



## Investment Management, LP

### Form ADV

### Part 2A: Firm Brochure

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**DW Investment Management, LP**

590 Madison Avenue, 9th Floor

New York, NY 10022

Tel: +1.212.751.6100

Fax: +1.212.486.2326

Email: [info@dwinvestmentmanagement.com](mailto:info@dwinvestmentmanagement.com)

**This brochure provides information about the qualifications and business practices of DW Investment Management, LP. If you have any questions about the contents of this brochure, please contact us at 212-751-6100. 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 DW Investment Management, LP also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

DW Investment Management, LP is an investment adviser that is registered with the United States Securities and Exchange Commission. Registration with the United States Securities and Exchange Commission does not imply a certain level of skill or training.

## Material Changes

Because much of the information in this ADV Part 2 is additional information we are providing due to legislative changes and was not previously provided in our ADV Part 2, we recommend that you read this ADV Part 2 in its entirety.

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## **1. Advisory Business**

DW Investment Management, LP, founded in March 2009, is an investment advisory firm specializing in discretionary investment management for private pooled investment vehicles. The principal owner of our firm is David Warren.

We provide investment management services for private pooled investment vehicles. We specialize in investing client assets in corporate credit, mortgage-backed securities, asset-backed securities and other similar securities of issuers or markets that we determine are experiencing, or that we anticipate will experience, substantial changes. We typically trade a wide variety of instruments, including derivatives, to effect our clients' investment strategies.

Our clients are exclusively pooled investment vehicles managed by Brevan Howard Capital Management ("BHCM"), an unaffiliated offshore manager. We currently serve as the sole investment manager for the Brevan Howard Credit Catalysts Master Fund Limited and as one of the investment managers of the Brevan Howard Master Fund Limited. We tailor our advisory services to the investment mandates of our pooled investment vehicle clients. These mandates are described in their respective investment management agreements with our firm. Clients can impose upon us restrictions on investing in certain securities or types of securities. These types of terms are all arranged on a case-by-case basis.

The amount of client assets that we manage on a discretionary basis, as of March 14, 2011, is \$3,027,114,000. We do not manage any client assets on a non-discretionary basis.

## **2. Fees and Compensation**

Our firm receives compensation for managing assets for our clients based on the total value of the assets under management and/or the performance achieved for each client's account. BHCM pays these fees to us from the fees that it charges our clients. Our clients are "qualified purchasers" under the Investment Company Act of 1940.

BHCM deducts any applicable asset-based fees from our clients' accounts at the end of each month, and any performance-based compensation at the end of every year. After deducting these fees, BHCM remits our portion of these fees to us. We do not receive any fees in advance.

Our clients also may incur a variety of expenses in connection with our advisory services, for example:

- brokerage commissions,
- clearing and settlement charges,
- borrowing charges on securities sold short,

- interest on borrowings, including borrowings from brokers and custodians,
- any issue or transfer taxes or fees in connection with securities transactions,
- any foreign withholding taxes,
- legal and/or rating agency fees incurred for specific transactions and
- exchange fees and charges.

For more information on brokerage transactions and costs, please see Section 9: Brokerage Practices.

In addition, our clients may incur additional expenses under agreements that they have with BHCM.

Neither our firm nor any of our principals or employees receives any transaction-based compensation for the sale of securities or other investment products.

### **3. Performance-Based Fees and Side-By-Side Management**

We have differing compensation arrangements among our clients. We may face conflicts of interest with respect to our clients because of these varying fee schedules. Specifically, we may have an incentive to favor a client for which we may receive more compensation than another.

As a fiduciary, we focus on acting in the best interests of *each* of our clients. Our policies and procedures are designed to identify and mitigate any conflicts of interest. Specifically, we address any potential conflicts of interest relating to our varying fee schedule by adhering to our trade allocation policy which sets forth objective factors for determining how to allocate investment opportunities among clients. For a detailed explanation of our trade allocation policy, please see Section 9: Brokerage Practices.

### **4. Types of Clients**

We provide investment advice to private investment funds, our only clients, which are pooled investment vehicles. As previously mentioned, BHCM has hired us to manage certain of our clients' assets.

We do not have any particular requirements for opening or maintaining an account with us.

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

We primarily employ a combination of relative value and long/short trading strategies, particularly focusing on the corporate credit, mortgage-backed and asset-backed securities markets, though we do trade in a variety of instruments. We seek outright price appreciation of securities and relative price appreciation of a security when compared to another, but do not target any particular yield, index, or other rate of return. We concentrate our clients' investments in developed markets. While we trade heavily in U.S. markets, we may also trade credit-related securities in global markets.

We attempt to achieve our clients' investment goals by identifying catalysts that we believe will yield price appreciation over a foreseeable time period. Some of the catalysts we seek to identify include corporate earnings, corporate events, company defaults, mortgage cash flows, prepayments, losses or other events that we believe will cause market prices to move in line with our expectations. In selecting investments for our clients, we conduct fundamental and broad technical analyses of the credit markets. Specifically, we engage in macro analysis of the credit markets as a whole, relative value analysis of one credit to another and micro analysis of individual companies and securities.

**Despite our analyses, investing in any securities involves a risk of loss that any of our clients or any of the investors in our clients must be prepared to bear.**

The primary securities we have utilized to achieve our clients' investment goals to date have been corporate bonds, mortgage-backed securities, and credit default swaps. We have also purchased and sold equity securities, trade claims, convertible bonds, equity futures, and options on bond indices and equities. We have used credit default swap indices extensively, both as hedges and to express outright views on various markets. We purchase many bonds at substantial discounts to par value. These bonds trade at substantial discounts because there is great uncertainty both as to when or if principal will be repaid to our clients. In many cases, we do not expect bonds we purchase to return 100% of principal.

In the following pages, we give more detail about many of the various strategies that we utilize in advising our clients, some of the important risks associated with these strategies, and a number of the products we have used or may use to achieve our clients' goals. The following explanation of certain risks is not meant to be exhaustive, but rather highlights some of the more significant risks involved in our investment strategies:

- *Investment Judgment and Market Risk:* The success of our investment programs depends, in large part, on correctly evaluating future price movements and/or cash flows of potential investments. We cannot guarantee that we will be able to accurately predict these price movements or cash flows and that our investment programs will be successful. Investments in securities and other financial instruments involve a degree of risk that the entire investment may be lost.
- *Trading Risk:* The use of derivatives, leverage, short sales and option trading can, in certain circumstances, substantially exacerbate the impact of unfavorable

price movements on our clients' investments. Also, changes in the general level of interest rates may negatively affect our clients' results.

- *Financial Markets and Regulatory Change:* The instability pervading global financial markets has heightened the risks associated with the investment activities and operations of hedge funds, including those resulting from a reduction in the availability of credit, a decrease in market liquidity and an increased risk of bankruptcy of third parties with which we work. Market disruptions over the recent years and the increase in capital being allocated to hedge funds and other alternative investment vehicles have led to increased scrutiny and regulation over the hedge fund and asset management industry. In addition, the laws and regulations affecting business continue to evolve unpredictably. Laws and regulations applicable to our clients, especially those involving taxation, investment and trade, can change quickly and unpredictably in a manner adverse to our clients' interests.
- *Catalyst-Driven Investing:* Catalyst-driven investing involves buying or selling securities of companies that are going through, or are expected to go through, substantial changes.

The fact that certain of the companies in whose securities we invest are in transition, out of favor, financially leveraged or troubled, or potentially troubled, and may be or have recently been involved in major strategic actions (for example, a merger or a tender offer), restructurings, bankruptcy or reorganization, means that their securities are likely to be particularly risky investments although they also may have the potential for correspondingly high returns. These companies' securities may be considered speculative, and the ability of these companies to pay their debts on schedule could be affected by adverse interest rate movements, changes in the general economic climate, economic factors affecting a particular industry, or specific developments within the companies.

Catalyst-driven investing requires making predictions about (1) the likelihood that an event will occur and (2) the impact such event will have on the value of a company's securities. If the event fails to occur or its effect was not foreseen, losses can result. For example, the adoption of new business strategies or completion of asset dispositions or debt reduction programs by a company may not be valued as highly by the market as anticipated, resulting in losses. In addition, a company may announce a plan of restructuring which promises to enhance value and fail to implement it, resulting in losses to investors. In liquidations and other forms of corporate reorganizations, the risk exists that the reorganization either will be unsuccessful, will be delayed or will result in a distribution of cash or a new security, the value of which will be less than what we paid for it. Because of the inherently speculative nature of catalyst-driven investing, our clients' results will fluctuate from period to period. Accordingly, the results of a particular period will not necessarily be indicative of results that we expect to obtain in future periods.

- *Corporate Bonds:* A primary focus of our investment strategy consists of investing in corporate bonds and their derivatives. Corporate bonds generally provide periodic returns and the eventual return of the principal at the end of the term. The values of corporate bonds and their derivatives, like other credit-based securities, change in response to interest rate fluctuations and market perception of an issuer's ability to pay off its obligations. Corporate bonds are also subject to the risk that their issuer may be unable to make interest or principal payments on its obligations.

We may invest in corporate bonds with investment grade ratings and with below-investment grade ratings, as well as "distressed" corporate bonds and bonds of companies emerging from a restructuring, all discussed below.

- *Credit Default Swaps:* Utilizing credit default swaps is a major component of our investment strategy. A credit default swap is a contract between two parties under which they both agree to isolate and separately trade the credit risk of at least one third-party entity. Essentially, the buyer of a credit default swap receives credit protection, and the seller of the swap guarantees the credit worthiness of the third-party entity. The market for credit default swaps is unregulated, and the contracts may be frequently traded so that the identities of the ultimate obligors are not clear. The possibility also exists that the counterparty may not have the financial strength to abide by the contract's provisions. The leverage involved in many credit default swap transactions, and the possibility that a widespread downturn in the market could cause massive defaults and challenge the ability of risk-buyers to pay their obligations, both add to the uncertainty of an investment in these instruments.

We may enter into credit default swaps with respect to corporate debt, mortgage-backed securities, asset-backed securities or indices referencing portfolios of these securities.

- *High Yield, Low-Rated or Unrated Securities:* Debt securities (including bonds) in which we invest on behalf of our clients may or may not be rated by credit rating agencies. If they are rated, their ratings may range from the very highest to the very lowest. Bonds with ratings below investment grade are sometimes colloquially called 'junk bonds'. Securities rated below investment grade normally provide a yield that is significantly higher than that of investment grade securities, but are quite speculative for reasons enumerated below. The lower-rated categories include debt securities that are in default and debt securities of insolvent issuers. The rating that a credit rating agency assigns to a security does not reflect an assessment of the volatility of the security's market value or the liquidity of an investment in the security. The values of lower-rated securities (including unrated securities of comparable quality) generally fluctuate more than those of higher-rated securities because investors generally believe that there are greater risks associated with them. In addition, the lower rating reflects a greater possibility that the financial condition of the issuer, or adverse changes in general economic conditions, or both, or an unanticipated rise in interest rates, may impair

the ability of the issuer to make payments of principal and interest. The inability (or perceived inability) of issuers to make timely payment of interest and principal would likely make the values of our clients' securities more volatile and could limit our ability to sell the securities at prices approximating the values we had placed on the securities. In general, the market for lower-rated or unrated securities is smaller and less active than that for higher-rated securities, which can adversely affect our ability to sell these securities at favorable prices. In addition, the market prices of lower-rated securities are likely to be more volatile because: (1) an economic downturn or increased interest rates may have a more significant effect on the yield, price and potential for default; (2) past legislation has limited (and future legislation may further limit) investment by certain institutions in lower-rated securities or the tax deductibility of the interest by the issuer, which may adversely affect the value of the securities; and (3) it may be difficult to obtain information about financially or operationally troubled issuers. We will not necessarily dispose of a security when its rating is reduced below its rating at the time of purchase.

- *Distressed Debt and Securities:* Distressed debt refers to bonds and other forms of securities issued by a company that is undergoing bankruptcy or reorganization or is likely to do so in the near future. Distressed bonds will often have low ratings as discussed above. The debt securities of distressed corporations are sometimes overly discounted by the market, as risk adverse investors tend to sell securities due to an actual or potential bankruptcy filing. These situations can create attractive buying opportunities for investors specializing in valuing distressed securities. We purchase these instruments on behalf of our clients with the anticipation that the company will emerge from its financial difficulties and become profitable again. In the interim, the purchase of the debt may allow the shareholders or bondholders to participate actively in the process of reorganizing the company as it attempts to position itself for a return to profitability. The risk of investing in distressed debt and securities is that the subject company's projected performance never takes place. When this is the case, the securities that we bought on behalf of our clients may become worth less than the amount initially paid for them, resulting in a loss. In addition, when investing in distressed debt, the amount and timing of payments, if any, by the debtor can be uncertain. Receiving late or incomplete loan payments can adversely affect our clients' return.

Significantly, on our clients' behalf, we may participate more actively in the affairs of a distressed issuer than is typical of investors. A heightened level of involvement may make our clients more vulnerable to litigation risks or prevent them from being able to sell their securities at certain times.

- *Post-Reorganization Securities:* Investing in securities issued by companies that have just experienced a reorganization may entail a higher degree of risk than investing in securities of companies that have not undergone a reorganization or restructuring. Specifically, post-reorganization securities may be subject to heavy selling and/or downward pricing pressure after completing a reorganization or



restructuring. If our expected outcome of a reorganization or restructuring proves incorrect, our clients may experience a loss.

- *Collateralized Debt Obligations:* Collateralized debt obligations are securitized interests in pools of assets. Collateralized debt obligation pools are split into different risk classes, or tranches, with “senior” tranches being the least risky. Interest and principal payments are made in order of seniority, so that junior tranches cost less and get paid more to compensate for additional risk. Holders of collateralized debt obligations only receive payment when the underlying borrowers make payments, otherwise the holders have no other recourse against the pool.

Collateralized debt obligations often consist of concentrated portfolios of assets. The concentration of an underlying pool in any one borrower would subject the collateralized debt obligation to a great degree of risk should the borrower default. Similarly, the concentration of a pool in any one industry would subject the collateralized debt obligation to a great degree of risk should the industry experience an economic downturn.

The value of collateralized debt obligations generally fluctuates with, among other things, the financial condition of the borrowers of the underlying assets, general economic conditions, the condition of certain financial markets, political events, developments or trends in any particular industry and changes in interest rates.

Finally, the underlying obligations that form collateral debt obligations are often given poor ratings by credit rating agencies. The lower ratings, as previously explained, reflect a greater possibility that adverse changes in an obligor’s financial condition and/or in general economic conditions could affect the obligor’s ability to make payments of principal or interest.

- *Bank and Participation Loans:* We may invest in bank loans and participation loans on behalf of our clients. Participation loans are large loans made by multiple lenders to a single borrower. When investing in loans, there is always a risk that the borrower may default.

Investing in these loans involves unique risks such as: (1) lender-liability claims, which are claims under which borrowers allege that their lenders are not treating them fairly; (2) environmental liabilities that may arise with respect to collateral securing the loans; (3) limitations on our clients’ abilities to enforce their rights with respect to participation loans; and (4) the possible invalidation of an investment transaction as a fraudulent conveyance to defer, hinder or defraud creditors under creditors’ rights laws. Our clients will generally bear costs of successful claims by third parties that arise from these and other risks. Because of the private syndication of loans and the unique and customized nature of loan agreements and the confidential information about the borrower that they contain, loans are not as easily purchased or sold as publicly traded securities. However,

as the secondary market for loans continues to grow, new loans are increasingly adopting standardized documentation to facilitate loan trading. This may improve loan market liquidity. Nevertheless, there can be no assurance that future levels of supply and demand in loan trading will provide an adequate degree of liquidity or that the current level of liquidity will continue.

- *Convertible Bonds:* Convertible bonds are bonds that can be converted into or exchanged for a specified amount of common stock of the same or a different issuer within a particular period of time at a specified price or formula. The holder of a convertible bond typically receives interest or a dividend until the security matures or is converted or exchanged. Convertible bonds are unique in that they generally (1) have higher yields than common stocks, but lower yields than comparable non-convertible securities; (2) are less subject to fluctuation in value than the underlying security due to their fixed-income characteristics; and (3) provide potential for capital appreciation if the market price of the underlying security increases.

The value of a convertible security is a function of its “investment value” and its “conversion” value. A convertible security’s investment value is determined by its yield in comparison to yields of other securities of comparable maturity and quality that do not have a conversion privilege. Changes in interest rates influence a convertible security’s investment value. Investment values decline as interest rates increase and vice versa. The issuer’s credit standing and other factors may also affect the convertible security’s investment value. A convertible security’s conversion value is determined by the market price of the underlying security. If the conversion value is low relative to the investment value, then the investment value principally governs the price of the convertible security. As the market price of the underlying security approaches or exceeds the conversion price, the conversion value will increasingly influence the price of the convertible security.

Convertible securities may be convertible only upon the occurrence of certain contingencies. If these contingencies fail to occur, this could also adversely affect our client’s ability to achieve its investment objective.

Convertible bonds may be subject to redemption at the issuer’s option. If one of our clients’ accounts holds a convertible bond that its issuer redeems, this could adversely affect our client’s ability to achieve its investment objective.

Convertible securities may be convertible only upon the occurrence of certain contingencies. If these contingencies fail to occur, this could also adversely affect our client’s ability to achieve its investment objective.

- *Investing in Loans Generally:* When investing in any type of loan, there is always the risk that a borrower made a material misrepresentation or omission in the process of obtaining the loan. This inaccuracy or incompleteness can adversely affect the valuation of the collateral underlying the loan and/or can adversely affect our ability to perfect or effectuate a lien on the collateral securing the loan.

- *Trade Receivables and Trade Claims:* Trade receivables are obligations backed by the amounts due to a business from another company for the sale of goods or services. However, they are unsecured in that there is no underlying hard asset that can be repossessed in the event of non-payment. Two key features of trade receivables investments are that they are short term (typically a 60-day or less turn around) and non-interest bearing.

Trade claims are unsecured rights of payment arising from obligations other than borrowed funds. Trade claims include vendor claims and other receivables that are adequately documented and available for purchase.

The performance of trade receivables and trade claims depends in part on the obligor's current financial condition, competitive position in its industry and strategic direction. Investors in trade receivables and trade claims are also exposed to the risk of dilution, which occurs when the amounts invoiced by the obligor are reduced for reasons other than payment or default (for example, the return of goods, invoice errors, product disputes over quantity, quality or delivery). Finally, as with all debt investments, there is always a risk that the obligor may default on its payments.

- *Residential Mortgage-Backed Securities:* Residential mortgage-backed securities are interests in packages of mortgage loans backed by residential property. Holders of residential mortgage-backed securities bear various risks, including credit, market, interest rate, structural and legal risks. Residential mortgage loans are the borrowers' obligation only and are not typically insured or guaranteed by any other person or entity. The rate of defaults and losses on residential mortgage loans is affected by a number of factors, namely general economic conditions and economic conditions in the area in which the property is located, the borrower's equity in the mortgaged property and the borrower's financial circumstances. If a residential mortgage loan defaults, foreclosure may be a lengthy, difficult and expensive process. Furthermore, the market for defaulted residential mortgage loans or foreclosed properties may be quite limited.

At any one time, a portfolio of residential mortgage-backed securities may be backed by loans with disproportionately large principal amounts secured by properties in only a few states or regions. As a result, these loans may be more susceptible to geographic risks, such as adverse economic conditions, adverse events affecting local industries and natural hazards, than would be the case for a package of mortgage loans having more diverse property locations.

- *Commercial Mortgage-Backed Securities:* Commercial mortgage-backed securities are interests in packages of mortgage loans that are backed by commercial property, such as apartments and retail shops. Typically, mortgage loans on commercial properties are structured so that a substantial portion of the loan principal is payable at maturity (rather than during the course of the loan term). Thus, repayment of the loan principal often depends on the future availability of real estate financing and/or the future value and salability of the

real estate. If real estate financing is unavailable at that time or borrowers are unwilling to refinance or dispose of encumbered property to pay off the loans, the loans may default.

Most commercial mortgage loans underlying mortgage-backed securities are nonrecourse obligations, which means that there is no recourse against the borrower's assets other than confiscating and selling the property (foreclosure). Foreclosure can be costly and delayed by litigation or bankruptcy. When considering factors such as the property's location, the legal status of title to the property, the property's physical condition and financial performance, environmental risks and governmental disclosure requirements with respect to the property's condition, a third party may be unwilling to purchase the property at a foreclosure sale or pay a price sufficient to satisfy all of the borrower's obligations. In addition, the borrower may retain revenues from the underlying property or use the revenues to pay others. Diverted revenue generally cannot be recovered without a court-appointed receiver to control cash flow related to the property.

- *Distressed Mortgage-Backed Securities:* On behalf of our clients, we may purchase securities backed by mortgage loans on which the borrowers are or were having trouble making payments. These mortgage-backed securities may include loans in default or loans that may have a greater than normal risk of future defaults, delinquencies, bankruptcies or losses due to fraud. Returns on investments in mortgage-backed securities depend on the borrowers' ability to make required payments and, if a borrower defaults, the ability of the loan's servicer to foreclose and liquidate the underlying mortgage loans.
- *Asset-Backed Securities:* Asset-backed securities are securities backed by assets other than mortgages or other mortgage-related assets. Credit card receivables, automobile and recreational vehicle loans, student loans, equipment leases, commercial and industrial bank loans, home equity loans and lines of credit, manufactured housing loans, royalty streams and various types of accounts receivable commonly support asset-backed securities. Asset-backed securities present certain risks that are not presented by mortgage-backed securities. Primarily, asset-backed securities do not have the benefit of the same security interest in the related collateral. Credit card receivables, for example, are generally unsecured and credit card debtors are entitled to the protection of a number of state and federal consumer loan laws, many of which give debtors the right to set off certain amounts owed on the credit cards, reducing their balance due. The risk of investing in asset-backed securities is ultimately dependent upon payment of consumer loans by the debtor.

The collateral supporting asset-backed securities is usually of shorter maturity than mortgage loans and is less likely to experience substantial prepayments. The value of an asset-backed security is affected by changes in the market's perception of the assets backing the security and the creditworthiness of the servicing agent for the loan pool, the originator of the loans or the financial institution providing

any credit enhancement, as well as by the expiration or removal of any credit enhancement.

- *Municipal Bonds:* A municipal bond is a debt security issued by a state, municipality or county to finance its capital expenditures. Municipal bonds are generally exempt from federal taxes and from most state and local taxes.

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. State constitutions or laws may limit the taxing powers of any governmental entity and an entity's credit will depend on many factors, including the entity's tax base, the extent to which the entity relies on federal or state aid, and other factors beyond the entity's control.

Municipalities are subject to a particular chapter of the U.S. Bankruptcy Code which generally provides for fewer creditors' rights than those typically afforded to creditors of businesses. In addition, revenue bonds issued by municipalities to finance the development of low-income, multi-family housing involve distinct risks in addition to those associated with municipal securities generally.

- *Leverage/Borrowing:* We may borrow against the assets of our clients when we believe that the proceeds from doing so will exceed the interest paid on the borrowing. Borrowing involves risk to our clients because the interest on the borrowed amount may be greater than the income from or increase in the value of the securities purchased with the borrowed amount. Also, the value of the securities purchased with the borrowed amount can decline below the amount borrowed.

Any investment profits made with the proceeds from borrowings in excess of interest paid on the borrowings will cause the income and value of a client's account to be greater than would otherwise be the case. On the other hand, if the value of the additional securities purchased with the borrowed money does not increase enough to cover the interest paid on the borrowings, then the income and value of a client's account will be less than would otherwise be the case. Generally, borrowing-type techniques used to increase potential returns are all forms of leverage.

Ultimately, to the extent we employ leverage, our clients' assets will tend to increase or decrease at a greater rate than if we did not utilize borrowed money.

- *Margin Transactions:* To increase their buying power, sometimes we engage in margin transactions on behalf of our clients. Trading on margin is a form of leverage. Specifically, when we trade on margin, our clients are borrowing from a broker to purchase more securities than they otherwise would be able to with their initial cash investment. The securities purchased on margin serve as collateral for the broker's loan. Trading on margin is risky because it not only can

increase gains, but also can amplify losses to the point where a client may lose more than its initial investment.

We may employ short-term margin borrowing, which can be especially risky. For example, should the collateralized securities decline in value, a client could be subject to a “margin call,” under which it must either deposit additional funds or securities with the broker or sell the pledged securities to compensate for the decline in value. If the value of a client’s assets suddenly drops, we might not be able to liquidate the client’s assets quickly enough to satisfy its margin requirements.

- *Hedging Transactions:* On our clients’ behalf, we often engage in hedging transactions. Employing hedging techniques reduces a portfolio’s vulnerability to various risks. Hedging entails determining certain risks in one’s portfolio and making trades to offset those risks. For instance, if we buy stock in a company, we may also short the stock of a competitor company. Hedging against a decline in the value of a portfolio position does not eliminate fluctuations in the values of portfolio positions or prevent losses if the values of such positions decline, but rather it establishes other positions designed to gain from those same developments, moderating the decline in the portfolio positions’ value. On the other hand, hedging transactions also limit the opportunity for gain if the value of the portfolio position should increase.

The success of a client’s hedging strategy is subject to our ability to assess correctly the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the investments in the portfolio being hedged. There is a risk that we may not always choose the right variable to hedge against. Also, it is important to note that we may not always choose to hedge against, or might not anticipate, certain risks, and, our clients’ portfolios will always be exposed to certain risks that cannot be hedged.

Many other investment strategies we employ can be used as hedging techniques, such as options, futures contracts, forward contracts, swaps, currency transactions and short selling.

- *Futures:* A future, also known as a futures contract, is a contractual agreement to buy or sell a particular commodity or financial instrument at a pre-determined price in the future. At times, futures may be illiquid investments because certain commodity exchanges limit fluctuations in particular futures contract prices during a single day. Once the price of a futures contract has increased or decreased by an amount equal to the daily limit, that contract cannot be traded unless traders are willing to trade it within that limit. This could prevent us from promptly selling unfavorable contracts and thus would subject our clients to substantial losses. There is also the risk that an exchange or the Commodity Futures Trading Commission may suspend trading, order immediate liquidation or settlement in a particular contract. This could also prevent us from promptly selling unfavorable contracts.

Specifically, we may invest in Eurodollar futures. Eurodollars are U.S.-dollar denominated deposits at foreign banks or foreign branches of U.S. banks. Eurodollar futures contracts enable purchasers to obtain a fixed rate for the lending of funds and sellers to obtain a fixed rate for borrowing funds. The final settlement of Eurodollar futures is based on the LIBOR (London Interbank Offered Rate).

We may also purchase and sell futures contracts based on major stock indices, such as the S&P 500. A stock index fluctuates with changes in the market values of the stocks included in the index. Accordingly, the success of futures on stock indices is subject to our ability to correctly predict movements in the direction of the stock market generally or of a particular industry or market segment.

- *Forwards:* A forward, or a forward contract, is a contract between two parties to buy or sell an asset at a specified future date at a price agreed upon at the time the contract is made. It is very similar to a futures contract, except forward contracts are negotiated privately and are not traded on an exchange, and thus, are not subject to limitations on daily price moves. On the other hand, this means that there is not a big secondary market for forwards, which means they may be difficult to sell should they become unfavorable for our clients.
- *Options:* There are certain risks associated with the sale and purchase of options. We may, on behalf of our clients, invest in call and/or put options. Call options are the right to buy a security at a certain price within a defined time period. Put options are the right to sell a security at a certain price within a defined time period. A buyer of either type of option assumes the risk of losing its entire investment in the option. A buyer of a call option risks losing its investment if the particular security never reaches the designated price within the set time period. A buyer of a put option risks losing its investment if the particular security does not decline enough to reach the designated price within the set time period.

We may trade options over-the-counter, instead of on an exchange. The risk of nonperformance by opposing parties on over-the-counter options is typically greater than the risk of nonperformance on exchange-traded options. Also, options not traded on exchanges are not subject to the same level of government regulation as are exchange-traded instruments, and many of the protections afforded to participants in a regulated environment may not be available in connection with over-the-counter transactions.

Not only will we buy and sell traditional equity stock options on behalf of our clients, but we may buy and sell options on any of the instruments that we discuss in this section.

- *Interest Rate Swaps:* An interest rate swap is a contract between two parties under which parties exchange interest rates on a principal amount. The principal amount is never exchanged but is used to calculate each party's interest payments. For example, A pays B a fixed rate of interest on the principal and B pays A a

variable rate of interest on the principal. There is always the risk that interest rates will go in an unanticipated direction, which could result in losses to our clients. The risk also exists that the other party will default and be unable to complete the contract, which could also result in losses to our clients.

- *Equity Securities:* We may buy equity securities, seeking to profit from both security selection and thematic sector or market timing decisions. The value of these investments will generally vary with their issuer's performance and movements in the equity markets. Consequently, our clients may suffer losses if we purchase equity instruments of issuers whose performance diverges from our expectations or if equity markets generally move in a downward direction and we have not hedged against this type of move (see above for an explanation of hedging).
- *Short Selling:* Short selling of securities occurs when we borrow securities, promising to buy them at a later date. If the price drops, we can buy the securities at the lower price and make a profit on the difference. If the price of the securities rises, we have to buy them back at the higher price, and the investment loses money. Buying the securities can itself cause the price of the securities to rise further which would exacerbate the potential for loss.
- *Global Securities:* We buy and sell securities issued outside of the United States for our clients' accounts. Investing in global securities involves certain risk factors not typically associated with investing in U.S. securities, such as fluctuation between exchange rates and the costs of converting from one currency to another. Our investment theses may work out the way we anticipated in local currency terms, yet our clients may still suffer losses in dollar terms if currencies move in ways we do not anticipate or hedge.

In addition, there may be less information available regarding global securities because companies and governments in other countries may have different standards of accounting, auditing and financial reporting compared to those of the U.S. There also might be a greater risk of political, social or economic instability and the possibility that withholding or other taxes may be imposed on our clients' income. We also may have less familiarity with legal systems in other countries.

- *Currencies:* We may, on behalf of our clients, enter into transactions to purchase or sell one or more currencies to hedge a currency exposure created by other investment activities. Because currency control is of great importance to the issuing governments and influences economic planning and policy, purchases and sales of currency and related instruments can be negatively affected by government exchange controls, blockages, and manipulations or exchange restrictions imposed by governments. These can result in losses to our clients.
- *Illiquid Investments:* On behalf of our clients, we may, from time to time, make illiquid investments or make investments that become illiquid. Illiquid investments are investments that are not heavily traded and cannot easily be



converted to cash. If any of our clients requires cash and we must sell illiquid investments at an inopportune time, we might not be able to sell such investments at prices that reflect our assessment of their value or the amount paid for them. The sale of restricted and illiquid securities often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in over-the-counter markets.

- *Limited Number of Investments:* At times, our clients may only participate in a limited number of investments. Consequently, the success of each of those clients could be substantially adversely affected by the unfavorable performance of a single investment.
- *Short-Term Debt:* Client assets not being utilized to effect the above strategies may be held in custody or placed in money market instruments, such as U.S. treasury bills and short-term certificates of deposit. Money market instruments typically do not carry much risk of loss; however, their potential for gain is negligible when compared to other strategies mentioned above.

Our investment strategy focuses on utilizing a number of diversified credit instruments. We encourage our clients to consider all of the risk factors we have explained, as any investment can be risky and our clients must be prepared to assume any potential loss.

## **6. Disciplinary Information**

Neither our firm, nor any of our directors, officers or principals has been involved in any investment-related criminal or civil actions in a domestic, foreign or military court that would be material to an evaluation of our firm's advisory business or the integrity of our firm's management.

Neither our firm, nor any of our directors, officers or principals has been involved in any administrative proceedings before the Securities and Exchange Commission, any other federal regulatory agency, any state regulatory agency or any foreign financial regulatory authority that would be material to an evaluation of our firm's advisory business or the integrity of our firm's management.

Neither our firm, nor any of our directors, officers or principals has been involved in any self-regulatory organization proceedings that would be material to an evaluation of our firm's advisory business or the integrity of our firm's management.

We do not believe the following is material to our business or to David Warren, but we include it to err on the side of completeness. Morgan Stanley and several individuals, including David Warren, have been named in a civil lawsuit unrelated to our firm. Rather, the lawsuit pertains to mortgage-backed securities issued by certain Morgan Stanley entities in 2006, after David Warren had left the mortgage-backed securities department at Morgan Stanley. The plaintiffs do not allege any misconduct on the part of

Mr. Warren and allege only that he was a signatory to a shelf registration statement filed in 2005. The plaintiffs' claims are based on alleged false and misleading statements in the registration statements and offering documents related to the mortgage-backed securities offerings at issue. Morgan Stanley has filed a motion to dismiss all claims in federal district court in New York. We believe that this suit against Mr. Warren is without merit and that it will be defended vigorously.

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

Neither our firm, nor any of our directors, officers or principals is registered as a broker-dealer or a representative of a broker-dealer or has an application pending to register as a broker-dealer or a registered representative of a broker-dealer.

Neither our firm nor any of our directors, officers or principals is registered, or has an application pending to register, as a futures commission merchant, commodity pool operator, a commodity trading adviser, or is an associated person of any of the above.

Neither our firm nor any of our directors, officers or principals has any affiliations in which we or any of our directors, officers or principals would be under common control or ownership with any of the following:

- a broker-dealer, municipal securities dealer or government securities dealer or broker,
- an investment company or other pooled investment vehicle,
- another investment adviser or financial planner,
- a futures commissions merchant, commodity pool operator or commodity trading adviser,
- a banking or thrift institution,
- an accountant or accounting firm,
- a lawyer or law firm,
- an insurance company or agency,
- a pension consultant,
- a real estate broker or dealer or
- a sponsor or syndicator of limited partnerships.

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

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

We have adopted a Code of Ethics in accordance with Securities and Exchange Commission requirements. Our Code of Ethics works to ensure that our employees conduct certain personal securities transactions in a manner consistent with our firm's fiduciary duty to our clients and to promote compliance with legal and regulatory requirements. The key policies under our Code of Ethics are as follows:

- Our firm and our employees have a fiduciary duty to our clients.
- Our firm and our employees must identify and comply with all applicable federal securities laws.
- Our employees must report personal securities transactions.
- Our firm and our employees must not trade for personal accounts ahead of our clients.
- Any person with knowledge of violations of federal securities laws, our Code of Ethics, or the policies and procedures set forth in our Compliance Manual must report this knowledge to our Chief Compliance Officer and/or appropriate supervisory personnel.
- We must provide our Code of Ethics and any amendments to all of our employees.
- We must retain written acknowledgements from all of our employees that they received, understand and abide by our Code of Ethics and any amendments.

We provide a copy of our Code of Ethics to any client or prospective client that requests one.

We strongly discourage having clients purchase securities from each other (commonly called a "cross trade.") However, in rare circumstances, we may determine that it is in the best interests of our clients to effect a cross trade. In these circumstances, and only following extensive compliance review, we engage unaffiliated brokers or custodians to effect our clients' cross trades. We instruct brokers and custodians to execute our clients' cross trades at the midpoint between the current best bid price and current best offer price. Both participating clients share equally in any transaction costs resulting from cross trades.

Our employees may invest in the same securities that we buy and sell for our clients. However, we discourage our employees from personally trading in securities in which we invest for our clients.

First, employees must obtain written pre-approval from our Chief Compliance Officer before trading in any securities for their personal accounts, subject to a few exceptions,

such as trading in government bonds or holding money market funds, or when an external adviser has complete discretionary authority over an employee's account. Our Chief Compliance Officer may refuse to approve any proposed transaction for any reason, particularly if the transaction may pose a conflict of interest with our fiduciary duty to our clients. If our Chief Compliance Officer decides to approve an employee's personal trades of securities that our clients hold or securities related to those that our clients hold, then our Chief Compliance Officer may require that employee to (1) hold the securities for as long as our clients hold the securities or (2) sell the securities if we subsequently make investments for our clients and we determine that the two positions have divergent interests. In addition, if our Chief Compliance Officer decides that a conflict exists between an employee's personal trades of securities and our clients, then our Chief Compliance Officer may require that employee to unwind the personal trades. Further, employees may not time personal trades to precede orders of the same or similar securities that we place for our clients, nor should their trading activity be so frequent as to conflict with the employee's ability to fulfill his or her job responsibilities. In fact, we require that all employees hold all securities they trade for periods of at least 30 days. Finally, if an employee receives approval to trade in the same securities in which we are investing for our clients, he or she must trade the securities in the same direction as we are investing for our clients and may do so only after our clients have established their desired positions.

It is important to note, employees may not trade in securities that we maintain on our "Restricted List," which contains the names of securities or companies about which our firm, our employees or BHCM or its affiliates may have material nonpublic information.

In addition, employees must submit periodic holdings and transaction reports for all securities over which they have direct or indirect influence or control to our Chief Compliance Officer so that we can confirm that all employees are complying with our personal trading policies and procedures. Specifically, our Chief Compliance Officer, or our Chief Compliance Officer's designee, monitors all employees' securities reports to detect abusive behavior. Any personal trading that appears abusive may result in further inquiry by our Chief Compliance Officer and/or sanctions.

The personal trading policies and procedures we have described above apply not only to employees and their personal accounts but to certain of their family members and their accounts as well.

## **9. Brokerage Practices**

As part of our fiduciary duty to our clients, our firm has an obligation to seek "best execution" for all trades, to trade securities in a manner that is fair to each of our clients and to exercise diligence and care throughout the trading process. In selecting broker-dealers and determining the reasonableness of their commissions for our clients' transactions, we strive to achieve "best execution" by taking into account any combination of the following factors:

- net price to client,
- market impact,
- expertise in particular markets,
- research provided,
- ideas provided,
- confidentiality of trading activity,
- willingness and terms to finance,
- counterparty exposure,
- financial condition,
- in which venues a broker-dealer can trade and
- execution speed (if relevant).

If we determine, in good faith, that any commissions a broker charges or the prices a dealer charges are reasonable in relation to the value of services that we and our clients receive, our clients may pay commissions or prices that are greater than those another broker or dealer might charge.

#### “Soft Dollars”

“Soft dollars” refers to an arrangement in which an investment firm may pay higher prices to buy securities from, or accept lower prices for the sale of securities to, brokerage firms that provide it with investment and research information. While our firm does not currently utilize soft dollars, BHCM does engage in soft dollar arrangements and may require us to be a party to its soft dollar arrangements. Consequently, our clients may benefit from these arrangements and our firm may indirectly benefit from these arrangements. In addition, some of our clients have authorized our firm to utilize soft dollars in connection with managing their accounts, so it is conceivable that we may engage in soft dollar arrangements in the future.

The research services that broker-dealers might provide under soft dollar arrangements include:

- written information and analyses concerning specific securities, companies or sectors,
- market, financial and economic studies and forecasts,
- statistics and pricing or appraisal services,

- discussions with research personnel and
- invitations to attend conferences or meetings with management or industry consultants.

We are not involved in the allocation of soft dollar benefits among our clients by BHCM. If we choose to engage in soft dollar arrangements in the future, we will adopt appropriate allocation policies and procedures.

Using client transactions to obtain research and other benefits creates incentives that result in conflicts of interest between advisers and their clients. When BHCM uses our clients' markups or markdowns to obtain research products and services, our firm may receive a benefit because we do not have to produce or pay for the research products and services. If we choose to utilize soft dollar benefits in the future, the availability of these benefits could influence us to select one broker-dealer rather than another to perform services for clients, based on our interest in receiving the products and services instead of on our clients' interest in receiving the best execution prices. Obtaining these benefits could cause our clients to pay higher fees than those charged by other broker-dealers.

The use of soft dollars to obtain research could create a conflict of interest between our firm and our clients because our clients could pay for products and services that would not be exclusively for their benefit and that may be primarily or exclusively for the benefit of our firm. To the extent that we could acquire these products and services without expending our own resources, the use of soft dollar benefits could increase our profitability.

Because our clients' soft dollar arrangements are controlled by BHCM, we do not have any procedures to direct client transactions to broker-dealers in return for soft dollar benefits.

#### Client Referrals

We do not consider referrals in selecting or recommending broker-dealers. It is our policy to select broker-dealers only on the basis of our "best execution" policies described at the beginning of this section.

#### Directed Brokerage

We select all broker-dealers for our clients from a list of counterparties that has been pre-approved by BHCM.

#### Trade Aggregation and Allocation

We often find trades that are appropriate for more than one of our clients. We therefore often execute an aggregate trade, which we then allocate to our clients' accounts at the time of confirmation in a fair manner.

When deciding how to allocate an aggregated order, we typically consider any combination of the following factors:

- the amount of capital, and the amount of available capital, in each client's account;
- each client's investment mandates;
- each client's risk profile;
- how much we have already invested for each client in this type of trade; and
- whether the trade is too small to be broken into smaller allotments.

Ultimately, clients may benefit when we aggregate trades if we receive volume discounts on execution costs. To avoid any disadvantages to any of our clients due to potential adverse price movements, it is our policy not to buy or sell the same securities for one client account before doing so for another, unless doing so is necessary because of disproportionate withdrawals from or influxes of capital into a particular client account.

## **10. Review of Accounts**

Our Chief Investment Officer regularly reviews the securities held by our clients that we traded. He holds monthly portfolio risk meetings with our portfolio managers and BHCM's Risk Officer. In addition, our Chief Investment Officer receives a daily email describing all trades that our firm has executed for the prior trading day and meets frequently with our portfolio managers to discuss individual trades and aggregate trading strategies. Our Chief Investment Officer pays greater attention to losing positions as well as winning positions that are reaching price targets.

Our Chief Compliance Officer and BHCM's Compliance Department also monitor daily trading activity.

We provide BHCM with written daily trade information. In addition, we (1) assist in the preparation of a monthly written investor letter that BHCM distributes and (2) review for accuracy monthly written reports that BHCM produces for delivery to its underlying investors.

## **11. Client Referrals and Other Compensation**

In connection with managing our clients' accounts, our firm receives asset-based fees and performance-based fees from BHCM, as we have described in Section 2: Fees and Compensation. We do not, nor do any of our employees, receive any other economic benefit from non-clients for providing advisory services to our clients.

We may enter into arrangements with third party marketers to introduce us to potential investors for the clients we advise. Any referral fees we may pay to a third party for successful introductions will be borne solely by our firm, and not by any clients or their investors.

## **12. Custody**

We do not have physical or constructive custody of any client funds or securities. All of our clients' assets that we manage are held by prime brokers and custodians. BHCM is responsible for establishing all agreements and arrangements with third parties in relation to the custody of our clients' assets.

## **13. Investment Discretion**

Our firm accepts discretionary authority to manage securities portfolios for our clients. Essentially, this means that we have the authority to determine, without obtaining specific client consent, which securities to buy or sell and the amount of securities to buy or sell. Despite this broad authority, we are committed to adhering to the investment objectives and program set forth in each of our clients' investment management agreements and any risk mandate prescribed by BHCM. By entering into investment management agreements with us, our clients and BHCM give us complete authority to manage our clients' assets in accordance with their investment objectives and program.

## **14. Voting Client Securities**

We have the authority to vote the proxies of any investments in the portfolios that we manage for our clients. In addition to voting proxies for equity securities, we may also vote on corporate actions such as restructurings, bankruptcy reorganizations and mergers, and similar events related to our clients' debt (and other) investments. Though our clients do not typically direct our proxy voting, we consult with BHCM before casting our vote. We vote each client proxy in accordance with our fiduciary duty to our clients. Our portfolio managers decide how we vote each proxy, seeking to vote in a manner that maximizes the value of each client's assets and that is in each client's best interest. We may abstain from voting a client's proxy if we determine that doing so is in the best interest of the client.

If any employee identifies any potential material conflict of interest in connection with voting our clients' proxies, he or she must notify our Chief Compliance Officer. Our Chief Compliance Officer documents any potential material conflicts of interest and may consult with outside counsel or other third parties regarding the potential conflicts.

Our Chief Compliance Officer maintains records of all of our proxy votes. Upon request by our clients or BHCM, our clients can obtain (1) records of proxy votes on their behalf and (2) a copy of our proxy voting policies and procedures.



**15. Financial Information**

We do not require nor do we solicit prepayment of more than \$1,200 in fees per client, six months or more in advance.

We are not aware of any financial condition that is likely to impair our ability to meet our contractual commitments to our clients.

Our firm has never been the subject of a bankruptcy petition.