a fraudulent conveyance or a preferential payment.

In liquidation (both in and out of bankruptcy) and other forms of corporate reorganization, there exists the risk that the reorganization either will be unsuccessful (due to, for example, failure to obtain requisite approvals), will be delayed (for example, until various liabilities, actual or contingent, have been satisfied) or will result in a distribution of cash or a new security the value of which will be less than the purchase price to the client of the security in respect to which such distribution was made.

Equity Securities Generally. The value of equity securities of public and private, listed and unlisted companies and equity derivatives generally varies with the performance of the issuer and movements in the equity markets. As a result, clients may suffer losses if they invest in equity instruments of issuers whose performance diverges from the Investment Adviser's expectations or if equity markets generally move in a single direction and clients have not hedged against such a general move. The Funds also may be exposed to risks that issuers will not fulfill contractual obligations such as, in the case of convertible securities or private placements, delivering marketable common stock upon conversions of convertible securities and registering restricted securities for public resale.

Preferred Stock. Investments in preferred stock involve risks related to priority in the event of bankruptcy, insolvency or liquidation of the issuing company and how dividends are declared. Preferred stock ranks junior to debt securities in an issuer's capital structure and, accordingly, is subordinate to all debt in bankruptcy. Preferred stock generally has a preference as to dividends. Such dividends are generally paid 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.

Convertible Securities. A convertible security may be subject to redemption at the option of the issuer at a price established in the convertible security's governing instrument. If a convertible security held by clients is called for redemption, clients will be required to permit the issuer to redeem the security, convert it into the underlying common stock or sell it to a third party. Any of these actions could have an adverse effect on a client's ability to achieve its investment objective.

Illiquid Securities. Valuation of illiquid securities may be difficult or uncertain because there may be limited information available about the issuers of such securities. The market prices, if any, for such securities tend to be volatile and may not be readily ascertainable, and clients may not be able to sell them when they desire to do so or to realize what it perceives to be their fair value in the event of a sale. The sale of restricted and illiquid securities often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in the over-the-counter markets. The Funds may not be able to readily dispose of such illiquid investments and, in some cases, may be contractually prohibited from disposing of such investments for a specified period of time. As a result, clients may be required to hold such securities despite adverse price movements. Even those markets which the Investment Adviser expects to be liquid can experience periods, possibly extended periods, of illiquidity. Occasions have arisen in the past where previously liquid investments have rapidly become illiquid.

Restricted Securities. Restricted securities cannot be sold to the public without registration under the Securities Act. Unless registered for sale, restricted securities can be sold only in privately negotiated transactions or pursuant to an exemption from registration (e.g., under Rule 144A of the Securities Act). Although these securities may be resold in privately negotiated transactions, because there is often little liquidity for these securities, they may be difficult and take a substantial amount of time to sell, and the prices realized from these sales could be less than those originally paid by clients. Restricted securities may involve a high degree of business and financial risk which may result in substantial losses.

Undervalued Securities. The identification of investment opportunities in undervalued securities is a difficult task, and there are no assurances that such opportunities will be successfully recognized or acquired. While investments in undervalued securities offer the opportunity for above-average capital appreciation, these investments involve a high degree of financial risk and can result in substantial losses. Returns generated from a client's investments may not adequately compensate for the business and financial risks assumed.

Unlisted Securities. Unlisted securities may involve higher risks than listed securities. Because of the absence of any trading market for unlisted securities, it may take longer to liquidate, or it may not be possible to liquidate, positions in unlisted securities than would be the case for publicly traded securities. Companies whose securities are not publicly traded may

not be subject to public disclosure and other investor protection requirements applicable to publicly traded securities.

American Depositary Receipts and Global Depositary Receipts. American Depositary Receipts ("ADRs") are receipts issued by a U.S. bank or trust company evidencing ownership of underlying securities issued by non-U.S. issuers. ADRs may be listed on a national securities exchange or may be traded in the over-the-counter market. Global Depositary Receipts ("GDRs") are receipts issued by either a U.S. or non-U.S. banking institution representing ownership in a non-U.S. company's publicly traded securities that are traded on non-U.S. stock exchanges or non-U.S. over-the-counter markets. Holders of unsponsored ADRs or GDRs generally bear all the costs of such facilities. The depository of an unsponsored facility frequently is under no obligation to distribute investor communications received from the issuer of the deposited security or to pass through voting rights to the holders of depositary receipts in respect of the deposited securities. Investments in ADRs and GDRs pose, to the extent not hedged, currency exchange risks (including blockage, devaluation and non-exchangeability), as well as a range of other potential risks relating to the underlying shares, which could include expropriation, confiscatory taxation, imposition of withholding or other taxes on dividends, interest, capital gains, other income or gross sale of disposition proceeds, political or social instability or diplomatic developments that could affect investments in those countries, illiquidity, price volatility and market manipulation. In addition, less information may be available regarding the underlying shares of ADRs and GDRs, and non-U.S. companies may not be subject to accounting, auditing and financial reporting standards and requirements comparable to, or as uniform as, those of U.S. companies. Such risks may have a material adverse effect on the performance of such investments and could result in substantial losses.

Initial Public Offerings. Investments in initial public offerings (or shortly thereafter) may involve higher risks than investments issued in secondary public offerings or purchases on a secondary market due to a variety of factors, including, without limitation, the limited number of shares available for trading, unseasoned trading, lack of investor knowledge of the issuer and limited operating history of the issuer. In addition, some companies in initial public offerings are involved in relatively new industries or lines of business, which may not be widely understood by investors. Some of these companies may be undercapitalized or regarded as developmental stage companies, without revenues or operating income, or the near-term prospects of achieving them. These factors may contribute to substantial price volatility for such securities and, thus, for the value of a client's portfolio.

ITEM 9
DISCIPLINARY INFORMATION

None.

ITEM 10
OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS

A. Broker-Dealer Registration Status.

The Investment Adviser and its management persons are not registered as broker-dealers and do not have any application pending to register with the SEC as a broker-dealer or registered representative of a broker-dealer.

B. Futures Commission Merchant, Commodity Pool Operator or Commodity Trading Adviser Registration Status.

The Investment Adviser and its management persons are not registered as, and do not have any application to register as, futures commission merchants, commodity pool operators, commodity trading advisors or associated persons of the foregoing entities.

C. Material Relationships or Arrangements with Industry Participants.

Not applicable.

D. Material Conflicts of Interest Relating to Other Investment Advisers.

We do not recommend or select other investment advisers for our clients.

ITEM 11
CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS
AND PERSONAL TRADING

A. Code of Ethics.

We strive to adhere to the highest industry standards of conduct based on principles of professionalism, integrity, honesty and trust. In seeking to meet these standards, we have adopted a Code of Ethics (the "Code"). The Code incorporates the following general principles that all employees are expected to uphold:

- employees must at all times place the interests of clients first;
- all personal securities transactions must be conducted in a manner consistent with the Code and any actual or potential conflicts of interest or any abuse of an employee's position of trust and responsibility must be avoided;
- employees must not take any inappropriate advantage of their positions;
- information concerning the identity of securities and financial circumstances of clients, including a client's investors, must be kept confidential; and
- independence in the investment decision-making process must be maintained at all times.

Clients may request a copy of the Code by contacting us at the address or telephone number listed on the first page of this document.

B. Securities in which the Investment Adviser or a Related Person Has a Material Financial Interest.

1. *Cross Trades*

The Investment Adviser may determine that it would be in the best interests of certain clients to transfer a security from one client to another (each such transfer, a "Cross Trade") for a variety of reasons, including, without limitation, tax purposes, liquidity purposes, to rebalance the portfolios of the clients, or to reduce transaction costs that may arise in an open market transaction. However, currently, the Investment Adviser trades through a single master-feeder structure, and thus the likelihood of such Cross Trades is low. If the Investment Adviser decides to engage in a Cross Trade, the Investment Adviser will determine that the trade is in the best interests of each client involved in it and take steps to ensure that the transaction is consistent with the duty to obtain best execution for each of those clients. Further, no cross trades may be effected without the express written approval of the Investment Adviser's chief compliance officer.

The Investment Adviser may execute Cross Trades with the assistance of a broker-dealer who executes and books the transaction at the close of the market on the day of the transaction. Alternatively, a Cross Trade between two clients may occur as an "internal cross", where the Investment Adviser instructs the custodian for the clients to book the transaction at the price determined in accordance with the Investment Adviser's valuation policy. If the

Investment Adviser effects an internal cross, the Investment Adviser will not receive any fee in connection with the completion of the transaction.

2. Principal Transactions

To the extent that Cross Trades may be viewed as principal transactions due to the ownership interest in a client by the Investment Adviser or its personnel, the Investment Adviser will comply with the requirements of Section 206(3) of the Advisers Act, including that any such transactions will be considered on behalf of investors in such a client and approved or disapproved by (i) an advisory board comprised of representatives of such investors or (ii) a committee consisting of one or more persons selected by the Investment Adviser (or its affiliate), and any valuation approved by such a committee will be determined by an independent third party that has appropriate experience in providing such valuations. Further, no principal transactions may be effected without the express written approval of the Investment Adviser's chief compliance officer.

C. Investing in Securities that the Investment Adviser or a Related Person Recommends to Clients.

The Code places restrictions on personal trades by employees, including that they disclose their personal securities holdings and transactions to the Investment Adviser on a periodic basis, and requires that employees pre-clear certain types of personal securities transactions. Generally, and subject to certain exceptions, the Investment Adviser's employees may not engage in personal securities trading and may only dispose of securities held in their respective personal trading accounts. Any such disposition of securities must be pre-cleared. However, related persons may purchase and sell mutual funds and broad-based exchange-traded funds ("ETFs"). Some clients may invest in the same or similar mutual funds and ETFs.

The Investment Adviser, its affiliates and its employees may give advice or take action for their own accounts that may differ from, conflict with or be adverse to advice given or action taken for clients. These activities may adversely affect the prices and availability of other securities or instruments held by or potentially considered for one or more clients. Potential conflicts also may arise due to the fact that the Investment Adviser and its personnel may have investments in some Funds but not in others or may have different levels of investments in the various Funds.

The Investment Adviser has established policies and procedures to monitor and resolve conflicts with respect to investment opportunities in a manner it deems fair and equitable, including the restrictions placed on personal trading in the Code, as described above, and regular monitoring of employee transactions and trading patterns for actual or perceived conflicts of interest, including those conflicts that may arise as a result of personal trades in the same or similar securities made at or about the same time as client trades.

D. Conflicts of Interest Created by Contemporaneous Trading.

The Investment Adviser currently manages a single master-feeder fund structure, and therefore manages investments for a single trading vehicle (the Master Fund). To the extent that the Investment Adviser may, in the future, trade for multiple clients simultaneously, it is the policy of the Investment Adviser to allocate investment opportunities among all clients in a fair and equitable manner, to the extent practical and in accordance with each client's applicable investment strategies, over a period of time.

The default rules that determine what "fair and equitable" allocations are as follows:

- For all purchases of securities, trades are allocated on a pro rata basis, on the basis of levered capital (or, if applicable, on "buying power"); and
- For all sales of securities, trades are allocated on a pro rata basis, but on the basis of the position size in the various accounts.

The Investment Adviser will have no obligation to purchase or sell a security for, enter into a transaction on behalf of, or provide an investment opportunity to any client solely because the Investment Adviser purchases or sells the same security for, enters into a transaction on behalf of, or provides an opportunity to any client if, in its reasonable opinion, such security, transaction or investment opportunity does not appear to be suitable, practical or desirable for the client.

ITEM 12 BROKERAGE PRACTICES

A. Factors Considered in Selecting or Recommending Broker-Dealers for Client Transactions.

As noted previously, we have full discretionary authority to manage the Funds, including authority to make decisions with respect to which securities are bought and sold, the amount and price of those securities, the brokers or dealers to be used for a particular transaction, and commissions or markups and markdowns paid. The Investment Adviser's authority is limited by its own internal policies and procedures and each Fund's investment guidelines.

Portfolio transactions for each client will be allocated to brokers and dealers on the basis of numerous factors and not necessarily lowest pricing. Brokers and dealers may provide other services that are beneficial to us and/or certain clients, but not beneficial to all clients. Subject to best execution, in selecting brokers and dealers (including prime brokers) to execute transactions, provide financing and securities on loan, hold cash and short balances and provide other services, we may consider, among other things, the following:

- Financial stability;
- Whether the broker's trades are cleared through a larger parent company or financially stronger third party;
- Speed, likelihood and timeliness of execution;
- Ability to complete the transaction adequately through to clearance, confirmation and delivery;
- The value of the research provided and useful ideas
- Access to secondary markets;
- Responsive personnel;
- Trading experience;
- Familiarity and expertise with the trading security; and
- Track record in achieving best results on similar transactions.

Additionally, any new broker will be subject to the Investment Adviser's financial review process and subject to an appropriate background search in order to ensure that there are no regulatory concerns or pending disciplinary proceedings.

Accordingly, the commission rates (or dealer markups and markdowns) charged to the Funds by brokers or dealers in the foregoing circumstances may be higher than those charged by other brokers or dealers who may not offer such services. The Investment Adviser need not solicit competitive bids and does not have an obligation to seek the lowest available commission cost or spread. Generally, neither the Investment Adviser nor the Funds separately compensate any broker or dealer for any of these other services.

We maintain policies and procedures to review the quality of executions, including periodic reviews by its investment professionals.

1. *Research and Other Soft Dollar Benefits.*

The Investment Adviser currently does not expect to receive or use soft dollars.

Although not currently anticipated, the Investment Adviser may pay a broker-dealer commissions (or markups or markdowns with respect to certain types of riskless principal transactions) for effecting Fund transactions in excess of that which another broker-dealer might have charged for effecting the transaction in recognition of the value of the brokerage and research services provided by the broker-dealer. The Investment Adviser will effect such transactions, and receive such brokerage and research services, only to the extent that they fall within the safe harbor provided by Section 28(e) of the Securities Exchange Act of 1934, as amended, and subject to prevailing guidance provided by the SEC regarding Section 28(e). The Investment Adviser believes it is important to its investment decision-making processes to have access to independent research.

Also, consistent with Section 28(e), research products or services obtained with "soft dollars" generated by one or more Funds may be used by the Investment Adviser to service one or more other clients, including clients that may not have paid for the soft dollar benefits. The Investment Adviser does not seek to allocate soft dollar benefits to client accounts in proportion to the soft dollar credits the client accounts generate. Where a product or service obtained with soft dollars provides both research and non-research assistance to the Investment Adviser (*i.e.*, a "mixed use" item), the Investment Adviser will make a good faith allocation of the cost which may be paid for with soft dollars. In making good faith allocations of costs between administrative benefits and research and brokerage services, a conflict of interest may exist by reason of the Investment Adviser's allocation of the costs of such benefits and services between those that primarily benefit the Investment Adviser and those that primarily benefit the Funds.

When the Investment Adviser uses client brokerage commissions (or markups or markdowns) to obtain research or other products or services, the Investment Adviser receives a benefit because it does not have to produce or pay for such products or services. The Investment Adviser may have an incentive to select or recommend a broker-dealer based on the Investment Adviser's interest in receiving research or other products or services, rather than on its clients' interest in receiving most favorable execution.

At least annually, the Investment Adviser considers the amount and nature of research and 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 its Funds on the basis of that consideration. Broker-dealers sometimes suggest a level of business they would like to receive in return for the various products and services they provide. Actual brokerage business received by any broker-dealer may be less than the suggested allocation, but can (and often does) exceed the suggested level, because total brokerage is allocated on the basis of all of the considerations described above. In no case will the Investment Adviser make binding commitments as to the level of brokerage commissions it will allocate to a broker-dealer, nor will it commit to pay cash if any informal targets are not met. A broker-dealer is not excluded from receiving business because it has not been identified as providing research products or services.

2. Brokerage for Client Referrals.

Neither the Investment Adviser nor any related person receives client referrals from any broker-dealer or third party.

3. *Directed Brokerage.*

The Investment Adviser does not recommend, request or require that a client direct the Investment Adviser to execute transactions through a specified broker-dealer.

B. Order Aggregation.

The Investment Adviser currently manages a single master-feeder fund structure, and therefore manages investments for a single trading vehicle (the Master Fund). To the extent that the Investment Adviser may, in the future, trade for multiple clients simultaneously, if the Investment Adviser determines that the purchase or sale of a security is appropriate with regard to multiple clients, the Investment Adviser may, but is not obligated to, purchase or sell such a security on behalf of such clients with an aggregated order, for the purpose of reducing transaction costs, to the extent permitted by applicable law. When an aggregated order is filled through multiple trades at different prices on the same day, each participating client will receive the average price, with transaction costs generally allocated *pro rata* based on the size of each client's participation in the order (or allocation in the event of a partial fill) as determined by the Investment Adviser. In the event of a partial fill, allocations may be modified on a basis that the Investment Adviser deems to be appropriate, including, for example, in order to avoid odd lots or *de minimis* allocations. When orders are not aggregated, trades generally will be processed in the order that they are placed with the broker or counterparty selected by the Investment Adviser. As a result, certain trades in the same security for one client (including a client in which the Investment Adviser and its personnel may have a direct or indirect interest) may receive more or less favorable prices or terms than another client, and orders placed later may not be filled entirely or at all, based upon the prevailing market prices at the time of the order or trade. In addition, some opportunities for reduced transaction costs and economies of scale may not be achieved.

C. Trade Errors.

The Investment Adviser maintains an internal trade error policy that will apply in the absence of any specific regulatory or contractual provisions (e.g., for an account that constitutes "plan assets" under ERISA). Among other things, this policy requires that the Investment Adviser's personnel correct errors as soon after discovery as reasonably practical, report errors to the chief compliance officer, and reverse losses suffered as a result of the Investment Adviser's gross negligence or willful misconduct.

ITEM 13

REVIEW OF ACCOUNTS

A. Frequency and Nature of Review of Client Accounts or Financial Plans.

We perform various daily, weekly, monthly, quarterly and periodic reviews of each client's portfolio. Such reviews are conducted by the members of the Investment Adviser's Management Committee, our portfolio manager, or our research associates.

B. Factors Prompting Review of Client Accounts Other than a Periodic Review.

A review of a client account may be triggered by any unusual activity or special circumstances.

C. Content and Frequency of Account Reports to Clients.

We generally provide annual audited financial statements to our clients within 90 days of the applicable client's fiscal year end.

Investors in the Funds receive a letter from the Investment Adviser, no less frequently than quarterly, documenting the performance of their Fund, along with a commentary by the Investment Adviser, although the Investment Adviser may provide certain investors with information on a more frequent and detailed basis if agreed to by the Investment Adviser. Information also may be available through the Investment Adviser's password-protected website. In addition, the Investment Adviser issues investors tax reports and audited financial statements concerning their respective Funds within 90 days of the end of the Fund's fiscal year. While all investors generally receive similar information, to the extent an investor receives additional information (that other investors have not received), which is in addition to information provided in a Fund's regular reports to investors, such information may provide such investor with greater insight into the Fund's activities. This may enhance such investor's ability to make investment decisions with respect to the Fund and possibly affect such investor's decision to request a redemption from the Fund.

ITEM 14
CLIENT REFERRALS AND OTHER COMPENSATION

A. Economic Benefits for Providing Services to Clients.

We do not receive economic benefits from non-clients for providing investment advice and other advisory services.

B. Compensation to Non-Supervised Persons for Client Referrals.

Neither we nor any of our related persons directly or indirectly compensates any person who is not a supervised person, including placement agents, for client referrals.

ITEM 15 CUSTODY

The Investment Adviser is deemed to have custody of client funds and securities because it has the authority to obtain client funds or securities, for example, by deducting advisory fees from a client's account or otherwise withdrawing funds from a client's account. Account statements related to the clients are sent by qualified custodians to the Investment Adviser.

The Investment Adviser is subject to Rule 206(4)-2 under the Advisers Act (the "Custody Rule"). However, it is not required to comply (or is deemed to have complied) with certain requirements of the Custody Rule with respect to each Fund because it complies with the provisions of the so-called "Pooled Vehicle Annual Audit Exception", which, among other things, requires that each Fund be subject to audit at least annually by an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board, and requires that each Fund distribute its audited financial statements to all investors within 120 days of the end of its fiscal year.

ITEM 16
INVESTMENT DISCRETION

The Investment Adviser serves as the management company with discretionary trading authority to each Fund.

Our investment decisions and advice with respect to each Fund are subject to each Fund's investment objectives and guidelines, as set forth in its offering documents.

The Investment Adviser or an affiliate of the Investment Adviser entered into an investment management agreement, or similar agreement, with each Fund pursuant to which the Investment Adviser or that affiliate was granted discretionary trading authority.

ITEM 17

VOTING CLIENT SECURITIES

A. Policies and Procedures Relating to Voting Client Securities.

In compliance with Advisers Act Rule 206(4)-6, the Investment Adviser has adopted proxy voting policies and procedures. The general policy is to vote proxy proposals, amendments, consents or resolutions (collectively, "Proxies") in a prudent and diligent manner that will serve the applicable client's best interests and is in line with each client's investment objectives.

We may take into account all relevant factors, as determined by us in our discretion, including, without limitation:

- 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 limited circumstances, the Investment Adviser may refrain from voting Proxies where we believe that voting would be inappropriate, taking into consideration the cost of voting the Proxies and the anticipated benefit to its clients. Generally, clients may not direct our vote in a particular solicitation.

Conflicts of interest may arise between the interests of the clients on the one hand and us or our affiliates on the other hand. If we determine that we may have, or be perceived to have, a conflict of interest when voting Proxies, we will vote in accordance with our Proxy voting policies and procedures. Clients may obtain a copy of our Proxy voting policies and our Proxy voting record upon request.

ITEM 18
FINANCIAL INFORMATION

The Investment Adviser is not required to include a balance sheet for its most recent fiscal year, is not aware of any financial condition reasonably likely to impair its ability to meet contractual commitments to clients, and has not been the subject of a bankruptcy petition at any time during the past ten years.