



## Item 1 – Cover Page

### **CAPSTONE INVESTMENT ADVISORS, LLC**

### **PART 2A OF FORM ADV: FIRM BROCHURE**

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This brochure ("Brochure") provides information about the qualifications and business practices of Capstone Investment Advisors, LLC ("CIA"). If you have any questions about the contents of this brochure, please contact CIA at (212) 232-1470. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission ("SEC") or by any state securities authority. Registration with the SEC does not imply a certain level of skill or training. Additional information about CIA is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).



## ***Item 2 – Material Changes***

Below is a summary of material changes made to the brochure since the last annual filing, dated March 2014. CIA is discussing only material changes since the last brochure.

1. CIA began managing CPP-2014-1 Fund Limited, KS-Capstone Fund Limited and Capstone Income Opportunities, Ltd., each a Cayman exempted corporation. Descriptions of each fund and certain issues relating to their management are contained in this brochure.

CIA recommends that you read this Brochure in its entirety. If CIA makes any material changes to this Brochure this Item will be revised to include a summary of such changes.



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## Item 4 – Advisory Business

CIA is a Delaware limited liability company founded by Paul Britton on March 8, 2007. CIA's principal owner is Mr. Britton.

CIA is a multi-strategy investment manager that focuses on relative value trading with a volatility bias. CIA has a quantitative approach to trading and our business is model driven with a qualitative overlay. CIA seeks to capitalize on perceived inefficiencies in the pricing of volatility in target derivative markets. Through offices in New York and London, CIA trades globally across equities, fixed income, FX and commodities. CIA aims to generate alpha through a combination of 'risk-on' and 'risk-off' strategies. CIA's multi-strategy volatility strategy is currently offered through pooled investment vehicles. The strategy, or specific components thereof, may in the future be offered through managed accounts or single investor vehicles.

As of December 31, 2014, CIA had approximately \$3,269,134,726 of net assets under management on a discretionary basis.

CIA serves as the management company with discretionary trading authority to private pooled investment vehicles that are offered to investors on a private placement basis (each, a "Fund" and collectively, the "Private Funds"). The Funds include:

- Capstone Vol (US), LP, a Delaware limited partnership (the "Domestic Fund"), Capstone Vol (Offshore) Limited, an exempted company incorporated under the laws of the Cayman Islands (the "Offshore Fund"), and Capstone Volatility Master (Cayman) Limited, an exempted company incorporated under the laws of the Cayman Islands (the "Master Fund"). The Domestic Fund, Offshore Fund, Intermediate Fund (defined below) and Master Fund are collectively referred to herein as the "Volatility Fund".
- CPP-2012-1 Fund Limited, an exempted company incorporated under the laws of the Cayman Islands (the "CPP 2012").
- CPP-2014-1 Fund Limited, an exempted company incorporated under the laws of the Cayman Islands (the "CPP 2014" and together with CPP 2012, the "Tail Protection Funds").
- Capstone Income Opportunities, Ltd. an exempted company incorporated under the laws of the Cayman Islands and Capstone Income Opportunities Feeder Fund Limited, an exempted company incorporated under the laws of the Cayman Islands (together, "CIO").
- KS-Capstone Fund Limited, an exempted company incorporated under the laws of the Cayman Islands ("KS-Capstone" and together with the Tail Protection Funds and CIO, the "Solutions Funds").

CIA also provides subadvisory services on behalf of a registered investment advisor to BMO Alternatives Strategy Fund, a corporation registered under the Investment Company Act of 1940, as amended.

As used herein, the term "client" generally refers to each Fund.

CIA is registered with the SEC as an investment adviser. CIA has full discretion in all investment decisions made on behalf of the Funds. Investment advice is provided directly to the Funds



according to each Fund's particular investment objectives and not individually to each Fund's investors.

Capstone Fund Services, LLC ("CFS"), a Delaware limited liability company affiliated with CIA, serves as the general partner of the Domestic Fund (in such capacity, the "General Partner") and is the manager of Capstone Volatility Intermediate (Cayman) Limited, an exempted company incorporated under the laws of the Cayman Islands (the "Intermediate Fund"), which invests substantially all of its assets in the Master Fund.

Capstone Investment Advisors (UK), LLP (the "CIA UK") is a London-based subsidiary of CIA that has been appointed by the Master Fund as an investment adviser. CIA UK is authorized and regulated by the UK Financial Conduct Authority. CIA and CIA UK are filing a single Form ADV in reliance on the position expressed in American Bar Association, Business Law Edition, SEC No-Action Letter (January 18, 2012).

*This Brochure generally includes information about CIA and its relationships with its clients and affiliates. While much of this Brochure applies to all such clients and affiliates, certain information included herein applies to specific clients or affiliates only.*

*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, as amended, and other exemptions of similar import under U.S. state laws and the laws of other jurisdictions where any offering may be made. Persons reviewing this Brochure should not construe this as an offer to sell or 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.*



## Item 5- Fees and Compensation

Compensation received by CIA and/or an affiliate for their investment advisory services to the Funds is comprised of management fees based on a percentage of assets under management and performance-based fees or allocations. The fees are deducted directly from the applicable Fund's account. Note that some Fund investors may pay more or less than other Fund investors for the same management services, depending, for example, on when a Fund investor subscribes or the total size of its investment with CIA. In this regard, CIA may waive or modify fees for Fund investors that are members, employees or affiliates of CIA, relatives of such persons and certain large or strategic investors.

### **VOLATILITY FUND**

For its investment management services to the Volatility Fund, CIA is entitled to receive a management fee ("Management Fee") at an annual rate (up to 2.0%) of the month-end net asset value ("NAV") of each investor's capital account balance or series of shares, as applicable. The Management Fee is generally paid in arrears as of the end of each calendar month. CIA has agreed to reduce the management fee paid by certain strategic investors through side letter arrangements.

CFS is generally entitled to receive an allocation of profits ("Performance Compensation") on a quarterly basis (and upon withdrawals from a Fund) of up to 20% of the net realized and unrealized appreciation in NAV of the Volatility Fund, subject to the individual investor's high water mark.

CIA generally waives its right to Management Fees and Performance Compensation with respect to investments by principals, employees and affiliates of CIA.

### **SOLUTIONS FUNDS**

Generally CIA receives a monthly management fee from each Solutions Fund as set forth in the respective offering document of each Solutions Fund. Generally, the management fee for a Solutions Fund is either a flat annual fee or is calculated as a percentage of one or more of the following: (i) assets under management; (ii) notional asset value; or (iii) risk adjusted exposure. CIA also receives a performance fee from one of the Solutions Funds calculated on the amount of profits generated in respect of the account or in relation to a benchmark, to be paid on an annual basis or upon a withdrawal from the account.

### **OTHER TYPES OF FEES OR EXPENSES**

In addition to the Management Fee and Performance Compensation, the Funds also bear certain costs and expenses incurred directly or indirectly by each Fund in connection with the investments, operations and administration of CIA and its affiliates attributable to asset management services and accounting and operational services. These expenses include such Fund's *pro rata* share of expenses incurred by CIA and its affiliates for goods and services that benefit the Fund or are related to the Fund's investments, operation and administration, in each of the foregoing cases as determined by CIA in its discretion.

Investors in the Funds indirectly bear the fees and expenses charged to the Funds. These fees vary, but typically include, without limitation, (i) clearing and executing broker fees, (ii) data feed and market data costs (and related software and hardware expenses), (iii) trading,



research and risk management costs (and related software and hardware expenses, which includes third-party software consultants and certain employee expenses of CIA for the same as more fully described below), (iv) exchange membership expenses, (v) interest expenses, (vi) stock loan expenses, (vii) regulatory and self-regulatory fees, (viii) other transactional charges, (ix) expenses relating to cash management, (x) expenses relating to the continuing offering of interests or shares, as applicable, including the cost of producing and distributing offering memoranda and other marketing materials, expenses paid to third-party vendors and travel expenses, (xi) legal, compliance services provided by third party consultants, independent director, audit, accounting, tax and custodial fees and expenses, including fee and expenses related to the Investment Manager's compliance with its reporting requirements with respect to the Funds, including, but not limited to, Form PF and similar filings, (xii) fees and expenses of the administrator and the costs of printing and distributing periodic and annual reports and statements, and (xiii) fees and expenses of software consultants engaged by CIA for the benefit of the Funds, and as of January 1, 2014, the pro rata costs of the salary, bonuses and benefits (including healthcare and severance expenses) payable by CIA or CIA UK to employees relating to the software and hardware development and maintenance described above.

With respect to technology related costs, it is important to note that technology is a deeply embedded quantitative component each Fund's trading process. The strategies implemented by Capstone entail quantitative investment processes with qualitative overlays. Specifically, the technology development team creates internal modeling tools, automated trading execution platforms, automated hedging platforms, and other similar tools related to maximizing the trading efficiency of the Funds. One quantifiable outcome of the advanced execution platforms is that the Funds generate rebates from trading, which typically add positively to Fund performance annually. At any given time, the technology development team is engaged in about 6-12 key projects related to the Funds. CIA reimbursement of employee expenses will not exceed its actual cost.

To the extent that an expense is incurred by CIA or its affiliates for goods or services that benefit or relate to more than one Fund or account, CIA will allocate such expenses to the Funds and such other accounts generally based on the front-office personnel (such as portfolio managers and analysts) utilizing such services. When allocating to a person that supports more than one Fund, such person's "charge" is generally split evenly among such Funds. Previously CIA allocated such expenses on a pro rata basis based on the relative net asset values of the various accounts or by capital usage (in the case of tail hedge products). However, allocating in this manner would not accurately reflect actual services used as certain solutions accounts require significantly larger investments than the amounts actually traded to cover initial margin requirements. The determination of whether an expense should be allocated and/or borne by the Funds (and if so, in what proportion relative to other accounts, as applicable) shall be final and binding on all investors. CIA's determinations as to how certain expenses should be allocated among itself and the Funds, as well as among the different Funds, may be subject to conflicts of interest. CIA has agreed to cap the expenses or not to allocate certain expense types charged to certain Funds or investors. For allocation purposes, CIA will pay for these waived expenses rather than charging additional amounts to the other Funds.

The Volatility Fund requires investors to commit to a lock-up of their investment for a specified time period. Such investors may withdraw their investment prior to the expiration of such lock-up period upon payment of a withdrawal fee assessed against such early withdrawal. Generally, the Board of Directors of the relevant fund (or, the General Partner, as the case may be) may waive or reduce such withdrawal fee in its discretion, including to the extent it determines that the other investors will not be disadvantaged by trading expenses incurred by the Volatility Fund



in connection with the withdrawal or that such Fund will not otherwise be materially disadvantaged by such reduction or waiver.

Fund assets are from time to time invested in income-producing cash equivalents or other short-term instruments, including U.S. government and agency securities, money market funds, short-term bond mutual funds, repurchase and reverse repurchase agreements, certificates of deposits, banker's acceptances and commercial paper. In some cases, a Fund may pay a third-party advisor that manages a money market fund or other short-term investment vehicle or account an advisory fee on assets invested for cash management purposes in addition to the fees paid to CIA, provided that no such additional fee shall be paid to CIA or its affiliates.

Fund investors should review all fees charged by CIA, broker-dealers and other third parties to fully understand the total amount of fees to be paid by the Funds. Please also see "Item 12—Brokerage Practices" below.

### **VARIANCE OF FUND TERMS**

CIA and/or a Fund may from time to time enter into "side letter" arrangements with certain Fund investors that may provide for terms of investment that are more favorable than the terms provided to other investor in such Funds, including, without limitation, with respect to fees, redemption rights, voting rights and information rights. Certain institutional Volatility Fund investors seek to use their ownership positions to promote good corporate governance and other responsible investment policies. Even though CIA does not have a formal ESG policy, given the non-fundamental nature of CIA's trading program, CIA ventures to address these sensitivities by agreeing to restrict certain securities at investor request. CIA balances these requests with the responsibility it has to all investors of the Volatility Fund and restricts securities after making a determination that such action will not have a material impact on the Volatility Fund's overall trading program.





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

CIA provides investment management advice to a variety of clients, including pooled investment vehicles, funds of one and a mutual fund. The fees charged to clients may include (i) both an asset based management fee and a performance fee, (ii) only an asset based (or investment exposure based) management fee or (iii) a fixed fee arrangement. Some investment professionals at CIA may manage accounts that charge performance fees “side by side” with accounts that do not have such characteristics. These investment professionals may have an incentive to favor accounts in the first category over accounts in the second category.

CIA is conscious of these potential conflicts and is committed to allocating investment opportunities on a fair and equitable basis and has established policies and procedures to address the conflicts of interest described above, as further described in Item 12.



## ***Item 7 – Types of Clients***

As described in “Item 4—Advisory Business” above, CIA generally provides investment advice to private investment vehicles, including the Funds. Investment advice is provided directly to the Funds and not individually to the Fund investors. At any time, investors in the Funds generally include institutions (e.g. pension plans, endowments, trusts, estates, charitable organizations, foundations, etc.), “fund-of-funds” and high net worth individuals/family offices. Any minimum initial and additional subscription requirements are disclosed in the offering documents for the relevant Fund. Investors will be required to make certain representations when investing in a Fund through the execution of a subscription agreement and other documents. Interests in the Funds are not registered under the Securities Act of 1933 (as amended), and such Funds are not registered under the Investment Company Act of 1940 (as amended). Accordingly, interests in the Funds are offered and sold exclusively to investors satisfying the applicable eligibility and suitability requirements either in private transactions within the United States or in offshore transactions.



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

### **METHODS OF ANALYSIS AND INVESTMENT STRATEGIES**

CIA has broad flexibility in selecting the assets traded and the investment strategies implemented by the relevant Fund(s) (within the general investment objective of the relevant Fund(s) as described in the relevant Fund offering document), and subject to any applicable investment guidelines that may be applicable to any investment vehicle). The investment strategies, approaches and techniques pursued by the Funds may evolve over time due to, among other things, the prevailing economic environment, market developments and trends, new regulatory constraints, the emergence of new or enhanced investment products, changing industry practice and technological innovation.

### **THE VOLATILITY FUND**

CIA serves as investment manager to the Volatility Fund (organized in a “master-feeder” structure) that focuses on volatility arbitrage. The Volatility Fund’s primary objective is to achieve long term capital appreciation that is uncorrelated or negatively correlated with global equity markets. The Volatility Fund seeks to achieve its investment objective primarily through a combination of Risk-On and Risk-Off strategies, as well as other investment strategies that CIA believes are complementary to its overall portfolio construction. The Volatility Fund seeks its trading opportunities primarily in U.S. markets and secondarily in European and Asian markets. Currently the Volatility Fund’s volatility arbitrage strategy focuses on the equity, fixed income, commodities, credit and foreign exchange markets. The Volatility Fund may also pursue volatility arbitrage opportunities outside of such asset classes and geographical markets. CIA also undertakes non-volatility based strategies, including statistical arbitrage, spread trading, corporate bonds and event-driven strategies. The use of these strategies is intended to create diversification across different market environments. The strategies are expected to have varying degrees of correlation (or negative correlation) to each other, which is intended to enable the Volatility Fund to produce more consistent returns regardless of market conditions. The Volatility Fund employs leverage in the execution of its investment strategies, both through its borrowings with its prime brokers and through the effective leverage embedded in its investments in derivative instruments, such as options, futures and swaps.

CIA bases its assessment of implied volatility on a variety of proprietary trading tools. Generally, the Volatility Fund’s volatility trading strategies seek to profit from differences between CIA’s assumption of the theoretical price of an option (mainly dependent on CIA’s implied volatility assumption), the price of the option in the marketplace and CIA’s assessment of how events in the near future are likely to affect the relationship between those two factors. CIA believes that to benefit fully from these inefficiencies it is important to practice a diverse mix of strategies that can capitalize on such inefficiencies opportunistically and such that each may act as a natural hedge to others in the portfolio. The Volatility Fund’s use of various “Risk-On” and “Risk-Off” strategies (as described below) is intended to create diversification across different market environments. The strategies are expected to have varying degrees of correlation (or negative correlation) to each other, which is intended to enable the Volatility Fund to produce more consistent returns regardless of market conditions. Generally, each investment undertaken by CIA on behalf of the Volatility Fund, irrespective of the strategy pursuant to which it is made, is intended to be additive and complementary, and not solely to add diversification to the portfolio.



CIA employs a mix of what it calls “Risk-On” strategies and “Risk-Off” strategies, with the intent and expectation of being able to emphasize its Risk-On strategies during stable market conditions and Risk-Off strategies during more uncertain markets. By utilizing a mix of these strategies, and maintaining a flexible and liquid portfolio, CIA seeks to take advantage of varying market environments, reducing concentration risk and providing a more non-correlated, market-neutral return.

By “Risk-On,” CIA means strategies that are employed during more benign, settled market environments, characterized by normal volumes and liquidity, lower than average volatility and correlation, more ample deal flow and an upward-sloping term structure of volatility. CIA’s Risk-On strategies generally include *Fixed Income and Inflation, Dispersion, Special Situations, Corporate Credit and Systematic Strategies*. Typical Risk-On themes include long Gamma and long Vega trades, long carry trades, long event volatility trades and market bullish trades.

“Risk-Off” means the opposite: markets characterized generally by more tentative, fearful or panicky investor sentiment, higher than average volatility and correlation, scarcer liquidity, higher cash positions, lack of deal flow and a flat or downward sloping term structure of volatility. CIA’s Risk-Off strategies generally include *Equity and Commodity Volatility Relative Value, World Index Relative Value and Sovereign Fixed Income and Currency Relative Value*. Typical Risk-Off trading themes include short Vega, short carry trades and market bearish positions.

CIA does not generally seek to anticipate whether a market environment on any day or during any period is a Risk-On or Risk-Off market environment. Rather, CIA intends to diversify its strategies and investments at all times so that it remains poised to take advantage of opportunities regardless of market environment, and to use risk management to execute stop-losses on out of favor strategies. As the markets change, the Fund’s balance of Risk-On and Risk-Off will fluctuate.

## **SOLUTIONS FUNDS**

CIA serves as investment manager to the Solutions Funds, a series of single investor funds that, as a primary objective, provides “tail-risk protection” or “tail-risk hedging” with respect generally to global-equity, fixed-income and commodities markets or that provide passive strategies such as equity replacement.

The Tail Protection Funds have two main objectives: the first objective is, upon the occurrence of a Convexity Event, to achieve a convex, non-linear payoff (a return profile that exhibits increasingly accelerating returns relative to the market correction). “Tail-risk” can be thought of as the risk of a rare and extreme move skewed to the downside that would have significant adverse impact on a traditional investment portfolio. The second objective is to limit the total annual fixed payments by the Tail Protection Funds on their investments to a pre-determined percentage of the NAV per share (the “Annual Premium Percentage”, or “APP”), determined at the beginning of each year so as to be the total budget for the each Tail Protection Fund each year in implementing its strategies. Because the pricing of derivatives to which each Tail Protection Fund is a party is expected to vary over time, there can be no assurances that a Tail Protection Fund will not be required to pay significantly more than the APP in any year.

CIA intends to effectuate the objectives of the Tail Protection Funds’ by holding a portfolio of derivative instruments that are intended to produce a convex payoff profile. The Tail Protection Funds employ various trading techniques, including trading options and futures and short selling. First, CIA will formulate and develop general trade types designed to produce payoffs that best serve the objective of a Tail Protection Fund – its tactics and tactical methods, as described



below. Second, CIA's proprietary models will regularly review the universe of tactics to determine the optimal portfolio to be held by such Tail Protection Fund at any given time. This process will seek to identify instruments with a relatively low cost of carry relative to the convexity of their return profile across U.S., European and Asian equity derivatives markets. Finally, once the models have reduced the possible investment universe to the tactics that provide what it determines deliver the best risk-reward at any given time, CIA makes the qualitative determination as to the allocation among such tactics. As indicated above, the Tail Protection Funds employ different tactics. "Tactics" are tactical methods applied to specific derivative products, underlyings and expiries. Representative examples of tactics may include "one-month straddle on S&P 500 delta neutral", "one-month straddle on Nikkei delta neutral", "three-month S&P 500 Variance delta neutral" and "six-month S&P 500 Variance delta neutral".

Examples of the types of tactical methods that the Tail Protection Funds may employ are described briefly below. Many of the tactics will be based on these more general tactical methods.

- SKEW TRADING. "Skew" refers to the tendency of implied volatilities of options on a given underlying asset and a given expiration date to increase as the strike price declines. CIA's skew trading strategy aims to identify combinations of options on a single underlying and a single expiry date that are mispriced based on incorrect skew assumptions. This tactical method is intended to make the greatest return in the event of rapid decline in the price in the underlying. Tactics using this methodology may include (without limitation) different indices, different term structures and combinations of skew trades with other methods.
- UPSIDE CALL RATIO ON THE "VIX" INDEX. VIX is the ticker symbol for the Chicago Board Options Exchange ("CBOE") Market Volatility Index. The VIX is highly negatively correlated with the S&P 500. Generally, options on the VIX provide investors the opportunity to benefit from this negative correlation in the event of market distress, benefiting as well from the leverage inherent in the option. A call ratio is combination options comprised of multiple short positions for each long position in options on the same underlying on the same expiration date such that the proceeds of the short position finance the cost of the short positions, while (in theory) the long positions provide convexity. CIA believes that purchasing call ratios on the VIX can offer a high degree of convexity for a low cost of carry.
- LONG VARIANCE SWAP AND SHORT AT-THE-MONEY STRADDLE, DELTA NEUTRAL. A "variance swap" is an instrument that provides an investor exposure to the variance (volatility-squared) of an underlying asset such as an index or stock. Generally, purchasing a variance swap is equivalent to being long variance. A straddle is a combination of a long put and long call option on the same underlying at the same expiry. The purpose is to be long movement of the underlying, up or down – i.e., long volatility. "Delta neutral" means that the combination is hedged so that there is no exposure to the movement of the underlying, only to the changing values of the "Greeks" of the option positions. CIA finds that this tactical method is capable of producing many of the characteristics targeted by the Convexity Fund. It can be expected to have a convex payoff and benefits from volatility of volatility, which itself increases when the market is more volatile. The cost associated with this strategy can best be represented by the volatility spread between the two products. The variance swap will usually trade at a premium to the straddle, but at times the spread compresses enough to provide a very compelling risk reward for a long tail strategy.



While generally following the same investment strategy, the Tail Protection Funds provide their investors the ability to tailor the management of its accounts through investment and risk guidelines and other specialized terms.

## **MATERIAL RISKS OF THE CIA'S STRATEGIES**

The strategies employed by CIA involve risk of loss that clients and Fund investors should be prepared to bear. The following is a summary of some of the material risks associated with the strategies expected to account for a significant portion of the Funds' investments. This summary does not attempt to describe all of the risks associated with an investment in a Fund. Although no summary can fully describe all of the risks associated with such an investment, the Confidential Information Memorandum or other offering document for each Fund contains a more complete description of the risks associated with an investment in that Fund.

### *MATERIAL RISKS RELATING TO THE INVESTMENT STRATEGIES OF THE VOLATILITY FUND AND TAIL PROTECTION FUNDS*

RISK OF INADEQUATE QUANTITATIVE MODELS. CIA's trading will be highly model driven and materially subject to possible flaws in the models. As market dynamics shift over time, a previously highly successful model often becomes outdated or inaccurate, perhaps without CIA recognizing that fact before substantial losses are incurred. In particular, a Fund may incur major losses in the event of disrupted markets and other extraordinary events that cause the relevant pricing models to generate prices that deviate from the market. There can be no assurance that CIA will be successful in continuing to develop and maintain effective quantitative models.

LEVERAGE RISK. The Volatility Fund employs leverage in the execution of its investment strategies, both through its borrowings with its prime brokers and through the effective leverage embedded in its investments in derivative instruments, such as options, futures and swaps. Transactions in options, futures and swaps are inherently and at times substantially leveraged. This is because a relatively small dollar amount enables the Volatility Fund to achieve a considerably larger exposure to the instrument underlying the options and futures. While a Fund may generally hold a substantial amount of cash, thereby reducing the effective leverage of such Fund, it is not required to hold any specific amount of cash, and the effective leverage may be substantial. The use of leverage increases any losses incurred on investments in direct proportion to the degree of leverage employed.

The Volatility Fund trades based upon its assumptions regarding the availability of leverage under current margin rules and arrangements. If controlling authorities increase margin requirements or the Volatility Fund is no longer entitled to exemptions from the general margin rules, the Volatility Fund may not be able to pursue its objectives and may be required to liquidate positions at inopportune times or at unfavorable prices.

RISK RELATED TO INVESTING IN DERIVATIVES. The prices of derivative instruments, including financial and commodity futures and options, are highly volatile. Because of the low margin deposits normally required in derivatives trading, an extremely high degree of leverage is typical of a derivatives trading account. Payments made pursuant to swap agreements may also be highly volatile. Like other leveraged investments, a futures transaction may result in losses in excess of the amount invested. In addition, the pertinent Fund's assets are also subject to the risk of the failure of any of the exchanges on which its positions trade or of its clearinghouses or counterparties.



Over-the-counter ("OTC") swap, forward and option contracts are not traded on exchanges and are not standardized. These markets can experience periods of illiquidity, sometimes of significant duration. Market illiquidity or disruption could result in major losses to a Fund. Such OTC derivative transactions also, subject a Fund to counterparty risk.

A Fund may make investments in credit default swaps, total rate of return swaps or other credit derivatives. Credit derivatives are a relatively recent development in the financial markets and entail certain legal, tax and market uncertainties. There is currently little or no case law or litigation characterizing these instruments, interpreting their provisions or characterizing their tax treatment. In addition, additional regulations and laws may apply to these instruments that have not yet been applied.

RISKS RELATED TO OPTIONS TRADING. Trading volatility is one of the most complex of all financial strategies and requires significant quantitative and mathematical resources and capabilities. The pricing of options involves a wide variety of factors—including the variability of interest rates, the time to expiration, the price of the underlying, the volatility of the underlying and general market sentiment. There can be no assurance that CIA will correctly value the Volatility Fund's or the CPP Fund's options positions or that the market will, in fact, revert to theoretical values; consequently, substantial losses could be incurred by a Fund.

- *Risks Related to the Pricing of Volatility of Options.* Options are often quoted in terms of implied volatility. If CIA incorrectly assesses market volatility, CIA will misprice the options which it trades, which may result in significant losses.
- *Risks Related to the Time Value of Options.* Longer-dated options tend to be far less liquid than near-term options. Certain trades which CIA may execute for the Volatility Fund and/or the CPP Fund will value longer-dated options, which carry material incremental liquidity risk.
- *"Pin Risk".* Concentrated equity option positions become more risky at expiration if the underlying is trading at or near the strike price. This results in a difficult portfolio management environment. Similarly, if an option closes right at strike, a Fund could lose the entire premium on the option and possibly additional money on its hedge.
- *Interest Rate Risk.* Prevailing interest rates are a principal component of options pricing. Consequently, unexpected changes in interest rates can result in the Volatility Fund and/or the CPP Fund incurring significant losses.

RISK OF MARKET STAGNATION. To the extent that the strategies implemented by the Volatility Fund depend on changes in volatility, in periods of trendless, stagnant markets and/or deflation, these strategies have materially diminished prospects for profitability.

RISKS OF SHORT SELLING. The Volatility Fund and the CPP Fund generally plan to engage in short-selling as part of their investment program. However, short selling, and especially short-selling on margin, is a risky strategy, and an unhedged short sale theoretically involves unlimited risk.

PORTFOLIO TURNOVER RATE MAY RESULT IN ADDITIONAL COSTS. The turnover rate of the Volatility Fund's and the CPP Fund's investment portfolios are expected to be significant, involving substantial brokerage commissions, fees and other transaction costs. The Volatility Fund and the CPP Fund will bear such costs.

TRANSACTION VOLUME AND MARKET LIQUIDITY MAY IMPAIR PERFORMANCE. A decline in cash flows into the capital markets or a slowdown in investment activity in the capital markets, as well





as other factors, may cause a decline in transaction volumes in the option markets. The Volatility Fund's and the CPP Fund's investment activities may be affected materially by transaction volumes in the option markets. Higher market volume typically provides greater opportunities to engage in revenue-generating transactions and narrower bid/offer spreads. Therefore, a decline in transaction volumes may result in a Fund incurring significant losses.

GLOBAL MARKET RISKS AND EMERGING MARKET RISKS. The Volatility Fund and the CPP Fund will invest primarily in U.S. markets, and also in European and Asian markets, but may invest on a more global basis in both developed and, from time to time, emerging markets. In doing so, a Fund is subject to currency exchange-rate risk; the possible imposition of withholding, income or excise taxes; the absence of uniform accounting, auditing and financial reporting standards, practices and disclosure requirements and little or potentially biased government supervision and regulation; and economic and political risks, including expropriation, currency exchange control and potential restrictions on foreign investment and repatriation of capital. Emerging markets present unusual risks, including government instability; political risk; lack of or less than transparent priority; the imposition of currency controls; expropriation risk; and the application of various laws and regulations. Volatility-related strategies in emerging markets are subject to unusual risks due to the uncertainty of such countries' legal regimes and procedures as well as the risk of other market participants having better access to relevant market information.

#### *MATERIAL RISKS RELATING TO THE INVESTMENT STRATEGIES OF THE VOLATILITY FUND*

RISKS RELATED TO INVESTING IN HIGH-YIELD DEBT SECURITIES AND LOWER RATED LOANS. High-yield debt securities will have greater credit and liquidity risk than investment grade obligations. Risks of high-yield debt securities may include: (i) limited liquidity and secondary market support, (ii) substantial marketplace volatility, (iii) subordination to the prior claims of banks and other senior lenders, (iv) the operation of mandatory sinking fund or call/redemption provisions during periods of declining interest rates, (v) the possibility that earnings of the high-yield debt security issuer may be insufficient to meet its debt service and (vi) the declining creditworthiness and potential for insolvency of the issuer of such high-yield debt securities during periods of rising interest rates and/or economic downturn.

STATISTICAL ARBITRAGE TECHNIQUES MAY BE SUBJECT TO CORRELATION RISKS. While CIA will utilize proprietary models to build its statistical arbitrage portfolios, it is possible that other statistical arbitrage funds' own proprietary models will generate very similar portfolios, so that buying and selling by the Volatility Fund will coincide with buying and selling activities by such other funds. This circumstance could produce exaggerated movements in the prices of the stocks in the portfolio that were not anticipated by the models, resulting in losses to the Volatility Fund.

DISPERSION STRATEGY RISK OF MISMATCHED PERFORMANCE OF RELATED POSITIONS. Pursuant to a "dispersion" strategy, the Volatility Fund may buy and sell ETFs, futures and/or index and ETF options to hedge its other holdings or positions. Certain of the Volatility Fund's positions may underperform the other positions to which they relate, which could result in losses.

CERTAIN OF THE FUND'S ASSETS WILL BE ILLIQUID. The Volatility Fund may invest and trade in illiquid and restricted, as well as thinly-traded, instruments. The Volatility Fund may only be able to liquidate these positions, if at all, at disadvantageous prices and hence may be required to hold such instruments despite adverse price movements.





#### *MATERIAL RISKS RELATING TO THE INVESTMENT STRATEGIES OF THE CPP FUND*

PREMIUM SPENT. The primary objective of the CPP Fund is to provide "tail-risk protection" or "tail-risk hedging" during a Convexity Event. It is not the CPP Fund's objective to have positive performance during a period of a calm, protracted market decline. Generally, investors should expect the CPP Fund to decline in value during most market environments, just as one would expect to pay insurance premiums to protect against other risks over time. Accordingly, in order to maintain the same level of exposure, investors will have to increase their investment periodically. In addition, an investment in the CPP Fund should be considered a long-term investment.



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

On October 19, 2006, Capstone Trading, LLC ("CT") (a now-closed proprietary trading businesses owned by Capstone Holdings Group L.L.C., a now closed affiliate of CIA), Scott Brindley (a trader with CIA) and a former employee settled a charge by the Chicago Board Options Exchange, Incorporated ("CBOE") alleging that CT, Brindley and the former employee failed to maintain a sufficient in-person trading percentage for a floor market maker and initiated and entered orders from off of the CBOE trading floor on behalf of a market-maker account with CBOE floor broker members, while not registered with CBOE as a market-maker. CT, Scott Brindley and the former employee neither admitted nor denied the alleged violations but agreed to be censured and to pay a fine.

To the best of CIA's knowledge, there are not legal or disciplinary events that are material to an advisory client or prospective advisory client's evaluation of CIA's advisory business or the integrity of CIA's management.

As part of the CIA's routine compliance monitoring, all employees are asked to certify upon hire, and thereafter on an annual basis, whether they have been the subject of any disciplinary actions.



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

As noted above, Capstone Fund Services, LLC (previously defined as “CFS”), an affiliate of CIA, serves as the general partner of the Domestic Fund and as the manager of the Intermediate Fund and as such is entitled to receive performance allocations from the Domestic Fund and Intermediate Fund.

Capstone Investment Advisors (UK), LLP (previously defined as “CIA UK”) is a London-based subsidiary of CIA that is authorized and regulated by the UK Financial Conduct Authority (the “FCA”). CIA UK provides discretionary investment advisory services to the Volatility Fund. CIA UK is compensated by CIA for these services, and Fund investors are not subject to additional fees as a result of these services. CIA and CIA UK are filing a single Form ADV in reliance on the position expressed in American Bar Association, Business Law Section. SEC No-Action Letter (January 18, 2012).

CIA 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.

CIA is registered as a commodity pool operator with the CFTC. CIA is also registered as a member of the NFA. While registered as such, CIA operates the Volatility Fund and the CPP Fund pursuant to an exemption from certain regulation as a commodity pool operator under CFTC Rule 4.7.

Private equity funds managed by NB Dyal Advisors LLC (“Dyal”) hold a passive, non-voting, minority equity interest in each of CIA and CFS. Dyal is ultimately controlled by Neuberger Berman. Dyal has no control over the investment process or day to day operations of the CIA, CFS, or the Funds, but has certain consent rights relating to actions by CIA and CFS in respect of themselves.

Except as described in the brochure, neither CIA nor any of its management persons has a relationship or an arrangement that is material to its advisory business or to its advisory clients with any related person that is a pooled investment vehicle, investment adviser, commodity pool operator or commodity trading adviser. In addition, CIA does not recommend or select other investments advisers for its clients.



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

### **CODE OF ETHICS AND PERSONAL TRADING**

In seeking to meet its fiduciary obligations, CIA has 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; employees must comply with all applicable laws and regulations, including, without limitation, federal securities laws; 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 the Funds, including the Funds’ investors, must be kept confidential; and independence in the investment decision-making process must be maintained at all times.

The Code places restrictions on personal trading by CIA employees, including that they disclose their personal securities holdings and transactions to CIA on a periodic basis. Employees are not permitted to buy and sell publicly traded securities other than treasury securities, municipal bonds, open-ended mutual funds and broad-based Exchange Traded Funds. Employees may make investments in other private investment funds subject to preclearance. In addition, employees are permitted to hold accounts over which a third-party manager exercises exclusive discretionary authority.

The Code also includes policies and procedures that are designed to prevent the misuse of material, non-public information (“Insider Trading Policies”). CIA’s Insider Trading Policies prohibit CIA and its employees from trading for the Funds or themselves, or recommending trading, in securities of a company while in possession of material, non-public information about the company, and from disclosing such information to unauthorized persons.

In addition, the Code contains restrictions on the giving and receiving of gifts and entertainment, prohibitions on serving on the boards of outside companies without prior approval, and policies and procedures concerning political contributions in connection with Rule 206(4)-5 under the Advisers Act.

Employees of CIA are required to certify to their understanding and compliance with the Code, initially upon commencement of employment, annually, and upon any change to the Code.

CIA will provide a copy of the Code to any current or prospective client or Fund investor upon request.

### **PRINCIPAL TRANSACTIONS AND CROSS TRADES**

CIA to the extent permitted under applicable law, may engage in principal transactions with clients. Any such transaction will be conducted in accordance with the disclosure and consent requirements of Section 206(3) of the Advisers Act. However, CIA will not engage in principal transactions involving the Volatility Fund.

CIA, to the extent permitted under applicable law, also may effect cross transactions in which CIA causes a transaction to be effected between a Fund and another account advised by it or any of its affiliates (a “cross trade”). Cross trades, which may or may not constitute principal



transactions, will be conducted in accordance with CIA's fiduciary responsibility to each participating client, must be in the best interest of each participating client and must be consistent with CIA's duty to seek best execution.

### **CONTEMPORANEOUS TRADING**

CIA may aggregate client trades when such aggregation is expected to be in the best interest of all participating clients. CIA will seek to allocate trades in a manner that is fair to all Funds participating in the trade and will never allocate trades based on a Fund's performance or fee structure. CIA may consider, among other things: (i) Fund investment objectives and restrictions, (ii) tax status, (iii) cash position, (iv) risk tolerance, (v) tolerance for higher turnover, (vi) size of the Fund's account, (vii) size of available positions, (viii) current market conditions, (ix) total portfolio invested positions and (x) the nature of the investment.

Currently the Tail Protection Funds are CIAs only products that execute similar trades on a regular basis. For each trade a random execution order is generated for the Tail Protection Funds and orders are filled according to the assigned order.



## Item 12 – Brokerage Practices

### GENERAL

CIA has complete authority over the selection of the brokerage firms used to execute and clear portfolio transactions on behalf of the Funds and custody assets of the Funds.

### BEST EXECUTION

CIA's policy is to place portfolio transactions with broker-dealers who will execute transactions at the most advantageous terms reasonably available under the circumstances. CIA will seek to obtain best execution taking into account all factors they deem relevant, including the quality of execution, the brokerage firm's financial responsibility and reputation, range and quality of the services made available to the Funds and the brokerage firm's professional services, including clearance procedures and ability to provide research information for consideration, analysis and evaluation by CIA. If CIA determines in good faith that the amount of transaction costs charged by a brokerage firm is reasonable in relation to the value of the products or services such brokerage firm provides, CIA may incur transaction costs in an amount greater than the lowest cost available.

CIA has no directed brokerage arrangements. If it were to engage in such arrangements, there is no assurance that best execution could be achieved.

Employees of CIA may receive gifts and gratuities from broker-dealers or persons with whom the CIA does business. This may include meals, tickets to sporting events and other entertainment, transportation, attendance at seminars or other educational training or informational events, logo items and other items of small value, including gifts associated with life events such as birthdays or weddings. Employees may not accept gifts from any party that exceeds, in the aggregate, \$150 in value in any calendar year without the consent of the CCO. CIA does not consider gifts and entertainment received when selecting broker-dealers. Any gifts and/or entertainment received must be reported to the CCO.

### SOFT DOLLAR BENEFITS

CIA currently has no material soft dollar arrangements. However, CIA uses full-service broker-dealers that provide research or other products or services to most or all of their customers, without being requested to do so. As a result, CIA may on occasion receive and use such services provided by these broker-dealers.

Such services may include research and other brokerage services. Because CIA believes that the research it receives is not material in nature and quantity and is provided by most broker-dealers with which CIA deals, CIA's receipt of such research is generally not expected to have a material effect on CIA's selection of broker-dealers. However, in such instances, CIA may have an incentive to select broker-dealers based on its interest in receiving such research rather than based on the Funds' interest in receiving the most favorable execution.

Such full services brokers-dealers may also provide other products, including consulting services, risk analytics and capital introductory services to CIA. In these situations CIA receives a benefit because it does not have to pay for such services. Additionally, the capital introductory services provided by full service brokers-dealers provide CIA with an opportunity to solicit new investor and client referrals. CIA does not separately compensate such broker-dealers for the provision of such services and does not believe that they "pay up" for such services. However, the



receipt of such services may pose a conflict of interest for CIA, as CIA may have incentives to select broker-dealers based on their interest in receiving such services rather than based on the Funds' interests in receiving the most favorable execution

Although CIA does not currently have any material soft dollar arrangements, the investment management agreement entered into between the Funds' and CIA (the "Investment Management Agreements") provide that CIA may select the prime brokers for the Funds, and specifically authorizes them to direct brokerage to firms which provide research services and brokerage services in exchange for receiving commissions. Products and services acquired this way are generally referred to as services acquired with "soft dollars" (collectively "Soft Dollar Services"). It is CIA's policy to enter into arrangements for Soft Dollar Services only to the extent that they are within the "safe harbor" provided by Section 28(e) of the Securities Exchange Act of 1934. Accordingly, CIA may in the future cause the Funds to pay a broker-dealer that provides brokerage services (either directly or through third-party relationships) an amount of commission or transaction cost in excess of that which another broker-dealer would have charged, if CIA determines in good faith that such commission or transaction cost is reasonable in relation to the value of brokerage, research or other services provided.

## **TRADING ERRORS**

From time to time, during the course of trading for the Funds, trading errors will occur. CIA has adopted a trading error policy that applies to the Funds. Pursuant to this policy, as a general matter and to the extent not inconsistent with CIA's or any third party's contractual arrangements with the relevant Fund or applicable law, including ERISA, trading errors will be absorbed (in the case of a trading loss) or retained (in the case of a trading gain) by a Fund on whose behalf the trade was placed. While CIA and its counterparties have controls in place to prevent trade errors, there is always the possibility that such errors may occur. Trading errors might include, for example, keystroke errors that occur when entering trades into an electronic trading system resulting in the wrong amount of securities purchased or sold or the wrong security purchased or sold. Given the volume of transactions executed by CIA on behalf of the Funds, investors (other than funds of one subject to ERISA) should assume that trading errors (and similar errors) may occur and that the Funds will be responsible for any resulting losses, even if such losses result from the negligence (but not gross negligence) of CIA's personnel. Investors may contact CIA with any questions related to CIA's trade error policies.



## Item 13 – Review of Accounts

Funds are generally reviewed daily by, or under the supervision of, CIA's Chief Risk Officer in conjunction with his designated responsibilities.

CIA considers the careful management of risk to be a critical element of a successful trading program and has developed a range of monitoring and analytical techniques intended to make risk management more rational and effective. For instance, CIA monitors markets on an ongoing basis. When volatility and trading losses reach predetermined levels, positions are generally reviewed to determine whether to scale back or eliminate such positions. Each Fund's portfolio of positions and investments is monitored to maintain the targeted levels of risk and volatility. CIA's Risk Management Committee seeks to enhance risk management disciplines, adding value-at-risk computations, stress tests and additional analyses to attempt to complement the risk control methods already implemented.

Fund investors receive monthly letters from CIA describing the performance of the relevant Fund, along with a commentary by CIA. Fund investors also receive monthly statements detailing their account information, including, but not limited to, the account's beginning and ending equity and the account's performance for that period. Performance information is also available through a secure link on CIA's website. In addition, CIA issues to the Fund investors annual audited financial statements concerning the relevant Fund (and, for U.S. investors, tax reports) within 120 days of the end of the Fund's fiscal year. Single investor funds and clients with separately managed accounts receive reports and other information in accordance with their managed account agreements.





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

CIA does not receive economic benefits from non-clients for providing investment advice and other advisory services. Neither CIA nor any related person directly or indirectly compensates any person who is not a supervised person, including placement agents, for investor referrals. CIA may in the future enter into arrangements with third party placement agents, distributors or others to solicit investors in the Funds and such arrangements will generally provide for the compensation of such persons for their services at CIA's expense.



## **Item 15 – Custody**

The assets of the Funds will be held in cash or securities at the banks, brokerage firms, clearing firms and other financial institutions selected by CIA. No cash or securities of the Funds will be held in the actual custody of CIA or its affiliates. However, CIA is deemed to have custody of certain assets contained in the Funds' portfolios since an affiliate of CIA serves as the general partner of any US-domiciled Fund and CIA has the ability to deduct their fees directly from the Funds' accounts. Such arrangements may cause CIA to have custody for purposes of the custody rule under the Advisers Act. In such instances, investors do not receive account statements from the custodian; rather, the Funds are subject to an annual audit and the audited financial statements are distributed to each Fund investor within 120 days of the end of the Fund's fiscal year.



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

CIA provides discretionary investment advisory services to the Funds. CIA makes investment decisions, without consultation with the Funds or the Funds' investors, regarding which securities are bought and sold for the Funds, the total amount of the securities to be bought and sold, the broker-dealers (if any) with which orders are placed for execution and (as applicable) the commission rates at which securities transactions are effected. Such discretionary authority is granted to CIA in the applicable limited partnership agreement or investment management agreement (or sub-advisory agreement, to the extent applicable). Certain separately managed accounts or single investor vehicles or Funds managed by CIA generally will provide investors with the ability to tailor the management of such accounts through investment and risk guidelines and may provide other specialized terms.



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

In compliance with Advisers Act Rule 206(4)-6, CIA has adopted proxy voting policies and procedures. All decisions about how to vote a proxy will be made in accordance with CIA's proxy voting policies and procedures, which are designed to take into account the best interests of the Funds, as determined by CIA in its discretion.

Due to the nature of CIA's advisory services, a majority of the strategies employed largely use quantitative valuation models and a largely systematic approach to trading rather than a long-term investment approach. Such strategies are generally not dependent upon the outcome of proxy contests, and in such circumstances CIA will generally refrain from voting proxies. If, however, CIA receives a proxy request with respect to a security CIA determines a Fund will continue to hold, and CIA determines that the costs and expenses associated with voting do not outweigh the potential benefit to such Fund of voting, CIA will seek to vote the proxy in the best interest of the pertinent Fund. Clients may obtain a copy of CIA's proxy voting policy and its proxy voting record upon request.



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

CIA is not aware of any financial condition reasonably likely to impair its ability to meet contractual commitments to its clients, and CIA has not been the subject of a bankruptcy petition at any time during the past ten years.