

# ***Prophet Capital Asset Management LP***

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## ***Disclosure Brochure***

***March 28, 2016***

This brochure provides information about the qualifications and business practices of Prophet Capital Asset Management LP. If you have any questions about the contents of this brochure, please contact us at 512.327.9500. 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.

Prophet Capital Asset Management LP is an investment adviser registered with the SEC. Such investment adviser registration does not imply any level of skill or training. The oral and written communications of an investment adviser provide you with information by which you determine to hire or retain an investment adviser.

Additional information about Prophet Capital Asset Management LP is also available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)

## Material Changes

Prophet Capital Asset Management LP (“PCAM, we, us, our, ours”) has not made any Material Changes to its brochure since its last update on March 31, 2015.

Our complete updated brochure may be obtained by contacting Kurt Rechner, Chief Compliance Officer, by phone at 512.327.9500 or by e-mail at [kurt@prophetcapital.net](mailto:kurt@prophetcapital.net). We will provide a current

brochure at any time without charge.

Additional information about PCAM is also available via the SEC’s website, at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). Information regarding our investment adviser representatives can also be found in the brochure supplement on the page shown in the table of contents to the right of this column.

## Table of Contents

Advisory Business.....	2
Fees and Compensation.....	2
Performance Based Fees.....	3
Types of Clients.....	4
Methods of Analysis, Investment Strategies and Risk of Loss.....	4
Disciplinary Information.....	6
Other Financial Industry Activities and Affiliations.....	6
Code of Ethic, Participation or Interest in Client Transactions and Personal Trading.....	6
Brokerage Practices.....	7
Review of Accounts.....	9
Client Referrals and Other Compensation.....	9
Custody.....	10
Investment Discretion.....	10
Voting Client Securities.....	10
Financial Information.....	11

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## **Advisory Business**

In 1995, Robert Epstein established Prophet Capital Management, Ltd. (“PCM”) to manage investment portfolios. In 1999, he established a hedge fund, Partners in Prophet, Ltd. (“PIP”), with PCM as its portfolio manager.

In 2008, Mr. Epstein (as principal owner) established Prophet Capital Asset Management LP (“PCAM”) and Prophet Capital GP, LLC (“PCGP”) as its general partner. David Rosenblum was designated a limited partner in 2009. Logan Lowe was designated as a limited partner in PCAM in 2015.

PCAM, which is located in Austin, Texas, is a Delaware limited partnership that is registered as an investment adviser with the SEC. PCAM was established primarily to manage proprietary hedge funds. We also offer asset management to unaffiliated institutional investors and on a sub-advisory basis to unaffiliated hedge funds.

Our investment strategies primarily focus on securities related to mortgage-backed securities, commercial mortgage-backed securities, structured assets and mortgage-backed securities derivatives. However, the PCAM managed funds provide PCAM discretion to invest in a broad range of assets, including CLOs, commercial real estate loans, and other assets. We also provide advice regarding commodities, real estate, oil and gas interests, public securities, and private

equity where we deem such investments are suitable for the hedge funds (“clients”) whose portfolios we manage.

## *Assets Under Management*

As of December 31, 2015, we managed approximately \$2.3 billion in client assets. Approximately \$2.1 billion is managed on a discretionary basis (meaning that we make all of the investment decisions for those clients). Assets in funds we sub-advise, which totaled approximately \$192 million, are managed on a non-discretionary basis (meaning that we recommend but must receive directions from the portfolio manager to effect transactions for their portfolios).

## **Fees and Compensation**

We offer our services on a fee-only basis. Our stated annual management fee is 2% of the value of the investment assets we manage for each hedge fund client plus an annual 20% performance fee. The fees for our sub-advised and separately managed accounts may be less, as stated in our management agreements with such clients. Please see the section entitled “Performance Fees” below for more information on that component of our fees.

Investors who began participating in our funds prior to December 31, 2008 pay a lesser fee. The fees that the funds and the underlying investors pay to us are negotiable at our sole discretion and vary depending upon the amount of assets we are asked to manage, existing client

relationships, and the extent of the services we are asked to provide. The clients whose portfolios we currently manage may be charged fees different than those reflected in this brochure and we may agree to reduce the fees that our clients pay to us, including with respect to one or more investors in such client hedge fund. We charge one-twelfth of our annual fee each month in arrears. The amount of the fee for each investor in our client hedge funds is based on the value of each underlying investor's share of the assets at the close of business on the last business day of the month as adjusted for redemptions and new investments.

Fees for the initial month are adjusted pro rata, based upon the number of calendar days in the month that our investment advisory agreement is in effect. Management fees are paid to us directly from the clients for which we provide investment advisory services, and performance fees are allocated to Prophet Capital Incentive, L.P., an affiliate of PCAM.

We determine the values of the assets of our clients through the review of market data and estimated valuations provided by other financial institutions that have experience in trading mortgage-backed securities. Due to the nature of the investment assets we manage for our clients, those valuations are not a guarantee of any kind as to the actual value of those assets.

Each client whose portfolio we manage has an administrator that is responsible for regularly reporting on the client's holdings and performance. We provide each such administrator with the value of each client's investment assets on at least a monthly basis. Each administrator independently calculates our advisory fee upon the information that we provide.

Each administrator provides us with statements on at least a monthly basis that reflect the value of each hedge fund's investment portfolio. We use this information to prepare statements for the investors in each of our client hedge funds that reflect the value of the investor's individual ownership interest in the hedge fund.

Our advisory fees do not include the fees of unaffiliated asset managers, broker-dealers, or custodians, which may be incurred in connection with a client's investment activities. Those fees are charged directly to the client's account and include (but are not limited to):

- custodial fees,
- brokerage commissions,
- transaction fees,
- unaffiliated asset managers and investment consultants; and
- other fees and taxes on brokerage accounts and securities transactions.

We do not share or participate in any way in the fees charged by these other entities. Please be sure to read the section entitled "Brokerage Practices," which follows later in this brochure.

We may terminate at any time our advisory agreement with a client whose portfolio we manage or for which we serve as a sub-advisor. Any unpaid fees become immediately due and payable upon termination.

### ***Performance-Based Fees***

Performance-based fees are designed to give a portion of the returns of an investment account to the investment adviser as a reward for positive performance. The fee is generally a percentage of the profits made on the investments in an investment account.

We assess annual performance fees as of December 31 of each year. These fees generally equal 20% of any “new appreciation” in each client’s portfolio over that year. “New appreciation” is the increase in the value of a client’s portfolio account as of December 31 of the current year as compared to the value in the account as of December 31 of the preceding year (considering redemptions and new investments made during the year). Performance fees earned by PCAM are paid to our affiliate, Prophet Capital Incentive, LP (“PCI”).

Performance fees are negotiable. The offering documents for the hedge fund clients whose assets we manage contain additional details regarding our performance fees.

### ***Types of Clients***

Currently, we provide investment advisory services to pooled investment vehicles (“hedge funds”) and institutional clients. Although PCAM does not have requirements for opening or maintaining an account, our proprietary hedge funds generally require that their investors make a minimum investment of \$5,000,000.

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

We select specific investments for the investment portfolios we manage through the use of fundamental and technical analysis.

Fundamental analysis is a method of evaluating an investment by attempting to measure its intrinsic value through examining related economic, financial and other qualitative and quantitative factors. This includes, for example, evaluating a bond's value considering economic factors such as interest rates and the overall state of the economy and by considering information about the bond’s issuer, such as potential changes in credit ratings.

Technical analysis is a method of evaluating securities by analyzing statistics associated with market activity, such as past prices and trading volume. Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future

performance.

Our investment strategies may include long-term and short-term purchases and sales, and the use of options, margin, trading (selling securities shortly after purchasing them) and short sales (selling securities we do not own). The offering documents or, in the case of corporate or institutional clients, the investment policy statement for each client whose portfolio we manage may set forth restrictions on the types of investments we can purchase or the investment strategies we can employ, as well as risk factors relevant to the investment strategy of the applicable client.

Although we manage each client's account in a manner consistent with the specific risk tolerances and investment objectives as described in the applicable fund's offering documents or a client's investment policy, there can be no guarantee that our efforts will be successful. General economic conditions, current interest rates, and any number of other factors can affect investment performance.

Clients and the investors in the hedge funds whose portfolios we manage should be prepared to bear the risk of loss. All investments present the risk of loss, including (among other things) loss of principal, a reduction in earnings (including interest, dividends and other distributions), and the loss of future earnings.

Our investment strategies primarily focus on securities related to residential mortgage-backed securities, commercial mortgage-backed securities, structured assets and mortgage-backed securities derivatives collateralized by commercial mortgage loans. These types of securities are influenced by the rate of delinquencies and defaults experienced on real estate loans and the severity of the losses incurred as a result of such defaults. The factors influencing delinquencies on real estate loans, defaults and loss severity include:

- economic and real estate market conditions by industry sectors (e.g., multifamily, retail, office, etc.);
- the terms and structure of the mortgage loans; and
- any specific limits to legal and financial recourse upon a default under the terms of the mortgage loan.

Investments in mortgage-backed securities may be particularly sensitive to changes in prevailing interest rates. The yield and payment characteristics of mortgage-backed securities differ from traditional debt securities. Interest and principal prepayments are made more frequently, usually monthly, over the life of the mortgage loans and principal generally may be prepaid at any time because the underlying mortgage loans generally may be prepaid at any time. Faster or slower prepayments than expected on underlying mortgage loans can dramatically alter the yield to maturity of a mortgage-backed security. Other types of structured finance

securities may present risks similar to those of the other types of collateral debt obligations, such as interest rate risks and market risks.

We may make extensive use of various types of derivative instruments for our clients. These instruments typically involve highly leveraged exposure to the underlying assets from which their performance is derived. The use of derivatives involves a variety of material risks, including the possibility of counterparty non-performance as well as deviations between the actual and the theoretical value of such derivatives. Derivatives are subject to a wide variety of contractual terms including a range of “early termination events” permitting the counterparty to liquidate the position prematurely. Derivatives may be extremely illiquid.

### ***Disciplinary Information***

PCAM has not been the subject of any legal or disciplinary events that would be material to a client’s or prospective client’s evaluation of our business or the integrity of our management.

Additional information is available at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

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

As described above, in addition to his position as a founder and partner of PCAM, Robert Epstein is the founder and sole owner of Prophet Capital GP,

LLC (“PCGP”). PCGP functions as the general partner of PCAM and PCI. Mr. Epstein is also the founder and sole owner of Prophet Asset Management, LLC (“PAM”) which serves as the general partner for PIP, Prophet Opportunity Partners LP (“POP”), Prophet Credit Partners LP (“PCP”), and Structured Prophet Yen Fund LP (“SPY”). PAM is wholly owned by Robert Epstein, and is governed by its Board of Managers, which is currently comprised of three managers: Mr. Epstein and two individuals that are not affiliated with PCAM.

PCAM and PCI are principally owned by Mr. Epstein, David Rosenblum, Logan Lowe, and a retired partner, Michael Hirschberg (each of whom is designated as a limited partner in those entities). PCGP owns less than one percent of PCAM and PCI.

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

We have adopted a Code of Ethics (“Code”) to address the securities-related conduct of our partners, officers and employees. The Code includes our policies and procedures developed to protect the interests of our clients in relation to the following:

- the duty at all times to place the interests of our clients ahead of ours;
- that all personal securities transactions of our partners, officers and employees be

- conducted in a manner consistent with the Code and avoid any actual or potential conflict of interest, or any abuse of their positions of trust and responsibility;
- that our partners, officers and employees may not take inappropriate advantage of their positions;
- that information concerning the identity of client security holdings and financial circumstances are confidential; and
- that independence in the investment decision-making process is paramount.

We will provide a copy of the Code to clients or investors or prospective clients or investors upon request.

PCAM does not buy or sell securities for its own account that we also recommend to our clients. Our partners, officers and employees are, however, permitted to buy or sell the same securities for their personal or family accounts that are bought or sold for the accounts of our clients. This may raise potential conflicts of interest when a partner, officer or employee purchases or sells a security that is also owned by a client, or is being considered for purchase or sale by a client account.

We have adopted policies and procedures that are intended to address these conflicts of interest. These policies and procedures:

- require our partners, officers and

employees to act in the best interests of our clients;

- prohibit favoring one client over another; and,
- provide for the review of personal transactions to discover and correct any same-day trades that result in a partner, officer or employee receiving a better price than a client.

Our partners, officers and employees must follow our procedures when purchasing or selling the same securities purchased or sold for client accounts.

### ***Brokerage Practices***

We use the prime brokerage services of JP Morgan Institutional Investments, Inc. (“JP Morgan”) with respect to the portfolios that we manage for clients. “Prime brokerage” refers to a group of services that a securities brokerage firm makes available to certain institutional clients like hedge funds. These services include (among others) transaction settlement, custody of assets, securities lending, and cash management.

Prospective clients may request that we employ the services of a securities brokerage firm other than JP Morgan to provide prime brokerage services. The selection of a prime brokerage arrangement will be mutually agreed at the time we enter into an investment advisory agreement.

We are independently owned and operated and not affiliated with JP Morgan. Our use of JP Morgan and



other broker-dealers, however, can be a beneficial business arrangement for us and for the broker-dealers.

PCAM has the discretionary authority to both choose the broker-dealer selected for each trade as well as negotiate commissions on behalf of the clients it advises. In selecting broker-dealers to execute transactions for our clients, we consider, among other things, the broker-dealer's:

- existing relationship with us,
- reputation,
- reporting capabilities,
- execution capabilities,
- pricing, and
- types and quality of research.

The determining factor in our selection of a broker-dealer is not the lowest possible transaction charges it will assess, but whether it can provide what is, in our view, the best qualitative executions for transactions in the accounts of our clients.

Broker-dealers may make available to us products and services that benefit us but may not benefit our clients directly. Some of these products and services may assist us in managing and administering our client accounts, such as software and other technology that:

- provide access to account data such as duplicate trade confirmations and duplicate account statements;
- facilitate trade execution, including access to a trading desk serving

investment adviser participants exclusively;

- provide pricing information and other market data;
- facilitate payment of our fees from client accounts; and,
- assist with back-office functions, record keeping and client reporting.

We do not currently receive soft dollar benefits from JP Morgan or any broker-dealers and will not voluntarily or knowingly make use of soft dollar services for ourselves or our clients. Moreover, we do not receive client referrals from JP Morgan or any broker-dealers.

Custodial fees and other fees for transactions settled through JP Morgan may be higher than the fees charged by other prime brokers providing the same services. We nonetheless believe that our selection of JP Morgan is consistent with our efforts to act in the best interests of all of our clients at all times. Furthermore, PCAM does not warrant or represent that commissions for transactions implemented by the broker-dealers we select are lower than commissions available elsewhere.

We may aggregate the purchase or sale of securities for various client accounts (purchase or sale of a security for the accounts of multiple clients in a single transaction). If we aggregate orders when we have the opportunity to do so, each participating client will receive a price that represents the average of the prices at which all of the transactions in a given block were executed. Aggregating

trades allows transaction costs to be shared equally and on a pro rata basis among all of the participating clients. If the order is not completely filled, the securities purchased or sold are distributed among all participating clients on a pro rata basis or in some other equitable manner.

Aggregate trades are placed only when we reasonably believe that the combination of the transactions provides better prices for clients than had individual transactions been placed for their accounts. We may aggregate trades concurrently in both discretionary and non-discretionary accounts.

Transactions for the account of our partners, officers and employees may be included in aggregate trades. Those transactions will be charged the same average price and pay the same commissions and other transaction costs as clients. Transactions for the accounts of our partners, officers and employees will not be favored over transactions for client accounts.

We are not obligated to include the transactions for any client's account in an aggregate trade. These trades will not be effected for any client if doing so is prohibited in the offering documents for that client. No client will be favored over any other client.

### ***Review of Accounts***

We review the investment portfolios of our client accounts on a continuous

basis. Account reviews are conducted by Messrs. Epstein, David Rosenblum, Logan Lowe, Kurt Rechner, Chief Compliance Officer; Michael Murphy, Chief Financial Officer; and, Brooke Courtade, Compliance Officer.

### ***Client Referrals and Other Compensation***

We may enter into written compensation agreements with unaffiliated third-parties solicitors who refer clients to us or prospective investors to our clients. We may pay these solicitors a percentage of the advisory fees paid to us by the clients or investors that they refer to us. These payments will solely be a portion of the fee that we customarily charge and will not result in an increase in the amount of the fee paid by the client.

Any solicitation or referral arrangements will comply with applicable laws and regulations that govern the nature of the service provided. Should a client or hedge fund investor be referred to us by a third-party to whom we will pay a referral fee, we will provide such client or hedge fund investor with a written disclosure that describes the specific fees to be paid. We will require that any client of ours include in its offering documents a disclosure describing this arrangement before we share fees with the third-party that referred investors to the client.

## ***Custody***

As noted above, JP Morgan, as the prime broker, is the qualified custodian of the investment assets of our hedge fund clients; for separately managed accounts, BONY-Mellon is the qualified custodian. Audited financial statements are prepared in accordance with generally accepted accounting principles and are delivered annually to all limited partners within 120 days of the end of our clients' fiscal year.

JP Morgan provides the independent administrator of each client with regular reports on the assets held in the hedge fund and the advisory fee we have charged. Each administrator is responsible for confirming the value of client account assets and verifying the accuracy of our advisory fee. Upon request, administrators provide hedge fund investors with regular reports regarding their respective investments.

Institutional or corporate clients will receive statements no less than quarterly from the custodian of their accounts; clients should carefully review the statements from the custodian.

## ***Investment Discretion***

As previously noted, we offer advisory services on both a discretionary and a non-discretionary basis.

When we service a client's account on a discretionary basis, we do not need advance approval from the client to

determine the type and amount of securities to be bought and sold for its account. We may only exercise discretion if our client has provided that authority to us in writing. This authorization is typically included in the investment advisory agreement the client enters into with us.

As previously described, PCAM also has the discretionary authority to both choose the broker-dealer selected for each trade, as well as negotiate commissions on behalf of the clients it advises. We will exercise discretion in a manner consistent with the stated investment objectives of each client as set forth in offering documents of the hedge fund.

When we service a client's account on a non-discretionary basis, we may be permitted to purchase and sell certain types of investments pre-determined by the client, subject to the subsequent review and approval or rejection by the client.

## ***Voting Client Securities***

Because of the nature of the securities we purchase and sell for the accounts of our clients, we generally do not receive proxies on behalf of our clients for the majority of the securities we purchase and sell for the accounts of our clients. PCAM may be granted authority by its clients to vote the proxies of the securities held in client portfolios. PCAM has developed proxy voting

procedures to ensure that the proxies are voted in the best interests of its clients.

Similarly, securities held in PCAM client accounts may be named in, or become subject to, class action lawsuits. PCAM has developed procedures taking into account all of the information available to it at the time to ensure that class action legal matters involving any securities in any PCAM client account

are handled in the best interest of its clients.

### ***Financial Information***

We have no financial commitment that impairs our ability to meet contractual and fiduciary obligations to our clients. We have not been the subject of a bankruptcy proceeding.