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This brochure provides information about the qualifications and business practices of Merced Capital, L.P. If you have any questions about the contents of this brochure, please contact us at (952) 476-7200 or by email to Investor.Relations@mercedcapital.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about Merced Capital, L.P. also is available on the SEC's website at www.adviserinfo.sec.gov.

Merced Capital, L.P. is a registered investment advisor. Registration with the United States Securities and Exchange Commission does not imply a certain level of skill or training.

March 15, 2017

Item 2 **Material Changes.**

Material Changes since March 22, 2016 Annual Update. On July 22, 2016, Merced Partners V, L.P., a newly-established private investment fund sponsored by the firm, held an initial closing. The maximum amount of commitments that may be accepted under the fund's partnership agreement is \$900,000,000. As of January 31, 2017, capital commitments to this new fund are \$199,136,618. The firm anticipates holding at least one additional closing prior to April 28, 2017. The new fund is not engaged in a general solicitation, and interests are not being offered to the public.

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Item 4 **Advisory Business**

Merced Capital Background and Ownership

Merced Capital was formed in 1988 by three executives from the Cargill Inc. financial trading business, all of whom have retired. Merced Capital is owned by the senior members of management of Merced Capital. The general partners of the various Merced Capital-managed funds described below are also owned by members of Merced Capital's senior management. A description of the education and qualifications of these principals of the business is provided below.

Merced Capital provides investment advisory services to eight pooled investment vehicles, each of which is a Delaware limited partnership (each, a "Fund" and together, the "Funds"):

Fund	Type
Merced Partners Limited Partnership ("Merced") <i>General Partner: Merced Capital</i>	Annual Liquidity
Harrington Partners, L.P. ("Harrington") <i>General Partner: Lydiard Partners, L.P. ("Lydiard")</i>	Lock-up
Merced Partners II, L.P. ("Merced II") <i>General Partner: Lydiard</i>	Lock-up
ILS Partners, L.P. ("ILS") <i>General Partner: Lydiard Partners II, L.P. ("Lydiard II")</i>	Lock-up
Merced Partners III, L.P. ("Merced III") <i>General Partner: Lydiard Partners III, LLC ("Lydiard III")</i>	Lock-up
Merced Partners IV, L.P. ("Merced IV") <i>General Partner: Series M4 of Merced Capital Partners, LLC ("Series M4")</i>	Lock-up
Merced Partners V, L.P. ("Merced V") <i>General Partner: Series M5 of Merced Capital Partners, LLC ("Series M5")</i>	Lock-up
Merced Shipping Partners, L.P. ("Merced Shipping") <i>General Partner: Series MSP of Merced Capital Partners, LLC ("Series MSP")</i>	Lock-up

All of the Fund general partners are owned and controlled by senior management of Merced Capital, and all have entered into written management agreements with Merced Capital pursuant to which Merced Capital provides investment advisory services to the Funds of which they are general partner. Other than Merced Capital, none of the Fund general partners has any employees.

Except for Merced V, none of the lock-up Funds are open to new investors and none are accepting capital commitments in addition to existing commitments from existing investors. Merced V held its initial closing on July 22, 2016, and it expects to hold at least one additional closing prior to April 28, 2017. Interests in Merced V are not being offered to the public generally and Merced V is not engaging in a general solicitation. Likewise, interests in Merced are not being offered to the public generally and Merced is not engaged in a general solicitation. Merced may accept a limited amount of new investments from investors meeting the suitability standards set forth in its private placement memorandum.

At the commencement of a “lock-up” Fund each investor contractually agrees to invest a fixed amount of capital during the term of the Fund. The capital is normally drawn from investors (this is referred to as a “capital call”) during the first three or four years of the Fund known as the commitment or investment period. Capital can also be called following the commitment period under limited circumstances. At the conclusion of the commitment period, the general partner begins to sell investments and return capital and profits (if any) to investors. The period during which investments are sold is often referred to as the harvest period. The length of the harvest period is generally set at three or four years by the partnership agreement. The general partner generally has the option to extend the harvest period by one or two years, and depending on the types of investments and market conditions the final sale and liquidation of the fund may extend beyond the contractually stated term.

The commitment periods of the lock-up Funds range from one year to five years and, except for Merced V, have ended. Only Merced and Merced V actively seek to make new investments at this time. Merced IV entered its harvest period on December 31, 2016 and will not make additional investments except in limited circumstances as set forth in its limited partnership agreement. Harrington, Merced II, Merced III, ILS and Merced Shipping are also in their harvest periods and are in the process of liquidating investments they hold. The harvest periods of the lock-up Funds range from nearly three years to five years, which in some cases may be extended by the general partner under the terms of the limited partnership agreement.

From time to time Merced Capital expects to form additional investment partnerships to pursue investment strategies it finds attractive. These strategies may be similar to strategies currently employed by Merced Capital and are likely to include new strategies as well.

Merced Capital does not currently provide investment advisory services directly to any investors in the Funds, or to any separately managed accounts, but it may do so in the future.

Key Personnel

Merced Capital relies on the following senior members of its management to advise the Funds and operate and manage its investment advisory business:

David Ericson

Mr. Ericson is a partner in Merced Capital and a co-founder of Lydiard, Lydiard II, Lydiard III, Series M4, Series M5 and Series MSP. Private asset and distressed debt investing have been the focus of his professional career. Prior to joining Merced Capital in 2001, Mr. Ericson managed capital at Morgens-Waterfall-Vintiadis, Touchstone Capital and Cargill Inc. Mr. Ericson received a B.A. in International Relations from the University of Minnesota in 1983 and a MBA from the University of Chicago in 1987. Mr. Ericson was born in 1959.

Vincent Vertin

Mr. Vertin is a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4, Series M5 and Series MSP. A wide range of finance and investing activity has been the focus of his professional career. Prior to joining Merced Capital in 2004, Mr. Vertin was an analyst at Providence Capital, an investment banker at JP Morgan and Dain Rauscher Wessels, a math instructor at the U.S. Naval Academy and a Captain in the U.S. Marine Corps. Mr. Vertin received a B.S. in Mathematics from the U.S. Naval Academy in 1992 as well as an M.S. in Applied Mathematics & Business from George Washington University in 1993. Mr. Vertin was born in 1969.

Hendrik Vroege

Mr. Vroege is a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4, Series M5 and Series MSP. Wind and other energy-related investing have been the focus of his professional career. Prior to joining Merced Capital in 2004, Mr. Vroege managed capital at Fortis Group. Mr. Vroege received a B.A. in Finance from the University of Oregon in 1986, a MBA from Rotterdam School of Management in 1988, and completed the Tuck Executive Program at Dartmouth College in 2000. Mr. Vroege was born in 1964.

Stuart Brown

Mr. Brown is a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4, Series M5 and Series MSP. Distressed investing has been the focus of his entire professional career. Prior to joining Merced Capital in 2003, Mr. Brown worked at Avenue Capital, Morgens-Waterfall-Vintiadis, Touchstone Capital and Cargill Inc. Mr. Brown received a B.A. in Economics from Northwestern University in 1986 and a MBA from Northwestern University in 1988. Mr. Brown was born in 1964.

Thomas Rock

Mr. Rock is the General Counsel and Chief Compliance Officer of Merced Capital and a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4, Series M5 and Series MSP. Transactional and other legal work have been the focus of his professional career. Prior to joining Merced Capital in 2005, Mr. Rock was Associate General Counsel at GE Capital, General Counsel at Smarte Carte, and was a partner at Oppenheimer Wolff & Donnelly and Rider Bennett. Mr. Rock received a B.A. in English from Carleton College in 1984 and a J.D. from Boston College Law School in 1987. Mr. Rock was born in 1962.

Joel W. Anderson

Mr. Anderson is the Chief Financial Officer of Merced Capital and a partner in Merced Capital, Series M4, Series M5 and Series MSP. He has worked in the investment advisory industry for his entire professional career. He joined Merced Capital in 1998 and became CFO in 2008. Prior to joining Merced Capital in 1998, Mr. Anderson worked for another investment advisor in Minneapolis. Mr. Anderson received his Bachelor of Arts degree from the University of Minnesota – Morris in 1997, where he double-majored in Management and Economics and minored in Mathematics. He earned a Masters of Business Administration from the University of Minnesota in 2003. Mr. Anderson was born in 1975.

Michael M. Sullivan

Mr. Sullivan is a partner in Series M5. A wide range of investment and legal work has been the focus of his professional career. Prior to joining Merced Capital in 2007, Mr. Sullivan was in management at Solonis/Intrascapes Data and held partner and associate positions at Rider Bennett. Mr. Sullivan received a B.S. in Business Administration from Colorado College in 1982 and a J.D. from the University of Minnesota in 1990. Mr. Sullivan was born in 1959.

Investment Philosophy and Strategy

Merced Capital focuses on trading in debt and equity securities and other obligations of financially distressed entities, high yield, below investment-grade or unrated debt securities, special and control situation transactions, and other trades deemed appropriate by Merced Capital. In addition, Merced Capital-managed funds invest in real estate, aircraft and aircraft leases,

ocean-going vessels, equipment, renewable energy, insurance-linked securities, natural resources, and other types of assets. The partnership agreements governing the Funds give Merced Capital wide discretion to determine the investment strategy for the Funds, except in cases where the Fund was established to pursue a very specific strategy (as in the case of ILS, which was organized to invest in insurance-related debt obligations, and Merced Shipping, which was organized to acquire a single bulk shipping carrier). The investment strategy and objective of each Fund is set forth in the Fund's offering document. Merced Capital may expand its areas of expertise in response to market conditions or other external factors. A brief explanation of the primary strategies employed by Merced Capital follows:

- *Financially distressed entities* are those financially troubled entities on the verge or in the process of a major financial restructuring and involve deteriorating as well as defaulted securities. Restructuring of distressed entities is the process of re-balancing assets and liabilities in a more financially prudent fashion. This process can take place either through a formal bankruptcy proceeding or restructuring outside of a court's supervision. This process creates opportunities to trade in different types of securities or obligations with different risk-reward profiles at different times in an entity's restructuring cycle. This cycle can last anywhere from a month to five years or longer.
- *High yield, below investment-grade or unrated securities* involve situations in which there is speculative credit risk and where the debtor is unlikely to obtain credit from traditional sources, such as banks.
- *"Special situation" transactions* are those assets that may be acquired at a discount to their inherent value. Typically, these situations arise because the assets lack transparency or liquidity. Some of these trades may arise as a result of Merced Capital's role as advisor to other entities. Trades in this area include equipment and real estate, where Merced Capital has historically concentrated a great deal of its investments.

Historically, Merced has traded primarily in below investment-grade or unrated securities and other obligations and acquired interests in financially distressed entities. Merced expects to continue to trade and invest with a similar risk profile. Merced has also allocated a material portion of its assets to "special situation" transactions. Typically these types of investments have been more difficult to exit, primarily because they consist of assets that are not traded on an exchange. For the foreseeable future, it is not anticipated that Merced will invest a material percentage of its assets in special situation opportunities (although it is not prohibited from doing so). Merced has acquired these special situation positions primarily through privately negotiated purchases ("Private Transactions").

Merced V will likely follow the same philosophies and strategies employed by predecessor lock-up funds managed by Merced Capital. To date, Merced V has invested under each of the primary strategies employed by Merced Capital, and intends to continue seeking investments under these primary strategies and, potentially, in other assets and asset classes.

Merced Shipping owns a single bulk cargo vessel, which is its only asset.

In the past the Funds have not used borrowed money (leverage) at the Fund level, and have used leverage at the asset-level on a selective basis in limited circumstances (for example, in leveraged aircraft sale-leaseback transactions or commercial property acquisitions). However, this policy is continuously reviewed, and the Funds are permitted to employ leverage of Fund capital in the future. In addition, to the extent the Funds own and control private operating companies, those

companies may use debt as a part of their capital structure. The Funds are permitted to engage in short selling of securities, which involves borrowing securities and then selling them.

Merced Capital-managed funds' activities may include purchasing, short selling or spread trading any or all of the securities within different companies' capital structure. These securities may be publicly or privately traded.

Merced Capital has traditionally limited the number of trades made outside the United States and, accordingly, the Funds have incurred limited foreign exchange risk. While Merced and Merced V are not precluded from trading in foreign assets or from incurring foreign exchange risk it is not anticipated that foreign transactions will be a major focus of Merced or Merced V within the foreseeable future but they are not precluded from trading in foreign assets or from incurring foreign exchange risk. Merced Capital employs various strategies to hedge foreign exchange risk, including entering into forward purchase contracts with respect to currencies in which investments are denominated.

Conflicts of Interest

Conflicts of interest arise from time to time in the conduct of Merced Capital's advisory business. Merced Capital and the other general partners of the Funds are given very wide discretion and independence under the partnership agreements governing the Funds – which is typical in the private fund industry. Merced Capital and the other Fund general partners, and their respective members, managers, directors, officers, partners, shareholders, employees and agents may exercise investment responsibility, or otherwise engage, directly or indirectly, in any other business, irrespective of whether any such business is similar to, or identical with, the business of the Funds. These other activities may include purchasing, selling, holding or otherwise dealing with investments that would be suitable for the Funds.

Merced Capital, its affiliates, and their respective members, managers, directors, officers, partners, shareholders, employees and agents may directly or indirectly purchase, sell, hold or otherwise deal with investments for their own accounts, for their family members or for other Funds, irrespective of whether such investments are purchased, sold, held or otherwise dealt with for the account of one or more of the Funds, potentially creating a conflict of interest. An investor will not, solely by reason of being a partner in a Fund, have any right to participate in any manner in any profits or income earned or derived by or accruing to the Fund's general partner, its members, Merced Capital, their affiliates, and their respective members, managers, directors, officers, partners, shareholders, employees and agents from the conduct of any business other than the business of the Fund or from any transaction or other investment effected by any such person for any account other than that of the Fund.

One Fund may take a position that is adverse to the interests of one or more of the other Funds. For example, one Fund may choose to short a security that another Fund holds. In such instances Merced Capital will attempt to protect the interests of all Fund investors.

Merced Capital may have conflicts of interest in allocating its time and activity among the Funds, other entities, or investments for their own accounts.

Allocation, Aggregation and Brokerage

Because Merced Capital manages multiple investment partnerships, Merced Capital and its affiliates, and their respective members, managers, directors, officers, partners, shareholders, employees and agents may advise one or more of the Funds to invest in the same assets or asset

class. To the extent a particular investment is suitable for more than one Fund, Merced Capital uses good faith efforts to allocate such investments among the Funds in a fair and reasonable manner, and in accordance with its Allocation Policy. A copy of Merced Capital's allocation policy is available to investors in its Funds upon request. As a general rule, if two or more Funds have substantially similar or overlapping investment objectives and strategies and other factors being equal, allocation of a particular position will be based upon the relative size of the Funds. However, Merced Capital may also take into account any one or more of the following factors in allocating investments among Funds:

- Fund's investment objective and strategies (determined by reference to the investment objectives and strategies outlined in the Fund's partnership agreement and private placement memorandum or other offering materials related to that Fund);
- Fund's tax status, and tax status of investors in that Fund;
- any restrictions placed on a Fund's portfolio by the Fund or by virtue of federal or state law (such as the Employee Retirement Income Security Act of 1974, as amended);
- total portfolio invested position;
- available capital and available cash in the Fund, taking into account any anticipated subscriptions and redemptions and any other reasonably foreseeable cash requirements of the Fund;
- existing exposure in the Fund to issuer or to issuer's industry;
- nature of the security or asset to be allocated, including the liquidity of the asset and the availability of reliable price information;
- size of available position;
- supply or demand for a security at a given price level;
- the expected holding period of an investment in relation to a Fund's investment and harvest period;
- current market conditions; and
- any other information determined by Merced Capital to be relevant to the fair allocation of investments.

From time to time Merced Capital may aggregate Fund orders for the purchase or sale of securities. Merced Capital will generally follow the guidelines set forth below in aggregating orders for securities:

- no Fund will be favored over any other Fund;
- each Fund that participates in an aggregated order will participate at the average share price for all Merced Capital's transactions in that security on a given

business day and transaction costs will be shared pro rata based on each Fund's participation in the transaction;

- if the aggregated order is filled in its entirety, it will be allocated among Funds in accordance with Merced Capital's allocation policy described above;
- if the aggregated order is partially filled, it will be allocated among Funds pro rata (*i.e.*, taking into account the relative size of each Fund account to which it is to be allocated) and in accordance with Merced Capital's allocation policy described above;

In connection with the purchase and sale of investments for the Fund, the General Partner may elect to pay higher commissions to brokerage firms that provide it with investment and research information than to firms that do not provide such services if the General Partner determines that such commissions are reasonable in relation to the overall services provided. The information received may be used by the General Partner in managing the assets of Funds other than the Fund that paid the higher commission.

Assets Under Management

As of December 31, 2016, Merced Capital managed \$1,802,154,366 in capital across eight funds.

Item 5 Fees and Compensation

Merced pays its general partner a management fee of 1.5% per annum of assets under management and incentive compensation of 20% of investment gains. The Lock-up Funds pay their respective general partners a management fee between 0.75% and 1.5% per annum of committed capital during the commitment period of the Lock-up Funds and on the amount of capital invested during the harvest period of the Lock-up Funds. In addition, the general partners are entitled to receive incentive compensation of between 15% and 20% of investment gains. In certain cases, the Funds must earn a minimum amount, or a "hurdle" or "preferred return", before the general partner of the Fund is entitled to receive its incentive compensation. The fees paid by the Funds are outlined in further detail in their respective partnership agreements and private placement memoranda. Upon the creation of new investment funds, Merced Capital reviews its fee structure and in certain cases seeks input from prospective investors prior to establishing management and incentive fee levels. In certain cases, the general partner of a Fund may choose to reduce the fees paid by one or more limited partners; in determining whether to grant a reduced fee the general partner will consider numerous factors such as the amount of capital to be committed by the limited partner, the amount of capital committed to other partnerships managed by Merced Capital, and the date on which the limited partner makes its capital commitment. Management fees are paid by the Funds either monthly (in the case of Merced) or quarterly (in the case of the other Funds) in advance. In the case of Merced, incentive fees are earned and paid annually on the value of investments in the fund as of the last business day of the year. In the case of the other Funds, incentive fees are paid after all invested capital has been returned to the partners in the Fund and, if the partnership agreement requires that a minimum hurdle or preferred return be met and paid, after such minimum has been paid. In the case of all Funds other than Merced, incentive fees are paid only on realized gains.

Merced Capital sets the value of each Fund's portfolio. In the case of Merced, which pays an incentive fee based on the year-over-year increase in value of its investments, and which pays a management fee based on the value of assets under management, there is the risk that Merced Capital could increase its management and annual incentive fees by overstating the increase in

value of Merced's assets. To protect against this risk, Merced Capital has established a valuation policy to assure that its investment valuations reflect fair value. In addition, Merced, like all of the Funds, is audited on an annual basis. The audit includes an audit of the value of the investments in each Fund.

Merced Capital's valuation policy is available to investors in its Funds upon request. The policy provides that securities that are widely traded are valued by reference to quoted market prices. Where reliable market quotations are not available, Merced Capital values these securities and other assets in good faith using such methods as it considers appropriate. Valuation methods include, as appropriate, financial models, appraisals, reference to sales of comparable assets, bids or other valuations received from third parties, and other methods that Merced Capital determines are likely to be reliable. Except to the extent required by applicable law, Merced Capital is not required to have valuations independently determined.

In addition to paying management and incentive fees, the Funds reimburse the general partners of the Funds for certain expenses. These expense reimbursement items vary by Fund, but typically include tax advice and preparation expenses, accounting expense, custodial fees, brokerage commissions, legal, and other operational expenses. The Funds do not reimburse their general partners for rent, infrastructure costs and compensation of investment personnel. In addition, Merced V does not reimburse its general partner for customary and routine overhead expenses, including compensation of all personnel. If any reimbursable expenses are incurred for the account of more than one Fund, then Merced Capital charges a Fund only that portion of the expense that Merced Capital in its discretion deems equitable under the circumstances, taking into account such factors as Merced Capital and the Fund's general partner deem appropriate in the circumstances.

Item 6 Performance-Based Fees and Side-by-Side Management

Merced Capital does not provide investment advisory services to clients other than the Funds. Accordingly, Merced Capital cannot favor accounts which are charged an incentive fee over accounts that do not pay incentive fees.

Item 7 Types of Clients

The Funds are all limited partnerships organized under the laws of the State of Delaware. The Funds' limited partnership interests are offered to investors pursuant to exemptions from registration available under state and Federal securities laws. The Funds do not offer interests outside the United States. Merced interests are offered on a "rolling" basis to "qualified purchasers" as defined in Section 2(a)(51) of the Investment Company Act of 1940, subject to the limitations of the other limited offering exemptions under the Federal securities laws. Merced V interests are currently being offered on the same basis, with a final closing anticipated by April 28, 2017. None of the other Funds are offering interests to investors.

Investors in the Funds include public and private pension funds, foundations, endowment funds, "funds of funds", high net worth individuals and family offices. The minimum investment in Merced is \$1,000,000, though this minimum can be waived by Merced Capital. Merced Capital typically sets a minimum of \$5,000,000 for investors in lock-up Funds, and has the ability to waive this minimum as well.

Item 8 Methods of Analysis, Investment Strategies and Risk of Loss

Methods of Analysis and Investment Strategies

A portfolio approach to trading is employed, so that risk to the Funds is mitigated by avoiding significant concentrations in a limited number of investments. However, at times individual positions may be material. The strategy used in any individual situation will be affected by the types of financial instruments and assets involved and the desired risk-reward profile. Merced Capital takes a fundamental approach to analyzing an investment, taking into account the fair value of an investment, downside protection, and expected cash flows. Merced Capital investment personnel rigorously review all aspects of a proposed investment, taking into account both factors specific to the investment as well as factors affecting the particular industry and the economy as a whole.

Merced Capital strives to diversify investments in number, industry focus, and geographic region. However, none of the Funds is precluded from investing a substantial amount of its capital in a single holding, industry, or geographic area. Merced and Merced V may invest outside the United States and, therefore, may incur foreign exchange or political risk, and they may enter into hedging arrangements with the intent to protect against foreign exchange risks.

Merced Capital expects to control and be actively involved in the stewardship of many of the companies and assets in which Merced and Merced V invest. Merced Capital intends to seek out investments wherein strong management and attentive ownership add meaningful value. However, the Fund may own interests in companies and assets that it does not control and over which it has little, if any, influence.

Merced Capital uses a wide variety of sources to find investments. Investments are evaluated by Merced Capital by thorough in-house analysis and assessment of the multitude of financial, legal, market, operational, industry and other factors that impact credit profile, business prospects, and asset and enterprise value. Merced Capital also retains outside legal, tax, industry-specific and other advisors to help it analyze the potential downside and upside of an investment.

Risk Factors

An investment in Funds managed by Merced Capital involves various risks, including the risk that an investor may lose part or all of its capital.* While Merced Capital attempts to attain a Fund's investment objectives through its research and portfolio management skills, there is no guarantee of successful performance, that the investment objective can be reached, or that a positive return will be achieved. As a general rule, investors should expect that investments with higher return potential will also have higher potential of risk of loss to capital and/or income. In addition, the Funds' investments may fluctuate in market value from day to day and, therefore, the value of an investment in the Funds could decrease as well as increase. The Funds, individually or taken together, do not constitute a balanced investment program for purposes of an investor's portfolio diversification needs and, therefore, investors should consult with their own financial advisers for the appropriateness of an investment in one or more of the Funds for their overall investment program. A prospective Fund investor should consider the following

* For purposes of the discussion of the risks of investing in a fund managed by Merced Capital, we have assumed that any fund formed after the date of this brochure will employ most if not all of the same strategies employed by existing funds, and that the risks of investing in any such fund will be similar. A prospective investor in any fund managed by Merced Capital should carefully read and understand the offering memorandum for the fund. Investors should also consult with their professional advisors.

factors and other considerations. The following risk factors do not purport to be a complete examination of all of the risks involved in investments typically considered by Merced Capital.

- General Economic Conditions and Market Risks. All investments risk the loss of capital and are subject to investment-specific price fluctuations as well as to macro-economic, market and industry-specific conditions, including but not limited to national and international economic conditions, domestic and international financial policies and performance, conditions affecting particular investments such as the financial viability, sales and product lines of corporate issuers, national and international politics and governmental events, and changes in income tax and other laws and regulations. Investments recommended by Merced Capital to the Funds may involve risks associated with limited diversification and significant concentration, leverage, investments in speculative assets and financial instruments and the use of speculative investment strategies and techniques, interest rates, volatility, tracking risks in hedged positions, credit deterioration or default risks, systems risks and other risks inherent in the Funds' activities. Certain investment techniques of Merced Capital can, in certain circumstances, magnify the impact of adverse market moves to which the Funds may be subject. In addition, the Funds' investments may be materially affected by conditions in real estate, financial and other markets and overall economic conditions occurring globally and in particular markets where the Funds may invest their assets.

Merced Capital may not accurately predict future risk exposures relating to the Funds. Risk management techniques are based in part on the observation of historical market behavior, which may not predict market divergences that are larger than historical indicators. Also, information used to manage risks may not be accurate, complete or current, and such information may be misinterpreted.

- Broad, Unrestricted Investment Mandate. Merced Capital's approach is to bring numerous and diverse core competencies, combined with a broad investment mandate, together to take advantage of opportunities that present themselves from time to time. This flexibility makes it difficult to describe all of the risks inherent in an investment in the Funds. The information set forth below describes some of the risks associated with investment sectors in which Merced Capital managed funds have historically invested. There may be risks unique to other assets or particular industries in which the Funds might invest. The Funds have very few limits on the types of investments they might make.
- Industry Specific Risks. A Fund may take significant positions in particular industries that are subject to risks unique to those industries. For example:
 - *Aircraft.* Merced Capital-managed Funds participate in the business of purchasing and leasing commercial jet aircraft. Investors should consider the risks associated with the aircraft sale and leaseback business, which include, for example, the uncertain business environment for the airline industry, the risk that a lessee's credit profile will deteriorate, the risk of a decline in the value of aircraft or rental rates, risks associated with inaccurate appraised values for aircraft, risks associated with loss of or damage to an aircraft, and the risk that liens on aircraft will have priority over payments to the Funds.
 - *Insurance.* The Funds may also make investments in debt and equity instruments that allow life insurance-related, credit-related and natural disaster related risks and returns to be transferred to investors and thus will be subject to the general risks

facing the insurance industry. These risks include, among others, the uncertainty associated with (i) projecting mortality rates, interest rates and life insurance policy lapse rates, (ii) projecting future credit profiles, default rates, and recoveries and the likelihood and magnitude of natural disasters, (iii) methodologies used to value assets owned by such companies, (iv) the general market and business environment for the insurance industry, (v) counter-party risk and (vi) the risk of regulatory changes, among other factors. The insurance industry is highly regulated by the federal, state and local governments. There is no guarantee that changes will not occur to regulations affecting the insurance and reinsurance businesses, and such changes may adversely affect the value of the Funds and their investments. There may be other risks unique to these and other particular industries in which the Funds invest. The Funds have very few limits on the types of investments they might make.

- *Power Generation Equipment.* The Funds may participate in the business of purchasing and re-selling high value power generation equipment such as industrial and aero derivative gas turbine generator sets. Investors should consider the risks associated with the purchase and sale of such equipment, which include, for example, the uncertain business environment for the global power generation industry, the re-marketing time for a particular piece of equipment and the risk of value deterioration resulting from technical and economic obsolescence.
- *Real Estate.* The Funds may invest directly in real estate that Merced Capital believes is undervalued or under circumstances where Merced Capital believes that relevant market values will appreciate, non-recourse mortgages where the mortgagor is not a significant operating company and in the securities or obligations of single purpose companies whose primary asset is real estate. Risks associated with real estate investments include, among other things, (i) lack of demand for commercial or housing space in a locale, (ii) changes in general economic or local conditions, (iii) changes in supply of, or demand for, similar or competing properties in an area, (iv) uncertainty of cash flow to meet loan and other fixed obligations, (v) changes in interest rates, (vi) unavailability of mortgage financing which may render the sale or refinancing of a property difficult and (vii) changes in tax, real estate, environmental, and zoning laws. Additionally, in connection with the ownership (direct or indirect) of real properties, a Fund or an entity in which a Fund invests may face potential costs and liabilities related to environmental laws, such as those related to the removal of hazardous or toxic substances.

With respect to investments in mortgage loans, the Funds will in large part be dependent on the ability of third parties to successfully operate the underlying properties. In addition, certain of the mortgage loans may be structured so that all or a substantial portion of the principal will not be paid until maturity, which increases the risk of default at that time. The possibility of partial or total loss of capital will exist and investors should not subscribe unless they can readily bear the consequences of such loss.

- *Land Lot Development/Entitlement.* The Funds may invest in unentitled land that Merced Capital will seek to process through the land use approval process and, subsequently, seek to dispose of at a profit. In any such projects, the Funds will be subject to risks relating to delays in the land use entitlement process and other regulatory conditions beyond Merced Capital's control. Each of these factors could result in increased costs of a project or loss of the Funds' investment. In addition, the price the Funds agree to pay for the land will be based on projections of expenses and

estimates of land use development costs, marketability to homebuilders and growth projections in the area in which land in which the Funds invest is located. If these projections are inaccurate, the Funds may overpay for the land they acquire and, due to the factors discussed above, the Funds may fail to achieve their expected returns. The Funds will also be subject to the risks normally associated with land use development activities. Such risks include, without limitation, risks relating to the availability and timely receipt of zoning and other regulatory approvals and land use entitlement. These risks could result in substantial unanticipated delays or expenses and, under certain circumstances, could prevent completion of development activities once undertaken, any of which could have an adverse effect on the Funds and on the amount of funds available for distribution to investors.

- *Homebuilding.* Homebuilding investments involve significant construction risk, which is the risk that the cost of building the homes runs over budget and erodes or eliminates profit. Cost overruns can occur during any stage of development and construction. In the land development stage, unforeseen conditions, lawsuits, hillside problems or soil instability, among other factors, can lead to cost overruns. During construction, unanticipated weather, labor relations problems, unavailability of skilled workers, delays in obtaining or unavailability of construction materials, and increased interest rates, among other factors, can result in increased costs. Finally, in the sales phase, delays in sales (which can result from a number of factors) may lead to higher costs. Periods of high interest rates, tight credit, overdevelopment in an area in which a specific homebuilding project exists, general economic conditions (including recession or slow job growth), and a drop in home buyer confidence are among the factors that may make the sale of homes difficult. Standing inventory results in increased interest costs and reduces the amount of capital available to build additional homes. In addition, during a slow market, the Funds may have to bear the cost of carrying undeveloped land pending a change to favorable building conditions.
- *Hard-Asset Lending.* This is a highly competitive market and Merced Capital believes it will continue to be so for the foreseeable future as the financial services industry continues to consolidate, producing larger, better capitalized and more geographically diverse companies with broad product and service offerings. Thus, the Funds' profitability in this subsector depends, in large part, on the Funds' ability to compete effectively. The Funds' competition within this industry includes mortgage REITs, specialty finance companies, savings and loan associations, banks, mortgage banks, insurance companies, mutual funds, private equity funds, hedge funds, institutional investors, investment banking firms, non-bank financial institutions, governmental bodies and other entities as well as family offices and high net worth individuals. The Funds may also compete with companies that partner with and/or receive financing from the U.S. Government. Many of the Funds' competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than the Funds do. In addition, larger and more established competitors may enjoy significant competitive advantages, including enhanced operating efficiencies, more extensive referral networks, greater and more favorable access to investment capital and more desirable lending opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to the Funds, such as funding from the U.S. Government for which the Funds are not eligible. In addition, some of the Funds' competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of possible loan transactions or to offer more favorable financing terms than the Funds would. Merced Capital cannot assure investors that

the competitive pressures the Funds face will not have a material adverse effect on the Funds' business, financial condition and results of operations.

- *Mortgage Backed Securities.* The Funds may invest in mortgage loans or asset-backed securities secured by such loans ("MBS"). The mortgage loans that the Funds acquire and the mortgage loans underlying their MBS investments are subject to risks of delinquency and foreclosure. The ability of a mortgage borrower to repay a loan secured by a residential property typically is dependent upon the income and assets of the borrower, which may be uncertain or subject to change due to a variety of factors that are outside the Funds' control. Most mortgage loans underlying MBS are effectively nonrecourse obligations of the borrower, meaning that there is no recourse against the borrower's assets other than the underlying collateral. In the event of any default under a mortgage loan held directly by the Funds, the Funds will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral (or its ability to realize such value through foreclosure) and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on the Funds. This risk can be magnified when investing in MBS. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process, which could have a substantial negative effect on the anticipated return on the foreclosed mortgage loan.
- *Hotel Investments.* Cash flow from any hotel in which the Funds may invest may be depressed or negative until, at the earliest, the development, renovation or rehabilitation has been completed and the hotel, including any restaurant, is available for operation and has stabilized. In addition, each hotel must achieve a stabilized occupancy and room rate at a level sufficient to be able to cover debt service, if any, and other expenses (many of which are fixed expenses, regardless of the occupancy rate of the hotels) in order to provide a positive cash flow to the Funds sufficient to make distributions. The Funds may hire new management for hotels in which it invests, the impact of which is not certain. There can be no assurance that the Funds will achieve such positive cash flow.
- Investments in Other Special Situation Transactions. The Funds may invest and trade in situations that Merced Capital believes offer opportunity due to some identifiable dislocation, such as lack of market transparency or liquidity. Risks to a Fund in this type of investing and trading include misjudging the nature or magnitude of the factors that have caused this dislocation, the quality of the position's fundamental assets, the scope of the position's liabilities and the Funds' ability to exit the position in a timely and profitable fashion.
- Investments in Financially Distressed Entities and Restructurings. The Funds may acquire debt, other obligations and equity of financially distressed entities. Although such positions may bring high returns to the Funds, they involve varying degrees of risk. The financial difficulties of such entities may never be overcome and may cause such entities to become subject to bankruptcy proceedings. The timing and outcome of any bankruptcy or restructuring is unpredictable. Any one or all of the entities in which the Fund acquires interests may be unsuccessful in its attempts to restructure and become

profitable or the positions may not show any return for a considerable period of time. In any bankruptcy or restructuring, a Fund may lose its entire investment, may be required to accept cash or securities with a value less than its original investment, or may be forced to liquidate its investment at a substantial loss. In addition, under certain circumstances, payments to the Funds and distributions by the Funds to their limited partners may be reclaimed if any such payment or distribution is later determined to have been a fraudulent conveyance, a preferential payment or similar transaction under applicable bankruptcy and insolvency laws. Furthermore, investments in restructurings may be adversely affected by statutes related to, among other things, fraudulent conveyances, voidable preferences, lender liability, and the bankruptcy court's discretionary power to disallow, subordinate or disenfranchise particular claims or re-characterize investments made in the form of debt as equity contributions. The Funds may also invest in securities and other obligations that are secured by receivables from financially distressed consumers. These types of investments expose the Funds to the greater credit risk of the underlying consumers. Defaults by consumers on their payment obligations due to loss of employment, higher interest rates, increased taxes, bankruptcy or other adverse economic developments in the financial, credit or labor markets could result in a significant decrease in the market value of these investments or a total loss of a Fund's investment.

- High Yield, Below Investment-Grade or Unrated Securities. The Funds may invest in high-yield or non-investment grade securities. Such securities are generally not exchange-traded and, as a result, these instruments trade in the over-the-counter marketplace, which is less transparent and less liquid than the exchange-traded marketplace. In addition, the Funds 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. Non-investment grade securities face ongoing uncertainties and exposure to adverse business, financial or economic conditions which could lead to the issuer's inability to make timely interest and principal payments. 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 that 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 are often highly leveraged and may not have available to them more traditional methods of financing. It is possible that a major economic recession could severely disrupt the market for such securities and may have an adverse impact on the value of such securities. In addition, it is possible that any such economic downturn could adversely affect the ability of the issuers of such securities to repay principal and pay interest thereon and increase the incidence of default of such securities.
- Municipal Bond Market Risk. The amount of public information available about municipal bonds is generally less than that for corporate equities or bonds and the investment performance of the Funds' investments in municipal bonds may therefore be more dependent on the analytical abilities of Merced Capital than would be the case for other investment types. The secondary market for municipal bonds, particularly below-investment grade bonds in which the Funds may invest, also tends to be less well-developed and less liquid than many other securities markets, which may adversely affect the Funds' ability to sell their bonds at attractive prices. The ability of municipal issuers to make timely payments of interest and principal may be diminished during general economic downturns and as governmental cost burdens are reallocated among federal, state and local governments. In addition, laws enacted in the future by Congress or state legislatures or referenda could extend the time for payment of principal and/or interest, or

impose other constraints on enforcement of such obligations, or on the ability of municipal issuers to levy taxes. Issuers of municipal securities might seek protection under Chapter 9 of the Bankruptcy Code. In the event of bankruptcy of such an issuer, the Funds could experience delays in collecting principal and interest and the Funds may not, in all circumstances, be able to collect all principal and interest to which they are entitled. Notably, certain provisions of Chapter 9 of the Bankruptcy Code currently limit the bankruptcy court's power to interfere with the municipal debtor's ability to use its property, raise taxes or make expenditures. Municipal debtors are generally subject to far less court oversight than corporate debts and generally conduct their affairs without seeking court approval. This gives creditors little ability to influence municipal affairs during the course of a case and provides few leverage points for creditors. Moreover, lenders cannot force a municipal petitioner to confirm a repayment plan by any specific time and creditors cannot file a competing repayment plan, which has the potential to give municipal debtors nearly unfettered control over how and when to emerge from bankruptcy. To enforce its rights in the event of a default in the payment of interest or repayment of principal, or both, the Funds may take possession of and manage the assets securing the issuer's obligations on such securities, which may increase the Funds' operating expenses. Any income derived from the Funds' ownership or operation of such assets may not be tax exempt. Investments in municipal bonds are also subject to the risk that federal or state governments change laws that currently exempt interest on municipal debt from taxation.

- Issuer Risk. There are varying sources of statistical default and recovery rate data for commercial loans, and high yield and distressed securities and numerous methods for measuring default and recovery rates. The historical performance of the loan market or high yield market is not necessarily indicative of its future performance. The Funds' income may be derived largely from repayments of principal and interest received in respect of debt instruments. A wide range of factors may adversely affect an obligor's ability to make repayments, including: adverse changes in the financial condition of such obligor or the industries or regions in which it operates; the obligor's exposure to counterparty risk; systemic risk in the financial system and settlement; changes in law or taxation; changes in governmental regulations or other policies; natural disasters; terrorism; social unrest, civil disturbances or general economic conditions. Default rates tend to accelerate during economic downturns. Any defaults may have a negative impact on the value of the Funds' investments and may reduce the return that the Funds receive from their investments in certain circumstances. In the case of debt ranking equally with the loans or debt securities in which the Funds invest, the Funds would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant investee company. Each jurisdiction in which the Funds invest has its own insolvency laws. As a result, investments in similarly situated companies in different jurisdictions may confer different rights in the event of insolvency
- Hedging Transactions. The Funds may hedge their investments, including by investing in derivatives and other financial instruments. In the event of an imperfect correlation between a position in a hedging instrument and the portfolio position that it is intended to hedge, the desired protection may not be obtained and the Funds may be exposed to additional risk of loss. Certain of the Funds' hedging transactions may be undertaken through brokers, banks or other organizations, and the Funds will be subject to risk of default or insolvency of such organizations. In such event, there can be no assurance that any money advanced to such organizations would be repaid or that the Funds would have any recourse in the event of default.

- Portfolio Investment Ratings. The Funds' investments are expected to include commercial loans and high yield corporate or other debt obligations of both U.S. and non-U.S. obligors rated below investment grade (or which are not rated at all), which have greater credit and liquidity risk than more highly rated obligations. Downgrades and negative rating actions may occur with respect to these investments and in such case there is no requirement to sell any such investment. Investments with lower ratings will have greater credit, insolvency and liquidity risk than more highly rated obligations and, therefore, a greater risk of loss. In addition to credit and liquidity risk, lower rated obligations have greater volatility than more highly rated obligations. Future periods of uncertainty in the United States economy and the possibility of increased volatility and default rates may further adversely affect the price and liquidity of the Funds' investments. Consequently, the Funds will bear a higher risk of losing all or part of an investment if the investment is downgraded or put on a watch list for downgrade. In addition, any reductions in ratings of or similar rating action with respect to investments may adversely affect the value of such investments.

- Investments in Private Companies. Investments made in private companies involve a number of particular risks, including:
 - these companies may have limited financial resources and limited access to additional financing, which may increase the risk of their defaulting on their obligations, leaving creditors such as the Funds dependent on any guarantees or collateral they may have obtained;
 - these companies frequently have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns;
 - there may not be as much information publicly available about these companies as would be available for public companies and such information may not be of the same quality; and
 - these companies are more likely to depend on the management talents and efforts of a small group of persons; as a result, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on these companies' ability to meet their obligations.

- Non-U.S. Investments. Certain Funds' portfolios include or are expected to include obligations of obligors domiciled in a variety of non-U.S. jurisdictions, and assets located in non-U.S. jurisdictions. Risks associated with investing in certain non-U.S. jurisdictions may include the following: (i) the unpredictability of international trade patterns; (ii) the possibility of governmental actions adverse to business generally or to foreign partners in particular; (iii) the imposition or modification of controls on foreign currency exchange, repatriation of proceeds, or non-U.S. investment; (iv) the imposition or increase of withholding or other taxes on income or gains; (v) potential tax filing requirements in such jurisdictions; (vi) the imposition of potentially confiscatory levels of taxation; (vii) price volatility; (viii) the absence of uniform accounting, auditing and financial reporting standards, practices and disclosure requirements; (ix) governmental influence on the national and local economies; and (x) fluctuations in currency exchange rates. Each of the foregoing could increase the risk of an investment in the Funds.

The governments of certain of the countries in which the Funds may invest have exercised and continue to exercise substantial influence over many aspects of the private sector. The availability of investment opportunities for the Funds depends in part on governments continuing to liberalize their policies regarding foreign investment and to further encourage private sector initiatives. In certain jurisdictions, foreign ownership of assets and companies may be restricted, requiring the Funds to share the applicable investment with local third-party partners or investors, and there may be significant local land use and permit restrictions, local taxes, and other transaction costs which adversely affect the returns sought by the Funds.

The securities of some non-U.S. issuers are less liquid and more volatile than securities of comparable U.S. issuers and securities markets in some countries are fragmented, small, and less liquid than the securities markets of the United States and certain other developed countries. In addition, the securities markets in the countries in which the Funds may invest have in the past experienced substantial price volatility which could have an adverse impact on the value of the Funds' investments. Periods of economic and political uncertainty may result in further volatility in the value of the Funds' investments. As a result, there may be greater volatility than the volatility that could be expected by investors in comparable securities traded in U.S. securities markets. There can be no assurance that such investments will not be sold at prices below their acquisition costs.

Fluctuations in currency rates may adversely affect the ability of the Funds to successfully acquire non-U.S. assets and may also adversely affect the performance of the Funds' investments in such assets. Because non-U.S. securities or other non-U.S. assets may be purchased with and payable in currencies of countries other than the U.S., the value of these assets measured in U.S. dollars may be affected favorably or unfavorably by changes in currency rates and exchange control regulations. In addition to currency and exchange risks, these investments may be subject to additional risks relating to foreign political and regulatory risks, which may affect the liquidity of such investments. Additional risks include possibilities of instability of the local country's political and economic structures, less predictable means of dispute resolution and enforcement of local rights regarding Fund investments.

Some countries in which the Funds invest may employ managed exchange rate regimes which, in addition to other policies, may distort the results of, and returns on, the Funds' investments in such countries. Several countries, however, have been unable to sustain their exchange rates and have devalued their currency or shifted to floating exchange rate regimes. It is not possible over the life of the Funds to assess the degree to which individual currencies will be permanently affected, but significant depreciation of any particular currency may adversely impact the Funds' investments in the applicable country and/or the Funds' returns from such investments.

Finally, some countries in which the Funds may invest control, in varying degrees, the repatriation of capital and profits that result from foreign investment. Capital markets, often opaque, continue to be highly regulated and will likely be subject to continuing government restrictions. There can be no assurance that the Funds will be permitted to repatriate capital or profits, if any, from these countries.

- Currency Exchange Risk. A portion of the Funds' investments may be denominated in various foreign currencies and in other financial instruments, the price of which is determined with reference to such foreign currencies. The Funds will, however, value

their investments and other assets in U.S. dollars. The value of the Funds' net assets not denominated in U.S. dollars will fluctuate with U.S. dollar exchange rates as well as the price changes of the Funds' investments in the various local markets and currencies. The Funds will incur costs in converting investment proceeds from one currency to another. The Funds are not obligated to engage in any currency hedging operations, and there can be no assurance as to the success of any hedging operations that the Funds may implement.

- Illiquidity of Investments. A Fund's portfolio is likely to consist of a number of securities and other obligations for which no significant market exists or which require a substantial period of time before a significant market develops. A Fund's investments may include public and private senior and senior secured debt, unsecured loans, second lien loans, debtor-in-possession financings, delayed drawdown loans, term and revolving bank loans, commercial mortgage-backed securities and residential mortgage-backed securities. Trading in loans is often subject to delays as transfers may require extensive and customized documentation, the payment of significant fees and the consent of the agent bank or underlying obligor. In addition, the Funds may make investments that are subject to legal or contractual restrictions or requirements that limit a Fund's ability to transfer them or sell them for cash. Other investments may be private, direct investments with no trading market at all. The resulting illiquidity of an investment may make it difficult for the Fund to sell such investments if the need arises. If a Fund needs to sell all or a portion of its portfolio over a short period of time, it may realize value significantly less than the value at which it had previously recorded those investments. There can be no assurance that the Funds will be able to generate returns for investors or that the returns will be commensurate with the risks of investing in the types of instruments described herein.
- Lack of Diversification. Merced Capital is under no obligation to diversify a Fund's investments, whether by reference to the amount invested or the industries or geographical areas in which portfolio companies operate. A Fund may invest in a limited number of investments, and as a consequence the aggregate returns realized by the partners may be adversely affected by the unfavorable performance of one or a small number of such investments. If Merced Capital elects to concentrate a Fund's investments in a particular industry, issuer, or geographic region, that Fund's portfolio will then become more susceptible to fluctuations in value resulting from adverse economic conditions affecting that particular industry, issuer, or geographic region.
- Leverage. Although the Funds do not currently expect to use leverage at the Fund level, they have the ability to borrow on a short term basis to meet liquidity needs. To the extent that a Fund uses leverage, a decrease in the value of the assets of the Fund will tend to have a greater adverse impact on the Fund's investors than if leverage were not used.
- Restrictions on Transfer and Investor Liquidity. Interests in a Fund will be issued in reliance upon certain exemptions from registration or qualification under applicable Federal and State securities laws and, therefore, will be subject to certain restrictions on transferability. There is no public or other market for interests in any of the Funds and none is expected ever to develop. Interests cannot be assigned, transferred or encumbered (*e.g.*, as security for a loan) without the consent of the respective general partner of the Fund. Accordingly, Fund interests constitute illiquid investments and should only be purchased by persons that are able to bear the risk of their investment for an indefinite time.

- Substantial Charges to Funds. The Funds are obligated to pay a management fee and various other expenses and fees regardless of whether the Funds achieve any profits. Furthermore, because of the nature of the Funds' investment and trading methods and techniques, their expenses (*e.g.*, for brokerage commissions and other transaction costs) may be higher than those of other investment entities. Brokerage commissions are inherent to the Funds' investment activities and must be borne by the Funds before there are any trading profits.
- Effect of Performance Based Compensation. The existence of performance based compensation may create an incentive for the Funds' general partners to make riskier or more speculative investments than it would otherwise make in the absence of such an arrangement.
- Long Term Investment. Although certain investments by a Fund may generate current income, the return of capital and the realization of gains, if any, will generally occur only upon the partial or complete disposition of such investments by the Fund. While an investment may be sold by a Fund at any time, it is not generally expected that this will occur for a number of years after an initial investment has been made.
- Capital Call Defaults; Exclusion From Investments. With respect to the Lock-up Funds, if an investor fails to make a capital contribution when due and the contributions, if any, made by non-defaulting investors are inadequate to cover the defaulted capital contribution, the Lock-up Fund may be unable to pay its obligations when due. As a result, the Lock-up Fund may be subjected to significant penalties that could materially adversely affect the returns to the non-defaulting investors, and the Lock-up Fund may be unable to complete investments. If an investor in a Lock-up Fund defaults, that investors may be subject to customary default provisions under the Lock-up Fund's partnership agreement, including the potential forfeiture of a portion of such investor's interests.

An investor may be excluded from participating in any investment if a Fund's general partner determines in its sole discretion that such participation might otherwise have certain materially adverse effects on an investment, the Fund, the Fund's general partner, or any of their respective affiliates, including if such participation would be likely to result in violations of law or the imposition of a material regulatory, compliance, legal, tax or other similar burden. If an investor is excluded from participating in an investment it will not participate in the acquisition of the investment or in any income, gain, loss, deduction, credit or distribution with respect thereto. In the event that one or more investors are excluded from participating in an investment, the investors who are not excluded, all things being equal, may have a percentage ownership interest in certain investments that is greater than their percentage ownership interest in other investments, their percentage interest in a Fund as a whole may be greater than the percentage interest of the excluded investors in the Fund as a whole.

- Involuntary Sale of Interest. Pursuant to the Funds' partnership agreements, a Fund's general partner may, upon written notice, cause an investor to sell its interest if the general partner determines, in its sole discretion, that the continued participation of such investor would be likely to result in violations of law or the imposition of a material regulatory, compliance, legal, tax or other similar burden on any of the Fund, the general partner, or any of the general partner's affiliates.
- Recycling; Reinvestment. During a Lock-up Fund's commitment period and, under certain circumstances, throughout the term of the Lock-up Fund, the Lock-up Fund's

general partner has the right to recall proceeds distributed by the Lock-up Fund constituting a return of capital. In addition, during the Lock-up Fund's commitment period, proceeds from realized investments constituting a return of capital may be redeployed or recycled in new investments by the Lock-up Fund. To the extent such recalled or recycled amounts are reinvested, an investor will remain subject to investment and other risks associated with such investments.

- Forecasts. The Funds' investors have been provided several forecasts and descriptions of goals and objectives of the Funds. Although those forecasts and stated goals and objectives are based upon assumptions and research which the general partners believe are reasonable, actual results of operations and achievements may differ materially from the statements, goals, and objectives provided, including those set forth in the Funds' partnership agreements.
- Targeted Returns. Any target returns disclosed with respect to any Fund are based on a variety of assumptions about asset mix, the capital markets and performance of the underlying assets, which the Funds may not be able to achieve. There can be no assurance that the Funds will achieve these or any other levels of returns.
- Sophisticated Investors. While investment in a Fund can offer the potential of higher than average returns, it also exposes investors to a correspondingly higher degree of risk and is therefore considered appropriate only for sophisticated investors who can afford to assume this risk. Investors must have knowledge and experience in financial and business matters and be capable of evaluating such merits and risks. Each investor in a Fund will be required to represent that it satisfies these criteria and that it is acquiring the interest for investment.

Item 9 Disciplinary Information

There are no legal or disciplinary events involving Merced Capital or its employees that are related to Merced Capital's business or the Funds. From time to time the Funds and Merced Capital are parties to litigation involving investments by the Fund. There is currently no material litigation involving Merced Capital or the Funds.

Item 10 Other Financial Industry Activities and Affiliations

Neither Merced Capital nor any of its affiliates is registered under any financial regulatory authority outside the United States. None of Merced Capital's employees is a registered broker or affiliated with any such securities broker or dealer. Merced Capital's sole business is management of private investment funds.

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

Merced Capital has adopted a Code of Ethics pursuant to SEC Rule 204A-1. Upon request, Merced Capital will provide the Code of Ethics to any investor (or prospective investor) in any Fund managed by Merced Capital. The Code of Ethics requires that Merced Capital employees disclose information regarding their personal securities accounts, and that they refrain from trading in securities about which they possess material, non-public information.

Merced Capital employees are not permitted to invest in equity securities in which the Funds invest.

Item 12 **Brokerage Practices**

Merced Capital maintains relationships with a large number of executing brokers. Merced Capital considers a variety of factors in selecting executing brokers, including ability to locate inventory, speed and reliability of execution, cost, and asset type. Executing brokers do not have access to or custody of assets of the Funds. Each of the Funds (except for Merced Shipping) maintains a custodial account with a large, super-regional national bank with an office in Minneapolis, and each Fund maintains bank accounts with another super-regional national bank.

Merced Capital does not receive so-called “soft dollar” benefits from any broker, other than various forms of research received from time to time, including brokers’ own research reports on companies, industries and the economy as well as research prepared by third parties and made available to Merced Capital by brokers that execute Fund transactions. The research provided by executing brokers benefits Merced Capital in the sense that it does not have to produce or pay for the research itself, which creates an incentive for Merced Capital to select a broker based on this benefit rather than on Merced Capital’s obligation to seek best execution on behalf of the Funds. However, Merced Capital does not “pay up” for such research and the receipt of any such research is not a material factor in the selection of brokers to execute Fund transactions.

Merced Capital monitors the Funds’ bank and custodial accounts on a daily basis and reconciles cash and securities on a daily basis. Merced Capital also monitors the safety and soundness of its bank and custodian and takes appropriate action to assure that cash balances are invested in a secure manner.

Merced, Merced III, Merced IV and Merced V maintain accounts with prime brokers, but their activity in those accounts is not material in relation to the overall activities of the Funds. The Funds may enter into additional prime brokerage arrangements if Merced Capital determines that it would be beneficial to the Funds.

From time to time, Merced Capital may aggregate Fund orders for the purchase and sale of securities. See *Item 4 – Advisory Business – Allocation, Aggregation and Brokerage* for more information.

Item 13 **Review of Accounts**

Merced Capital monitors Fund investments on a daily, weekly, monthly or quarterly basis, depending on the nature of the investment. Quoted securities are tracked and monitored daily. Less liquid, longer-term investments (such as equipment, real estate or operating companies) are monitored weekly or monthly, unless there is a change or potential disposition pending.

All Fund investors receive quarterly letters from Merced Capital regarding the prior quarter’s Fund performance and discussing any changes to the portfolio of the Fund.

Investors in Merced receive a monthly statement showing the investor’s capital account and gain or loss for the year to date. Investors in the lock-up Funds receive quarterly statements. Each of the Funds is audited following the close of each calendar year. Ernst & Young LLP has been the auditor of all funds managed by Merced Capital since Merced Capital was founded. Audited financial statements are provided to all investors in March of each year.

Item 14 **Client Referrals and Other Compensation**

Merced Capital does not pay any third party for client referrals and has never retained a placement agent or other type of capital raising firm.

Item 15 **Custody**

The Funds receive monthly statements from their banks and custodians. Merced Capital provides monthly statements to investors in Merced and quarterly statements to investors in the other Funds. Cash balances and positions held by custodians are monitored and reconciled daily.

Item 16 **Investment Discretion**

As noted above, the partnership agreements for the Funds give the general partner of each Fund broad discretion to make investment decisions on behalf of the Funds. No limited partner in any Fund has any authority to direct or manage the investment of the Fund's assets. Merced Capital is the general partner of Merced and exercises this authority in its capacity as general partner, and the general partners of the other Funds delegate this authority to Merced Capital pursuant to written agreement.

Item 17 **Voting Client Securities**

As adviser to the Funds, Merced Capital is responsible for voting all proxies and bankruptcy claims with respect to investments held by the Funds. Merced Capital votes proxies in the best interests of each particular Fund, which may result in different voting results for proxies for the same issuer. Merced Capital believes that voting proxies in accordance with the following guidelines is in the best interests of its clients:

- Generally, Merced Capital votes in favor of routine corporate housekeeping proposals, including election of directors (where no corporate governance issues are implicated), selection of auditors, and increases in or reclassification of common stock.
- Generally, Merced Capital votes against proposals that make it more difficult to replace members of the issuer's board of directors, including proposals to stagger the board, cause management to be overrepresented on the board, introduce cumulative voting, introduce unequal voting rights, and create supermajority voting.

For other proposals, Merced Capital determines whether a proposal is in the best interests of its clients and may take into account the following factors, among others:

- whether the proposal was recommended by management and Merced Capital's opinion of management;
- whether the proposal acts to entrench existing management; and
- whether the proposal fairly compensates management for past and future performance.

Merced Capital maintains a record of all votes and will consider any investor request to review such votes.

Item 18 **Financial Information**

Merced Capital does not solicit the prepayment of fees from clients six months or more in advance. There is no financial condition that is reasonably likely to impair Merced Capital's ability to meet its contractual commitments to the Funds.

Merced Capital has never been the subject of a bankruptcy petition.

Item 19 **Requirements for State-Registered Advisers**

Merced Capital is not registered with any state securities authority.