

Big Bear Capital, LLC

Form ADV Part 2A

Brochure

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This Brochure provides information about the qualifications and business practices of Big Bear Capital, LLC (“Big Bear”). If you have any questions about the contents of this brochure, please contact us at (646) 553-3670. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or any state securities authority.

Additional information about Big Bear is also available on the SEC’s website at <http://www.adviserinfo.sec.gov>. Big Bear’s IARD/CRD number is 291847.

That Big Bear is a Registered Investment Adviser with the Securities and Exchange Commission does **not** imply a certain level of skill or training. Additional information about Big Bear is available on the SEC’s website at www.adviserinfo.sec.gov

ITEM 1 – COVER PAGE

ITEM 2 – MATERIAL CHANGES

Big Bear is a newly registered investment adviser, and this is Big Bear's initial Form ADV Part 2A.

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ITEM 4 – ADVISORY BUSINESS

Big Bear Capital, LLC (“Big Bear”) is a wholly-owned subsidiary of Paulson Capital Holding Company, LLC (the “Parent Company”). Big Bear was organized on or about December 8, 2017. . The principal owner of the Parent Company are the membership interest holders of Paulson Capital Holding Company, LLC. Big Bear currently only advises Anato Opportunity Fund I, LP (the “Fund”).

Big Bear seeks to generate strong, risk-adjusted returns, while also seeking shorter duration investments. The Fund seeks consistent returns on capital.

In aiming to achieve this objective, Big Bear employs a strategy to take advantage of various market inefficiencies and anomalies, including securities whose market prices are mis-valued due to structural optionality, legislative and put-back optionality and the mis-modeling of conventionally used analytical software.

Big Bear primarily offers advice in structured products including but not limited to MBS, ABS, servicing strips, mortgage related derivatives, residuals, NIMs, CDOs, CLOs, call rights on the foregoing financial instruments, residential and commercial loans, bridge loans, distressed debt securities and interests in legal settlements.

The foregoing outline represents Big Bear’s present intentions in view of current market conditions and other factors. Big Bear may vary the foregoing investment strategy and guidelines to the extent it determines that doing so will be in the best interests of the Fund and investment results will vary, possibly substantially, over time. Any investment strategy pursued for the Fund is in the absolute discretion of Big Bear as disclosed in the Fund’s governing documents.

Big Bear advises the Fund and manages its portfolio according to the Fund’s investment objectives and restrictions, as described in the Fund’s offering documents. Generally, Big Bear has the authority to select which and how many securities and other instruments to buy or sell without consultation with the Fund or investors therein.

Big Bear does not participate in wrap fee programs.

As of December 31, 2017, Big Bear managed approximately \$27,937,000 in discretionary assets. Big Bear currently does not manage any non-discretionary assets.

ITEM 5 – FEES AND COMPENSATION

The fees and expenses applicable to the Fund are set forth in detail in its offering documents. A brief summary of those fees and expenses follows.

Big Bear receives from the Fund a management fee and a performance-based allocation, which may be paid to an affiliate of Big Bear. The management fee is payable monthly in arrears, equal to one-twelfth (1/12th) of two percent (2.0%) (two percent (2.0%) per annum) of the Net Asset Value of the Fund (as defined in the governing documents) as of the last Business Day of each month, before taking into account estimated and/or unpaid Performance Allocations (as defined below) (the “Management Fee”). The Management Fee is adjusted on a pro rata basis to account for any contributions and withdrawals made by Limited Partners during a calendar month.

Paulson Capital Holding Company, LLC, the General Partner of the Fund, receives a special allocation (the “Performance Allocation”) at the end of each calendar quarter equal to twenty percent (20%) of the net realized and unrealized income and capital appreciation of the capital accounts. Performance Allocation is subject to high watermark of each such capital account.

Fees are directly deducted from the Fund’s accounts.

Big Bear does not require or permit the payment of fees in advance.

Neither Big Bear nor its supervised persons accepts compensation for the sale of securities or other investment products to the Fund outside of its association with Big Bear.

Fund fees are not generally negotiable. However, Big Bear may waive all or part of the Fund fees otherwise attributable to any investors’ capital, by rebate or otherwise. For example, the Fund, the General Partner and Big Bear may enter into side letters or other similar arrangements with certain investors having the effect of establishing rights in favor of such investors more favorable than those described herein, including providing to such investors certain information that is not generally provided to other investors, permitting such investors to withdraw other than on a stipulated redemption date and charging such investor fees lower than the Management Fee or Performance Allocation. Big Bear has entered into side letters with strategic investors. However, all investors invest into the same class of Interests, so Big Bear cannot advantage or disadvantage one investor through investment selection or allocation. Lower fees for comparable services may be available from other sources.

Other Expenses

The Fund bears or reimburses the General Partner for all expenses incurred in connection with the organization of the Fund and the continuing offering of the interests. These expenses include, without limitation, legal fees, accounting fees, printing costs, government filing fees and out-of-pocket expenses incurred by the General Partner in connection with the offering. Other fees and expenses relating to the operation of the Fund will also be borne by the Fund. These expenses include all of its ordinary and extraordinary expenses, including: (i) all costs and expenses associated with the offering of Interests; (ii) brokerage commissions and other transaction costs and investment-related expenses incurred in connection with the Fund’s investment and trading activities, including research expenses and the costs of any independent accountants or other experts or consultants engaged by Big Bear in connection with specific investments; (iii) any interest, fees and costs of Fund-related borrowings; (iv) routine operational costs such as legal, accounting, bookkeeping, auditing, consulting and other professional expenses, administration and tax preparation expenses, all taxes (if any), costs and expenses related to regulatory compliance matters and fees payable to governments or agencies; (v) its pro rata portion of any E&O insurance; (vi) research-related travel expenses of Big Bear; (vii) information technology expenses related to investment research of Big Bear and (viii) extraordinary expenses (e.g., litigation costs, indemnification obligations and costs incurred in connection with a reorganization or restructuring of the Fund), if any. The Fund will also pay or

reimburse Big Bear for the Fund's pro rata portion of the regulatory and compliance costs of the Fund arising out of Big Bear's management of the Fund, such as legal, administrative and filing costs and expenses relating to the Investment Adviser's Form ADV.

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

As discussed in Item 5, the General Partner of the Fund is entitled to receive the Performance Allocation from the Fund.

Performance-based compensation is based upon unrealized, as well as realized, gains, and such unrealized gains may never be recognized by the Fund. Thus, performance-based compensation creates an incentive for Big Bear to recommend investments which are riskier or more speculative than those which would be recommended under a different fee arrangement. However, Big Bear owes a fiduciary duty to the Fund to act for the benefit of the Fund and take this duty into account whenever it recommends investments for the Fund.

Currently there are no other accounts Big Bear manages other than the private fund, Anato Opportunity Fund I, LP.

ITEM 7 – TYPES OF CLIENTS

Big Bear advises a pooled investment vehicle (i.e., a private investment fund). The investors of the Fund may include individuals, trusts, estates, endowments, foundations, corporations and/or pension and profit sharing plans. The offering of Fund interest is designed for sophisticated investors that are knowledgeable and experienced in financial and business matters such that they are capable of evaluating the merits and risks of an investment in the Fund. Interests may be purchased only by persons that have a substantive, pre-existing relationship with the General Partner or its principals, employees or representatives and are (i) “accredited investors” as defined in Rule 501 of Regulation D under the 1933 Act and (ii) “qualified clients” within the meaning of Rule 205-3 under the Advisers Act.

The minimum initial investment in the Fund is \$2,000,000, subject to waiver at the discretion of Big Bear.

ITEM 8 – METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

Investment Strategy

Big Bear's investment objective for the Fund is to seek to generate strong, risk-adjusted returns, while also seeking shorter duration investments. Big Bear seeks consistent returns on capital for the Fund.

In seeking to achieve this objective, Big Bear seeks to build a stable portfolio by identifying anomalies and extracting values:

- Focus on alpha opportunities
- Focus on structure products
- Capitalize on various market inefficiencies such as mis-valued, mis-modeled or un-modeled securities due to structural optionality, legislative and put-back optionality and the mis-modeling of conventionally used analytical software
- Extract arbitrage opportunities, such as recognizing the spread between the costs of calling deals and the values of the underlying loans
- Utilize none/minimal external leverage on long assets (no leverage has been used to date)
- Niche fund size
 - Ability to stay flexible and nimble with changes in market dynamics
 - Focus on smaller opportunities that tend to be neglected by larger market participants

On behalf of the Fund, Big Bear invests primarily in structured products including but not limited to MBS, ABS, servicing strips, mortgage related derivatives, residuals, NIMs, CDOs, CLOs, call rights on the foregoing financial instruments, residential and commercial loans, bridge loans, distressed debt securities and interests in legal settlements. Big Bear may at times invest in other foreign securities or loans, synthetic, structured products, re-securitization of the aforementioned financial instruments and/or corporate bonds. These investments may be both liquid and illiquid financial instruments across the globe.

Up to ten percent (10%) of the Fund's portfolio may be outside of the foregoing financial instruments, but Big Bear intends for those other financial instruments to be related to structured products markets in some capacity. The Fund may also be long or short United States Treasuries or the debt of foreign nations, Eurodollars, foreign currencies and Fannie Mae, Freddie Mac or Ginnie Mae TBAs, listed equities or private investments in other companies, including, without limitation, engaging in "private equity"-like transactions whereby Big Bear, through the Fund, will purchase equity interests in operating companies, with the intent to maximize profits. Because of the nature of these businesses, the Fund could be considered to be indirectly originating loans and/or servicing mortgages. Further, although it is not the current intention of the Fund to do so, in the future, the Fund may purchase loans and/or pools of loans that are originated by such subsidiaries of the Fund; provided that the Fund will only effect such purchase pursuant to policies and procedures that are intended to ensure that the applicable purchase price is consistent with arm's-length pricing.

The foregoing outline of Big Bear's investment strategy represents Big Bear's present intentions in view of current market conditions and other factors. Big Bear may vary the foregoing investment strategy and guidelines to the extent it determines that doing so will be in the best

interest of the Fund and investment results may vary substantially over time. Any investment strategy pursued for the Fund is in the absolute discretion of Big Bear.

Method of Analysis

In choosing investments, Big Bear will employ its strength in deep fundamental analysis of collateral and deals' capital structures and anticipates to use no/minimal leverage to seek strong returns. As such, investments in the portfolio will include deep value and high cash flow non-agency RMBS without restriction as to issuer, credit quality and/or capital structure.

In pursuit of this objective, Big Bear will analyze deal documents to determine how cash flows will be distributed to the various bondholders within a deal's structure. At times, discrepancies in deal documents and/or cash flow distribution models can be a source of both risk and opportunity.

Big Bear first evaluates the current opportunity set, generating views on potential investments. Big Bear then may conduct further analysis on the potential investments, including, without limitation: constructing detailed internal models; analyzing market and regulatory dynamics; dissecting legal, financial and business documents; comparing Big Bear's internal models with those generated by third-party software; creating a forced liquidity analysis and analyzing and modeling potential downside potential. Big Bear may formulate an investment thesis and target exit. Simultaneously, Big Bear may perform a hedge analysis and a technical analysis. Big Bear's portfolio managers and analysts will then make a collaborative decision to accept or to reject the proposed investment thesis, although the ultimate decision to invest in any given asset is made by Big Bear's CIO. Following investment, Big Bear regularly re-evaluates the original investment thesis to confirm the value proposition, current market dynamics, industry or fundamental developments and volatility. After each re-evaluation, Big Bear may exit from the transaction, even if the target price or event of such transaction has not yet been reached.

Big Bear has not used any leverage to date and generally intends to use little or no long-only leverage. In implementing its investment strategy, the Fund may engage in short selling and may borrow to leverage its investments, fund withdrawals, and pay expenses. The Fund may obtain its leverage in any manner deemed appropriate by Big Bear and the degree of leverage utilized by the Fund is limited to three hundred percent (300%) of the Fund's Net Asset Value, measured as of the time such leverage is employed.

The Fund may not be fully invested at all times and may hold cash and make temporary investments in short-term debt instruments, money market funds, government securities, certificates of deposit, bankers' acceptances and similar cash equivalents.

Risk of Loss

Although Big Bear uses what it considers to be seasoned investment research techniques and risk management strategies in investing and trading the Fund's assets, there is no assurance that Big Bear's research techniques or risk management strategies will be successful. As more fully described above, Big Bear may seek to manage risk by allocating the Fund's assets to fixed-income instruments, options, cash or cash-equivalents.

Structured Product Market Conditions. Structured products experienced unprecedented turmoil during the financial and credit crises of 2007-2009. During that period markets experienced a downturn in liquidity. Banks and other sources of assets ceased lending or significantly increased borrowing costs. Most assets lost substantial value. Resultant, many private investment funds suffered significant losses and subsequently contributed to investor's requesting

withdrawals from some funds. Facing substantial redemptions many funds either (A) sold positions into illiquid markets at disadvantageous prices or (B) implemented restrictions on withdrawals by implementing redemption gates and/or creating side pockets or designated investments for these assets. The burden was particularly acute for private investment funds that use leverage and/or implement less liquid strategies. New periods of similar turmoil would present similar stresses on private investment funds and could have an adverse effect on the Fund's performance.

The United States government's implementation of purchase programs helped provide stability to these same markets in 2010, and there has been a significant upturn in pricing from 2010-2014. The implementation of Dodd-Frank has resulted in the continued constraint on bank lending in this sector.

Developments in Asset-Backed and Mortgage-Backed Security Markets. From 2015-2016 pricing in structured products markets has been relatively stable. While there was ~1.836 trillion USD in outstanding non-agency RMBS bonds in Q1 2010, there is now 855.8 billion USD in outstanding bonds. This has resulted in increased competition for assets and the departure of some large entities, including broker dealers, from these markets.

General Credit Market Conditions. Big Bear attempts to take advantage of dislocations in the credit markets. These opportunities may come to fruition from uncertainty regarding the level and timing of delinquencies, liquidations and losses on mortgage loans and/or inefficiencies in the market and third party software. The identification of investment opportunities which meet Big Bear's goals is difficult and involves a significant degree of uncertainty. The credit and structured products markets are, in general, highly susceptible to interest rate movements, government intervention, macro-economic news, and investor sentiment. Additionally, the Adviser's ability to produce profits may be adversely affected by increase in market volatility.

Certain Risks

Interest Rate Risk. The Fund will invest in debt securities. Debt securities are subject to price fluctuations during the period they are outstanding depending upon the interest rate fluctuation during such period. This is called the interest rate fluctuation risk of debt securities. In general, as interest rates fall, the security's price will rise, and as interest rates rise, the security's price will fall. When interest rates fluctuate, the duration (which is based on the weighted average life of the cash flow of a security) may be used as an indication of the degree of change in the debt security's price. The bigger its duration value, the larger the change in the debt security's price for a given movement in interest rates.

Fixed-Income Investments. The Fund may invest in fixed-income financial instruments. The value of fixed-income financial instruments will change as the general levels of volatility and interest rates fluctuate. When interest rates decline, the value of fixed-income financial instruments can be expected to rise. Conversely, when interest rates rise, the value of such financial instruments can be expected to decline. Investments in lower-rated or unrated, fixed-income financial instruments, while generally providing greater opportunity for gain and income than investments in higher rated financial instruments, usually entail greater risk (including the possibility of default or bankruptcy of the issuers of such financial instruments).

Credit Risk. Debt securities generally are subject to credit risk. Credit risk relates to the ability of the issuer of a debt security (or a borrower under a note or a loan) to make interest and principal payments on the security (or loan) as they become due. If the issuer fails to pay interest, the Fund's income might be reduced and the value of the debt security may be reduced. If the issuer fails to

repay principal, the value of that security and the Net Asset Value of the Interests will be reduced. Debt securities that are below investment grade are particularly subject to risks of default. Furthermore, the obligor or relevant guarantor may also be in bankruptcy or liquidation. There can be no assurance as to the amount and timing of payments, if any, with respect to the securities.

If Fund's financial instruments are secured by collateral, the Fund may have difficulty liquidating the collateral or enforcing its rights under the terms of the securities if an issuer defaults. Collateral may be insufficient or the Fund's right to the collateral may be set aside by a court. Collateral will generally consist of assets that may not be readily liquidated, including, for example, equipment, inventory, work in the process of manufacture, real property and payments to become due under contracts or other receivable obligations. There is no assurance that the liquidation of those assets would satisfy an issuer's obligations under a financial instrument. Non-affiliates and affiliates of issuers of financial instruments may provide collateral in the form of secured and unsecured guarantees and/or security interests in assets that they own, which may also be insufficient to satisfy an issuer's obligations under a financial instrument.

Mortgage-Related Securities.

- (i) *Generally* — The Fund will invest in mortgage-related securities. Generally, mortgage-related securities tend to be sensitive to changes in interest rates. Therefore, during a period of rising interest rates, such mortgage-related securities may exhibit additional volatility. In addition, mortgage-related securities are subject to prepayment risk. When interest rates decline, borrowers may pay off their mortgage sooner than expected. This can reduce the returns of the Fund because the Fund may have to reinvest that money in lower prevailing interest rates. Special risks may also be associated with investments in fixed or adjustable rate, mortgage pass-through securities and fixed or adjustable rate, mortgage-related securities.
- (ii) *Sub-Prime Mortgage Market* — The Fund may buy and sell sub-prime mortgage loans (and/or related financial instruments) that are secured by residential real estate owned by borrowers who may not meet conforming underwriting guidelines because of unusual loan-to-value ratios, the nature or absence of income documentation, limited credit histories, high levels of consumer debt and/or past credit difficulties.

The Fund may also purchase and sell loans (and/or related financial instruments) secured by commercial real estate. Such loans may be sub-prime or investment grade. The collateral for such loans could include any type of commercial real estate, including, without limitation, office buildings, research parks, industrial real estate, "big box" malls, local and regional shopping malls, outlet malls, parking lots and/or garages and apartment complexes.

These types of sub-prime mortgage loans generally have higher delinquency and default rates than prime or ordinary course loans. Delinquency interrupts the flow of projected interest income from a loan and default can ultimately lead to a loss if the net realizable value of the property securing the loan is insufficient to cover the principal and interest due on the loan. Also, the cost of financing and servicing a delinquent or defaulted loan is generally higher than for a performing loan. In addition, because sub-prime mortgage loans frequently have a higher loan-to-value ratio than ordinary course loans, a decrease in the underlying property values increases the probability that a holder of a loan will receive less than the full amount due in the event of a default. The Fund bears the risk of delinquency and default on loans beginning

when the loans and/or related financial instruments are purchased until the loans are collected.

- (iii) *Market Conditions* — Over the last several years, the residential mortgage market in the United States has experienced a variety of difficulties and changed economic conditions that have adversely affected the performance and market value of mortgage-related securities and issuers backed by mortgage-related securities. Many markets continue to experience delinquencies, defaults and losses with respect to residential, mortgage-related securities, particularly in the sub-prime sector. In addition, in many U.S. states, housing prices and appraisal values continue to decline or are appreciating slowly or not at all. A continued decline or an extended flattening of those values may result in additional increases in delinquencies and losses on mortgage-related securities generally, particularly with respect to second homes and investment properties and with respect to any residential mortgage-related securities whose aggregate amounts outstanding (including any subordinate liens) are close to or greater than the related property values.

Risks Relating to Investments in Mortgage Backed Securities (“MBS”).

- (iv) *Risks of RMBS Generally* — RMBS are subject to particular risks because they have yield and maturity characteristics corresponding to their underlying assets. Unlike traditional debt securities, which may pay a fixed rate of interest until maturity when the entire principal amount comes due, payments on certain RMBS include both interest and a partial payment of principal. This partial payment of principal may be comprised of a scheduled principal payment, as well as an unscheduled payment from the voluntary prepayment, refinancing or foreclosure of the underlying assets. As a result of these unscheduled payments of principal, or prepayments on the underlying assets, the price and yield of RMBS can be adversely affected. See “Prepayment Risks” below.

The performance of any RMBS and the results of hedging arrangements entered into with respect thereto will be affected by (i) the rate and timing of principal payments on the underlying assets related thereto and (ii) the extent to which such principal payments are applied to reduce, or otherwise result in the reduction of, the principal or notional amount of such RMBS. The rate of principal payments on a pool of RMBS will in turn be affected by the amortization schedules of the assets (which, in the case of assets with an adjustable-rate feature, may change periodically to accommodate adjustments to the mortgage rates thereon) and the rate of principal prepayments thereon (including for this purpose, voluntary prepayments by borrowers and prepayments resulting from liquidations of RMBS due to defaults, casualties or condemnations affecting the related properties).

At any one time, a portfolio of RMBS may be backed by assets with disproportionately large aggregate principal amounts secured by properties in only a few states or regions. As a result, RMBS may be more susceptible to geographic risks relating to such areas, such as adverse economic conditions, adverse events affecting industries located in such areas and natural hazards affecting such areas, than would be the case for a pool of mortgage-related securities having more diverse property locations. See “Geographic Concentration of Mortgage Loans” below.

Increases in monthly payments on adjustable rate mortgages due to higher interest rates may result in greater future delinquency rates. Borrowers with adjustable payments may be exposed to increased monthly payments when the related mortgage

interest rate adjusts upward from the initial fixed rate or a low introductory rate, as applicable, to the rate computed in accordance with the applicable index and margin. This increase in borrowers' monthly payments, together with any increase in prevailing market interest rates, may result in significantly increased monthly payments for borrowers subject to adjustable rates.

Borrowers seeking to avoid these increased monthly payments by refinancing may no longer be able to find alternatives at comparably low interest rates. A decline in housing prices may also leave borrowers with insufficient equity in their homes to permit them to refinance. Furthermore, borrowers who intend to sell their homes on or before the expiration of the fixed rate periods may find that they cannot sell their properties for an amount equal to or greater than their unpaid principal balances. These events, alone or in combination, may contribute to higher delinquency rates and therefore potentially higher losses on RMBS.

- (v) *Investment in Non-Agency RMBS* — The Fund may invest in secured pools of RMBS that are not guaranteed by the U.S. government in any manner whatsoever (“**Non-Agency RMBS**”). Non-Agency RMBS are secured only by cash flows of the underlying mortgages; in contrast, agency mortgages carry the implicit, and in some cases the explicit, guarantee of the U.S. government. Investing in Non-Agency RMBS involves a high degree of risk.

Non-Agency RMBS performance may be affected by an increase of delinquencies, defaults and foreclosures on underlying mortgages. These Non-Agency RMBS may be made to borrowers with lower credit scores, incomplete application documentation, higher security balances and higher loan-to-value ratios. Also, fraudulent mortgage applications, below-normal equity contributions, equity contributions with “piggy-back” mortgages and mortgages supported by properties acquired for investment, may increase the likelihood of defaults, delinquencies and losses on mortgage portfolios. In addition, adjustable rate mortgages and hybrid mortgages that have or will enter their adjustable period where the borrower is likely to experience an increase in their monthly payments could increase the likelihood of default. Moreover, higher loan-to-value ratios may result in lower recoveries upon foreclosure and an increase in net losses. A decline in property values is likely to impact recoveries on any second lien position included in the mortgage pools underlying certain RMBS.

- (vi) *Risk of Collateral Underlying RMBS* — The collateral underlying the RMBS assets purchased for the Fund's portfolio may be distressed and not performing as anticipated when the securities were originated. Also, these securities may have lost their initial investment grade rating because of changes in the credit performance of the underlying collateral. For example, the Fund may invest in “super senior” RMBS structures that were originally rated “AAA” by Standard & Poor's or an equivalent rating by a nationally recognized rating organization without ratings enhancement. Such assigned credit ratings may decline to a rating that is below investment grade if losses in the underlying collateral are in excess of the nationally recognized rating organization's initial assumptions; this has occurred in the case of many RMBS recently. Investments of this type involve substantial financial business risks that can result in substantial or total losses. Among the concerns involved in investments in troubled issuers is the fact that it frequently may be difficult to obtain information as to the conditions of such issuers. The market prices of such securities are also subject to abrupt and erratic market movements and above average price volatility and the spread between the bid and ask prices of such securities may be greater than normally expected. It may take a

number of years for the market price of such securities to reflect their intrinsic value. It is anticipated that some of the portfolio securities of the Fund may not be widely traded and that the Fund's position in such securities may be substantial in relation to the market for the securities.

The Investment Adviser generally attempts to assess all of the foregoing risk factors, and others, in determining the nature and extent of the investment the Fund will make in specific securities. However, many risks, such as the outcome of governmental approvals or the outcome of pending or threatened litigation, cannot be quantified.

- (vii) *Risks of CMBS Generally* — The Fund may invest in CMBS, which are securities backed by obligations (including certificates of participation in obligations) that are principally secured by interests in real property having a multi-family or commercial use, such as regional malls, other retail space, office buildings, industrial or warehouse properties, hotels, nursing homes and senior living centers. CMBS are issued in public and private transactions by a variety of public and private issuers using a variety of structures, including senior and subordinated classes. CMBS may provide for the repayment of all or substantially all of the principal only at maturity. Commercial mortgage lenders typically look to the debt service coverage ratio of a mortgage secured by income-producing property as an important measure of the risk of default on a mortgage. Commercial property values and net operating income are subject to volatility and net operating income may be sufficient or insufficient to cover debt service on the related mortgage at any given time. The repayment of mortgages secured by income-producing properties is typically dependent upon the successful operation of the related real estate project as well as upon the value of the underlying real estate. The value of commercial real estate is also subject to a number of laws and regulations, such as regulations and laws regarding environmental clean-up and limitations on remedies imposed by bankruptcy laws and state laws regarding foreclosures and rights of redemption.

Most CMBS are effectively non-recourse obligations of the borrower, meaning that there is no recourse against the borrower's assets other than the collateral. If borrowers are not able or willing to refinance or dispose of encumbered property to pay the principal and interest owed on such mortgages, payments on the subordinated classes of the related CMBS are likely to be adversely affected. The ultimate extent of the loss, if any, to the subordinated classes of the CMBS may only be determined after a negotiated discounted settlement, restructuring or sale of the mortgage note, or the foreclosure (or deed-in-lieu of foreclosure) of the mortgage encumbering the property and subsequent liquidation of the property. Foreclosure can be costly and delayed by litigation and/or bankruptcy. Factors such as the property's location, the legal status of title to the property, its physical condition and financial performance, environmental risks, and governmental disclosure requirements with respect to the condition of the property may make a third party unwilling to purchase the property at a foreclosure sale or to pay a price sufficient to satisfy the obligations with respect to the related loan. Revenues from the assets underlying such CMBS may be retained by the borrower and the return on investment may be used to make payments to others, maintain insurance coverage, pay taxes or pay maintenance costs. A CMBS may pay fixed or floating rates of interest. A fixed-rate CMBS, like all fixed income securities, generally declines in value as rates rise. Moreover, although generally the value of fixed-income securities increases during periods of falling interest rates, the inverse relationship may not be as marked in the case of CMBS due to the increased likelihood of prepayments during periods of falling interest rates. This effect is mitigated to some

degree for CMBS providing for a period during which no prepayments may be made. Certain CMBS loans lack regular amortization of principal, resulting in a single “balloon” payment due at maturity. If the underlying mortgage borrower experiences business problems, or other factors limit refinancing alternatives, such balloon payment mortgages are likely to experience payment delays or even default.

- (viii) *Prepayment Risks* — During periods of declining interest rates, prepayments of MBS can be expected to accelerate and the Fund would be required to reinvest the proceeds at the lower interest rates then available. Prepayments of mortgages that underlie securities purchased at a premium could result in capital losses because the premium may not have been fully amortized at the time the obligation is prepaid. In addition, like other interest-bearing securities, the values of MBS generally fall when interest rates rise, but when interest rates fall, their potential for capital appreciation is limited due to the existence of the prepayment feature.

The extent of prepayments of principal of the assets underlying MBS may be affected by a number of factors, including, without limitation, the availability of mortgage credit, the relative economic vitality of the area in which the related properties are located, the servicing of the underlying assets, possible changes in tax laws, other opportunities for investment, homeowner mobility and other economic, social, geographic, demographic and legal factors. In general, any factors that increase the attractiveness of selling a mortgaged property or refinancing enhance a borrower's ability to sell or refinance or increase the likelihood of default under a mortgage-related security would be expected to cause the rate of prepayment in respect of a pool of mortgage-related securities to accelerate. In contrast, any factors having an opposite effect would be expected to cause the rate of prepayment of a pool of mortgage-related securities to slow.

The rate of prepayment on a pool of MBS is likely to be affected by prevailing market interest rates for mortgages of a comparable type, term and risk level. When the prevailing market interest rate is below a mortgage coupon, a borrower generally has an increased incentive to refinance. Even in the case of assets with an adjustable-rate component, as prevailing market interest rates decline, and without regard to whether the mortgage rates on such assets decline in a manner consistent therewith, the related borrowers may have an increased incentive to refinance for purposes of either (i) converting to a fixed-rate security and thereby “locking in” such rate or (ii) taking advantage of a different index, margin or rate cap or floor on another adjustable rate note. Therefore, as prevailing market interest rates decline, prepayment speeds would be expected to accelerate.

- (ix) *Geographic Concentration of Mortgage Loans* — The mortgage loans in which the Fund indirectly invests through RMBS, CMBS or other financial instruments may be concentrated in a specific state or states. Weak economic conditions in these locations or any other location (which may or may not affect real property values), may affect the ability of borrowers to repay their mortgage loans on time. Properties in certain jurisdictions may be more susceptible than homes located in other parts of the country to certain types of uninsurable hazards, such as earthquakes, as well as floods, hurricanes, wildfires, mudslides and other natural disasters. Declines in the residential real estate market of a particular jurisdiction may reduce the values of properties located in that jurisdiction, which would result in an increase in the loan-to-value ratios. Any increase in the market value of properties located in a particular jurisdiction would reduce the loan-to-value ratios of the mortgage loans and could, therefore, make

alternative sources of financing available to the borrowers at lower interest rates, which could result in an increased rate of prepayment of the mortgage loans. Natural disasters, such as wildfires, severe storms and flooding affecting regions of the United States from time to time may result in prepayments of mortgage loans. Properties located in certain parts of the southern and eastern United States may have been damaged by the hurricanes and tropical storms that recently affected those areas. In addition, certain areas in the United States, including, without limitation, New York City, Washington, D.C., Boston and Los Angeles and their surroundings and near energy and military infrastructure, may be considered at risk with respect to terrorist attacks, which could affect property values and rates of loan default and delinquency.

- (x) *Originators and Servicers of Mortgage-Related Securities May Experience Financial Difficulties* — Pooled MBS acquired by the Fund may be affected by originators and servicers (including those owned by the Fund) of mortgage-related securities experiencing serious financial difficulties and, in some cases, entering bankruptcy proceedings. These difficulties may result in part from: (i) declining markets for mortgage-related securities held on their balance sheets; (ii) increasing claims for repurchases of mortgage-related securities previously sold under provisions that require repurchase in the event of early payment defaults or for breaches of representations regarding quality; (iii) increasing costs of servicing a delinquent portfolio without a corresponding increase in servicing compensation; (iv) declining value of any residual interests retained by sellers of mortgages in the securitization market and (v) declining real estate values, which reduces the number of borrowers seeking or able to refinance their mortgages and results in a decrease in overall originations.

The terms of certain MBS may also provide that the servicer is required to make advances in respect of delinquent mortgages. However, servicers experiencing financial difficulties may not be able to perform these obligations. Even if a servicer were able to advance amounts in respect of delinquent mortgages, its obligations to make such advances may be limited to the extent that it does not expect to recover such advances due to the deteriorating credit of the delinquent mortgages. In addition, a servicer's obligations to make such advances may be limited to the amount of its servicing fee.

Any regulatory oversight, proposed legislation and/or governmental intervention designed to protect consumers may have an adverse impact on originators and servicers. These factors, among others, may have the overall effect of increasing costs and expenses of originators and servicers, while at the same time decreasing servicing cash flow and loan origination revenues. Such financial difficulties may have a negative effect on the ability of servicers to pursue collection on mortgages that are experiencing increased delinquencies and defaults and to maximize recoveries on sale of underlying properties following foreclosure.

Investors will be entitled to remove and replace the existing servicer under certain circumstances, including a failure to perform its servicing obligations, a bankruptcy of the servicer and, in some cases, if certain loss and/or delinquency triggers are exceeded. While transactions typically enlist a reputable "backup servicer," there is no guarantee that a suitable servicer could be found to assume the obligations of the existing servicer. The transition of servicing responsibilities to a replacement servicer could have an adverse effect on performance of servicing functions during or following a transition period and result in an increase in delinquencies and losses and a decrease in recoveries.

The Fund may purchase a portion of MBS consisting of RMBS that were originated or are serviced (or both) by mortgage companies that are currently in bankruptcy proceedings or subject to regulatory enforcement actions which have restricted the ability of such mortgage companies or its affiliates to originate mortgage-related securities and/or affect their ability to service or subservice such securities. Servicers who have sought bankruptcy protection may, due to the application of applicable bankruptcy laws, no longer be required to make service advances.

- (xi) *Credit Support Limitations* — The amount, type and nature of insurance policies, subordination, letters of credit and other credit support, if any, with respect to certain MBS and other financial instruments that the Fund will purchase are based upon actuarial analysis. There can be no assurance that the historical data supporting such actuarial analysis will accurately reflect future experience nor any assurance that the data derived from a large pool of mortgage-related securities or other assets accurately predicts the delinquency, foreclosure or loss experience of any particular pool of such securities.

Stripped Mortgage-Backed Securities, Residuals and other Mortgage-Backed Securities Derivatives. The Fund may invest in IOs, MTA IOs and IIOs, which are “strips” or “tranches” of stripped mortgage-backed securities (“**SMBS**”). The market for SMBS was developed specifically to reallocate the various risks inherent in MBS across various bond classes (“**tranches**”). SMBS consists of “strips” such as principal-only strips (“**POs**”) and IOs and MTA IOs in a pass-through structure or as tranches of certain MBS. In SMBS, all of the interest is distributed to holders of IOs and the entire principal is distributed to holders of POs. The yields to maturity on IOs and POs are very sensitive to the rate of principal payments (including prepayments) on the related underlying mortgage assets. If the underlying mortgage assets experience greater than anticipated prepayments of principal, the Fund may not fully recoup its initial investment in IOs. Conversely, if the underlying mortgage assets experience less than anticipated prepayments of principal, the yield on POs could be materially and adversely affected. IIOs are inverse IOs and IIOs experience greater variability of returns relative to changes in interest rates.

The coupon on many IIOs is calculated by subtracting a benchmark rate, typically the one month London Interbank Offering Rate (“**LIBOR**”) from a predetermined strike rate. Thus, an increase in the one month LIBOR will decrease the coupon of the financial instrument. Therefore, the value of an IIO is affected by the projected future LIBOR, or the “**LIBOR curve**.” Because an IIO floats inversely to LIBOR, the sensitivity of the market price to LIBOR is larger for IIOs than for most other debt instruments. When LIBOR increases, the IIO will decrease in value not only because the discounter (or opportunity cost) increases, but also because the IIO’s coupon cash flow decreases. Most problematic is if LIBOR increases beyond the predetermined IIO strike price, in which case the coupon equals zero, and all cash flow from the IIO ceases. In the event that LIBOR rates and forward LIBOR rates rise rapidly, these investments will incur substantial losses as the prices IIOs fall steeply.

The Fund may also invest in residuals of MBS. The cash flow generated by MBS (including SMBS) is applied first to make required payments of principal of and interest on the MBS and second, if applicable, to pay the related administrative expenses of the issuer. The residual in a MBS generally represents the interest in any excess cash flow remaining after making the foregoing payments, including mortgage servicing contracts. There is no guarantee that any residual will exist to pay the residual interest holders and thus the Fund may fail to recoup fully its initial investment in a residual.

To the extent that the Fund concentrates its investments in these or other “derivative” securities, the prepayment risks, interest rate risks and hedging risks associated with such securities will be severely magnified.

Collateralized Loan Obligations and Collateralized Debt Obligations. The Fund may invest in CLOs and/or CDOs. CLOs and CDOs issue classes or “tranches” of debt and equity that vary in risk and yield, and may experience substantial losses due to actual defaults, decrease of market value due to collateral defaults and the erosion or disappearance of subordinate tranches, market anticipation of defaults and investor aversion to CLO and CDO securities as a class. The risks of investing in CLOs and CDOs depend largely on the type of the underlying collateral. There is no public market for interests in CLOs and CDOs and such interests may be difficult to sell at an advantageous price or time.

Net Interest Margin Securities. The Fund may invest in NIMS, which are securities that allows their holders to access excess cash flows from securitized mortgage loan pools. In a typical NIMS transaction, excess cash flows from the securitized mortgage loan pools (but not any underlying mortgages or any other assets) are transferred to a trust account. Investors in NIMS receive interest payments from this trust account. The bigger the difference in these interest rates, the more the excess cash flows generated by the MBS and consequently the higher the value of the NIMS. Conversely, the value of the NIMS can decline rapidly if there is a significant increase in the default rate of the mortgages held in the MBS and a subsequent decrease in excess cash flows. Further, one or more insurance companies (together, the “**NIMS Insurer**”) may issue a financial guaranty insurance policy covering certain payments to be made on NIMS. The NIMS Insurer, if any, will be granted these rights, which may, in certain cases, be superior to the rights of any single holder of such NIMS in order to obtain their guaranty of the payment obligations of the issuing entity for the NIMS.

Investment in Loans. The Fund may invest in loans. Investing in loans entails the following risks:

- (xii) *General Credit Risks* — The Fund may be exposed to losses resulting from default and foreclosure. The value of the underlying collateral, if any, the creditworthiness of the borrower and the priority of the lien are each of great importance (although the Fund may invest in subordinate or second priority liens). There is no assurance that the Fund will correctly evaluate the value of the assets collateralizing the loans or the prospects for a successful reorganization or similar action. In any reorganization or liquidation proceeding relating to a company in which the Fund has funds, the Fund may lose all or part of the amounts advanced to the borrower. The Fund cannot guarantee the adequacy of the protection of the Fund’s interests, including the validity or enforceability of the loan and the maintenance of the anticipated priority and perfection of the applicable security interests. Furthermore, the Fund cannot assure that claims may not be asserted that might interfere with enforcement of the Fund’s rights. In the event of a foreclosure, the Fund or an affiliate of the Fund may assume direct ownership of the underlying asset. The liquidation proceeds upon sale of such asset may not satisfy the entire outstanding balance of principal and interest on the loan, resulting in a loss to the Fund. Any costs or delays involved in the effectuation of a foreclosure of the loan or a liquidation of the underlying property will further reduce the proceeds and thus increase the loss.
- (xiii) *Lower Credit Quality Loans* — There are no restrictions on the credit quality of the Fund’s loans. Loans purchased by the Fund may be deemed to have substantial vulnerability to default in payment of interest and/or principal. Certain of the loans

which the Fund may fund have large uncertainties or major risk exposures to adverse conditions and may be considered to be predominantly speculative. Generally, such loans offer a higher return potential than better quality loans, but involve greater volatility of price and greater risk of loss of income and principal. The market values of certain of these loans also tend to be more sensitive to changes in economic conditions than better quality loans.

- (xiv) *Lender Liability* — In recent years, a number of judicial decisions in the U.S. have upheld the right of borrowers to sue lending institutions on the basis of various evolving legal theories (collectively termed “**lender liability**”). Generally, lender liability is founded upon the premise that an institutional lender has violated a duty (whether implied or contractual) of good faith and fair dealing owed to the borrower or has assumed a degree of control over the borrower resulting in a creation of a fiduciary duty owed to the borrower or its other creditors or shareholders. While believed to be unlikely, because of the nature of certain of the Fund’s investments, the Fund could be subject to allegations of lender liability.
- (xv) *Loan Participations and Assignments* — The Fund may invest in fixed- and floating-rate loans, which investments generally will be in the form of loan participations and assignments of portions of such loans. Participations and assignments involve special types of risk, including credit risk, interest rate risk, liquidity risk and the risks of being a lender. Participations in commercial loans may be secured or unsecured. Loan participations typically represent direct participation in a loan to a corporate borrower and, generally, are offered by banks or other financial institutions or lending syndicates. When purchasing loan participations, the Fund assumes the credit risk associated with the corporate borrower and may assume the credit risk associated with an interposed bank or other financial intermediary may only be able to enforce its rights through the lender and may assume the credit risk of the lender in addition to the borrower. The participation interests in which the Fund invests may not be rated by any nationally recognized rating service. Investments in loans through a direct assignment of a financial institution’s interests with respect to the loan may involve additional risks to the Fund. For example, if a loan is foreclosed, the Fund could become part owner of any collateral and would bear the costs and liabilities associated with owning and disposing of the collateral. In addition, it is conceivable that, under emerging legal theories of lender liability, the Fund could be held liable as a co-lender. It is unclear whether loans and other forms of direct indebtedness offer securities laws protections against fraud and misrepresentation. In the absence of definitive regulatory guidance, the Fund relies on the Investment Adviser’s research in an attempt to avoid situations where fraud or misrepresentation could adversely affect the Fund.
- (xvi) *Liquidity* — Loans and interests in loans have significant liquidity risks and market value risks since they are not generally traded in organized exchange markets, but are traded by banks and other institutional investors engaged in loan syndications. Because loans are privately syndicated and loan agreements are privately negotiated and customized, loans are not purchased or sold as easily as publicly traded securities.
- (xvii) *Fraud* — Of paramount concern in purchasing loans is the possibility of material misrepresentation or omission on the part of borrower. Such inaccuracy or incompleteness may adversely affect the valuation of the collateral underlying the loans or may adversely affect the ability of the Fund to perfect or effectuate a lien on the collateral securing the loan. The Fund will rely upon the accuracy and completeness of representations made by borrowers to the originator of such loans to the extent

reasonable, but cannot guarantee such accuracy or completeness. Under certain circumstances, payments to the Fund may be reclaimed if any such payment or distribution is later determined to have been a fraudulent conveyance or a preferential payment.

U.S. State Laws. Applicable U.S. state laws generally regulate interest rates and other charges, require certain disclosures and may require licensing of loan originators from whom or from which the Fund may acquire financial instruments. In addition, other state laws, public policy and general principles of equity relating to the protection of consumers, unfair and deceptive practices and debt collection practices may apply to the collection of principal and/or interest under the financial instruments invested in by the Fund.

Manufactured Housing Securities. Mortgage loans secured by liens on manufactured housing properties pose risks not associated with mortgage loans secured by liens on other types of income-producing real estate. The successful operation of a manufactured housing property may depend upon the number of other competing residential developments in the local market, such as: (i) other manufactured housing properties; (ii) apartment buildings and (iii) site-built, single-family homes. Other factors may also include: (i) the physical attributes of the community, including its age and appearance; (ii) the location of the manufactured housing property; (iii) the ability of management to provide adequate maintenance and insurance; (iv) the type of services or amenities it provides; (v) the property's reputation; (vi) restrictions on the age of tenants that may reside at the property and (vii) state and local regulations, including rent control and rent stabilization.

Some of the manufactured housing mortgaged properties may require that residents be 55 years of age or older, thereby limiting the potential tenant pool. The manufactured housing properties are "special purpose" properties that could not be readily converted to general residential, retail or office use. Thus, if the operation of any of such manufactured housing properties becomes unprofitable due to competition, age of the improvements or other factors such that the related borrower becomes unable to meet its obligations on the related mortgage loan, the liquidation value of that manufactured housing property may be substantially less, relative to the amount owing on the related mortgage loan, than would be the case if the manufactured housing property were readily adaptable to other uses.

Settlement Interests. The Fund may purchase settlement interests of plaintiffs involved in lawsuits regarding mortgages and mortgage-related products. To accomplish this, the Fund will enter into a contract whereby the Fund buys the settlement interest for a sum of cash. The Fund takes the risk of non-performance by the other party to the contract. This risk may differ materially from those entailed in exchange-traded transactions that generally are supported by guarantees of clearing organizations, daily marking-to-market and settlement and segregation and minimum capital requirements applicable to intermediaries. Transactions entered directly between two counterparties generally do not benefit from such protections and expose the parties to the risk of counterparty default. The following are some of the types of counterparty risk that the Fund assumes:

- (i) *Counterparty Risk of Settlement Interest Contracts* — Unlike traditional purchase and sale contracts, under which the buyer may have collections directed into an account that is outside the control of the entity selling the accounts receivable, the Fund is often not able to utilize a similar mechanism because of certain state bar association rules governing the collection of client fees when purchasing settlement interests. Thus, although the Fund is the legal and beneficial owner of the settlement interests, the settlement interests generally will be deposited with the plaintiff's law firm's escrow

account, not in the Fund's account. This creates two levels of possible counterparty risk — first, with the underlying plaintiffs and second with the law firms themselves.

All of the settlement interests purchased by the Fund arise out of litigation in which a settlement agreement or memorandum of understanding among the parties has been reached or a judgment has been entered against a judgment debtor. As a result, the first level of credit risk to the Fund is dependent primarily upon the financial capacity of the plaintiff to pay the amounts due regarding the settlement interests. Provided that the judgment debtor makes the payment (which it may not for reasons, including, without limitation, bankruptcy), disbursements of settlement interests generally are made by parties independent of the plaintiff, such as a claims administrator, insurance carrier, Fortune 500 company or the plaintiff's attorney, mitigating the risk of nonpayment by the plaintiff (i.e., the plaintiff has no control of the cash flow). However, in a situation wherein the plaintiff's settlement interest is paid to the plaintiff or the plaintiff's attorney, the Fund only will have recourse to the plaintiff and his or her attorney if the attorney paid the settlement interest in contravention to the terms and provisions of the purchase and sale agreement.

Even if the settlement interest is properly disbursed, the payment is generally disbursed first to the plaintiff's law firm's escrow account, which provides an accounting to the Fund regarding the sums owed to the Fund. This process subjects the Fund to the potential of default by the law firm should it not remit the proceeds to the Fund as required by the contract. Although the Fund attempts to obtain direct payment or notification of disbursement of the case proceeds from either the applicable party or from another attorney involved in the case, the Fund may have to litigate its interest against a defaulting law firm and there is no assurance that the Fund will be able to successfully mitigate this risk in the future.

- (ii) *Fraud Risk* — As discussed above, although the Fund is the legal and beneficial owner of the settlement interests, the Fund is often unable to direct the proceeds from the settlement interests into a “lock box” account. Thus, a fraudulent law firm may improperly take funds from its clients' escrow account (including funds owed to the Fund). Although the Fund will litigate to realize its interest in the settlement interests, not only is the litigation cost expensive, but the Fund may be unable to recover the full amount it is owed, leading to losses for the Fund.
- (iii) *Payment Risk* — Although the Fund believes that it thoroughly documents the advance payment for settlement interests through a purchase and sale agreement, an administrator of class action settlement funds may negligently disburse funds to the plaintiffs (or to plaintiffs' law firm), rather than to the Fund. Although the Fund will litigate to realize its interest in the settlement interests, not only is the litigation cost expensive, but the Fund may be unable to recover the full amount it is owed, leading to losses for the Fund.
- (iv) *Litigation and Collection Costs* — Should the Fund need to collect on a defaulted contract, litigation could result. There is a high cost associated with any litigation and the results of litigation are always uncertain. Even before litigation is commenced, the Fund could experience substantial costs in trying to collect on defaulted investments, such as legal fees, collection agency fees or discounts related to the assignment of a defaulted contract to a third party.

Non-U.S. Securities. The Fund may invest in securities of non-U.S. issuers (including in European and Canadian RMBS pools). Investing in securities of non-U.S. issuers involves certain considerations comprising both risks and opportunities not typically associated with investing in securities of United States issuers, including, without limitation, risks relating to (i) currency exchange matters, including fluctuations in the rate of exchange between the United States dollar and the various non-U.S. currencies in which the Fund's portfolio securities will be denominated and costs associated with conversion of investment principal and income from one currency into another; (ii) differences between the United States and non-U.S. securities markets, including potential price volatility in and relative illiquidity of some non-U.S. securities markets, the absence of uniform accounting, auditing and financial reporting standards, practices and disclosure requirements, less government supervision and regulation, higher transaction costs and difficulty in enforcing contractual obligations; (iii) certain economic and political risks, including potential exchange control regulations and potential restrictions on foreign investment and repatriation of capital, political and social instability, expropriation, nationalization of issuers, voiding or non-performance of government contracts or obligations and (iv) the possible imposition of withholding taxes on income received from or gains with respect to such securities.

Hedging Transactions. The Investment Adviser may utilize financial instruments, for investment purposes and for risk management and hedging purposes in order to, among other things, (i) protect against possible changes in the market value of the Fund resulting from fluctuations in the securities markets and changes in interest rates; (ii) protect against volatility risk and the unrealized gains of the Fund in the value of its investment portfolio; (iii) facilitate the sale of any such investments; (iv) manage the duration of the investments of the Fund; (v) hedge the interest rate on any of the liabilities or assets of the Fund or (vi) for any other reason that the Investment Adviser deems appropriate. Since the characteristics of many financial instruments change as markets change or time passes, the success of the Fund's hedging strategy will also be subject to the Investment Adviser's ability to continually recalculate, readjust and execute hedges in an efficient and timely manner. While the Fund may enter into hedging transactions to seek to reduce risk, such transactions may result in a poorer overall performance for the Fund than if it had not engaged in any such hedging transactions. For a variety of reasons, the Investment Adviser may not seek to hedge certain (or any) holdings or may not seek to establish a perfect correlation between such hedging instruments and the holdings being hedged. Such imperfect correlation may prevent the Fund from achieving the intended hedge or expose the Fund to risk of loss. Moreover, it should be noted that the portfolio will always be exposed to certain risks that cannot be hedged, such as credit risk (relating both to particular financial instruments and counterparties) and "widening" risk.

Although risk management and monitoring is an integral component of the Investment Adviser's strategy, the Investment Adviser is not subject to any specific risk management or portfolio diversification policies in managing the Fund's portfolio. To the extent that the Investment Adviser engages in transactions intended to hedge certain of the Fund's market risks, the Fund may have exposure to movements of indices, economies or other market characteristics. The Investment Adviser does not expect to attempt to hedge all, or even most, of such risks. In fact, a number of the risks to which the Fund's portfolio is subject cannot be effectively hedged.

Derivatives Risk. The Fund may use various derivative instruments, including options, futures, forward contracts, structured investments and other derivatives, which may be volatile and speculative. Derivatives may be either traded over exchanges (e.g., futures) or through "interdealer" or "over-the-counter" markets (e.g., forwards). Certain positions may be subject to wide and sudden fluctuations in market-value, with a resulting fluctuation in the amount of profits and losses. Use of derivative instruments presents various risks, including the following:

- (xviii) *Tracking* — When used for hedging purposes, an imperfect or variable degree of correlation between price movements of the derivative instrument and the underlying investment sought to be hedged may prevent the Fund from achieving the intended hedging effect or expose the Fund to the risk of loss.
- (xix) *Liquidity* — Derivative instruments, especially when traded in large amounts, may not be liquid in all circumstances, so that in volatile markets the Fund may not be able to close out a position without incurring a loss.
- (xx) *Leverage* — Trading in derivative instruments can result in large amounts of leverage. Thus, the leverage offered by trading in derivative instruments may magnify the gains and losses experienced by the Fund and could cause its net asset value to be subject to wider fluctuations than would be the case if the Fund did not use the leverage feature in derivative instruments. See “Risk Factors – Leverage” above.
- (xxi) *Volatility* — The prices of derivative instruments can be highly volatile. Certain positions may be subject to wide and sudden fluctuations in market value, with a resulting fluctuation in the amount of profits and losses. Price movements of derivative contracts in which the assets of the Fund may be invested are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments and national and international political and economic events and policies. In addition, governments, from time to time, intervene, directly and by regulation, in certain markets, particularly those in currencies, securities, futures and options. Such intervention often is intended directly to influence prices and may, together with other factors, cause all of such markets to move rapidly in the same direction. No assurance can be given that the Fund will be profitable or that it will not incur substantial losses.
- (xxii) *Exchange-Traded Derivatives* — Many futures exchanges limit daily price fluctuations in futures contracts, in which case no trades may be executed at a price beyond the daily limit. Once the price of a particular futures contract has increased or decreased its daily limit, positions in the futures contract can be neither initiated nor liquidated unless traders are willing to execute trades at or within the limit. Futures prices have occasionally moved the daily limit for several consecutive days with little or no trading. Similar occurrences in the future might prevent prompt liquidation of unfavorable positions and result in substantial losses, which could exceed the margin initially committed to such positions. Even in the absence of a limit price movement, it may occasionally not be possible to execute futures and options trades at favorable prices if little trading in contracts is taking place. It is also possible that an exchange or a regulator may suspend or limit trading in a particular contract, order immediate settlement of a particular contract or order that trading in a particular contract be conducted for liquidation only.

Certain U.S. and non-U.S. exchanges may impose position limits with respect to the maximum net long or net short positions that any person may hold or control. While the Investment Adviser presently believes that established position limits would not adversely affect its trading decisions, it is possible that its trading decisions may have to be modified and that positions held by the Fund could have to be liquidated to avoid exceeding such limits.

- (xxiii) *Over-the-Counter Trading* — Certain derivative instruments may not be traded on an exchange and may not be cleared by a central counterparty. Uncleared, over-the-

counter instruments that may be purchased or sold by the Fund may include, without limitation, foreign currency contracts, forwards and certain swap transactions. Over-the-counter instruments, unlike exchange traded instruments, are two party contracts with price and other terms negotiated by the buyer and the seller. The risk of non-performance by the obligor on such an instrument that is not cleared through a central counterparty may be greater and the ease with which the Fund can dispose of or enter into closing transactions with respect to such an instrument may be less than in the case of an exchange traded instrument or cleared swap. Because performance of uncleared over-the-counter instruments is not guaranteed by any exchange or clearinghouse, the Fund will be subject to the risk of the inability or refusal to perform with respect to such financial instruments on the part of the counterparties with which they trade. Any such failure or refusal, whether due to insolvency, bankruptcy or other causes, could subject the Fund to substantial losses.

- (xxiv) *Regulation* — Financial instruments not traded on exchanges are also not subject to the same type of government regulation as exchange traded instruments and many of the protections afforded to participants in a regulated environment may not be available in connection with such transactions. The counterparty to an over-the-counter instrument entered into by the Fund may not be subject to the same credit evaluation and regulatory oversight as are members of exchange based markets. The same may be true with respect to financial instruments traded on certain types of alternative exchanges (e.g., exempt commercial markets) that are less regulated than traditional securities, commodities and futures exchanges.

The Dodd-Frank Act created a new, comprehensive U.S. regulatory regime for certain U.S. derivatives markets that currently is being introduced in stages. The new U.S. regulatory requirements include mandatory exchange trading and clearing of certain types of over-the-counter derivative transactions, limits on the size of derivative positions that can be held by a single person, increased margin and capital requirements, and enhanced conduct standards for uncleared derivatives. Unlike over-the-counter derivative transactions, cleared derivatives will be contracts between the Fund and a regulated clearing house and will have some of the risk factors previously associated exclusively with futures contracts. The impact of these changes on the Fund cannot be predicted with certainty, but could adversely affect its business by increasing its operating costs and limiting its ability to conduct certain U.S. derivatives transactions.

- (xxv) *Market Conditions* — Recent events in the financial markets resulting in the failure of large institutions that serve as counterparties to many over-the-counter financial instruments have resulted in greater illiquidity of such instruments and heightened concern for counterparty risk.

Options. An option is a right, purchased for a certain price, to buy or sell the underlying instrument, asset or product (the “**underlying**”) during or at the end of a certain period of time for a fixed price. The risks in trading options are different from the risks in trading the underlying and trading in options can provide a greater potential for profit or loss than an equivalent investment in the underlying. For example, if the Fund buys an option, it will be required to pay a “premium” representing the market value of the option. The value of an option may decline because of a decline in the value of the underlying relative to the strike price, the passage of time, changes in the market’s perception as to the future price behavior of the underlying or any combination thereof. Unless the price of the underlying changes and it becomes profitable to exercise or offset the option before it expires, the Fund may lose the entire amount of the

premium. Conversely, if the Fund sells an option, it will be credited with the premium, but will have to deposit margin due to its contingent liability to deliver or accept the underlying in the event that the option is exercised. Sellers of certain options are subject to unlimited risk of loss, as the sellers will be obligated to deliver or take delivery of an asset at a predetermined price that may, upon exercise of the option, be significantly different from the then-market value. The ability to trade in or exercise options may be restricted in the event that trading in the underlying becomes restricted.

During the option period, the covered call writer has, in return for the premium on the option, given up the opportunity to profit from a price increase in the underlying security above the exercise price, but, as long as its obligation as a writer continues, has retained the risk of loss should the price of the underlying security decline. The writer of an option has no control over the time when it may be required to fulfill its obligation as a writer of the option. Once an option writer has received an exercise notice, it cannot effect a closing purchase transaction in order to terminate its obligation under the option and must deliver the underlying security at the exercise price. If a put or call option purchased by the Fund is not sold when it has remaining value and, if the market price of the underlying security remains equal to or greater than the exercise price (in the case of a put), or remains less than or equal to the exercise price (in the case of a call), the Fund will lose its entire investment in the option. Also, where a put or call option on a particular security is purchased to hedge against price movements in a related security, the price of the put or call option may move more or less than the price of the related security.

Structured Investments. The Fund may purchase structured investments (such as swaps, options or other derivative instruments) that are indexed to a return on a collective investment vehicle. The value of structured investments depends largely upon price movements in the vehicle to which such structured investments are linked. Therefore, many of the risks applicable to the underlying asset (i.e., the hedge funds themselves) are also applicable to the structured investments. However, there are other risks associated with the structured investments. Structured investments expose the Fund to the credit risk of the parties with which it deals. Non-performance by parties of the obligations or contracts underlying the structured investments could expose the Fund to losses, whether or not the transaction itself was profitable. Structured investments may expose the Fund to additional liquidity risks as there may not be a liquid market within which to close or dispose of outstanding obligations or contracts. Structured investments may also be highly leveraged.

Forward Contracts on Foreign Currencies. The Fund may engage in interbank spot and forward contract markets for foreign currencies. Forward contracts are not traded on exchanges; rather, a bank or dealer will act as agent or as principal in order to make or take future delivery of a specified lot of a particular currency for the Fund's account. Although the Investment Adviser does not believe that the foreign currency market is necessarily more volatile than other commodity markets, such forward currency transactions may involve less protection against defaults than trading on exchanges. No governmental agency or any banking authority regulates the trading of forward contracts, although these contracts may be subject to certain margin limitations. The Fund is subject to the risk of a principal's failure or inability or refusal to perform with respect to such contracts. The failure of a principal with which the Fund has contracted would likely result in a default, thereby depriving the Fund of unrealized profits or forcing the Fund to cover its commitments for resale, if any, at the then market price. Assets of the Fund on deposit with such principals generally are not protected by the same segregation requirements imposed on regulated commodity brokers with respect to customer funds on deposit with them. Forward contracts will be transacted only with banks and dealers that the Investment Adviser believes to be large and well capitalized. If the Investment Adviser places trades for the Fund through an agent, the insolvency or bankruptcy of such party could also subject the Fund to the risk of loss.

Principals in the forward markets have no obligation to continue to make markets in currencies. There have been periods during which certain banks or dealers have refused to quote prices for forward contracts or have quoted prices with an unusually wide spread between the price at which they are prepared to buy and that at which they are prepared to sell. Government authorities may limit forward trading to levels below those preferred by the Investment Adviser.

Illiquid Investments. The financial instruments and other assets in which the Fund invests include assets that are subject to legal or contractual restrictions on their resale (e.g., financial instruments issued by privately held entities) for which there is a relatively inactive trading market, making purchases or sales at desired prices or in desired quantities difficult or impossible or are otherwise not generally traded on or through organized markets, but rather among banks and other institutional investors on an individually negotiated basis. Further, as part of its emergency powers, an exchange or regulatory authority can suspend or limit trading in a particular instrument, order immediate liquidation and settlement of a particular contract or order that trading in a particular contract be conducted for liquidation only. The possibility also exists that governments may intervene to stabilize or fix exchange rates, restricting or substantially eliminating trading in the affected currencies. Illiquid financial instruments may be required to be held for a lengthy period of time and often require more time to sell and result in higher brokerage charges or dealer discounts and other selling expenses than does the sale of financial instruments eligible for trading on national securities exchanges or for which there is an active over-the-counter market. In addition, due to thin trading in certain financial instruments or assets, investments in such financial instruments or assets may be less liquid than alternative investments for which there is a more active trading market, which could cause the Fund to suspend Net Asset Value calculations and/or withdrawals. Therefore, the Fund's investments in illiquid or thinly traded financial instruments or assets may reduce the returns of the Fund because it may be unable to sell the illiquid or thinly traded financial instruments or assets at an advantageous time or price. Also, the size of the Fund's positions may magnify the effect of a decrease in market liquidity for the financial instruments it trades. As in the past, changes in the overall market leverage (e.g., deleveraging or liquidations by other market participants of the same or similar positions) also may adversely affect the Fund's positions.

Sovereign Debt Risk. The Fund may invest in debt securities of sovereign nations or of their agencies or instrumentalities ("**Sovereign Debt**"). Investments in Sovereign Debt securities involve special risks. The governmental authority that controls the repayment of the debt may be unwilling or unable to repay the principal and/or interest when due in accordance with the terms of such securities due to: the extent of its foreign reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole or the government debtor's policy towards the International Monetary Fund and the political constraints to which a government debtor may be subject. If an issuer of Sovereign Debt defaults on payments of principal and/or interest, the Fund may have limited legal recourse against the issuer and/or guarantor. In certain cases, remedies must be pursued in the courts of the defaulting party itself and the Fund's ability to obtain recourse may be limited.

U.S. Government Securities. U.S. government securities are debt securities (including bills, notes and bonds) issued by the U.S. Treasury or issued by an agency or instrumentality of the U.S. government which is established under the authority of an Act of Congress. Such agencies or instrumentalities include, but are not limited to, Federal National Mortgage Association ("**Fannie Mae**"), the Federal Home Loan Mortgage Corporation ("**Freddie Mac**"), Government National Mortgage Association ("**Ginnie Mae**"), the Federal Farm Credit Bank and the Federal Home Loan Banks. Although all obligations of agencies, authorities and instrumentalities are not direct obligations of the U.S. Treasury, payment of the interest and principal on these obligations may be backed directly or indirectly by the U.S. government. This support can range from the backing

of the full faith and credit of the United States to U.S. Treasury guarantees or to the backing solely of the issuing instrumentality itself. In the case of securities not backed by the full faith and credit of the United States, the investor must look principally to the agency issuing or guaranteeing the obligation for ultimate repayment and may not be able to assert a claim against the United States itself in the event the agency or instrumentality does not meet its commitments.

“To-Be-Announced” Instruments. The Fund may invest and trade in the “to-be-announced” (“TBA”) market, which is essentially a forward or delayed delivery market in mortgage pass-through securities (i.e., an interest in a pool of mortgages). The mortgages underlying the pass-through securities in the TBA markets are issued or guaranteed by either Ginnie Mae, Fannie Mae or Freddie Mac.

The TBA market allows mortgage lenders effectively to sell the loans they intend to fund even before the loans are closed. This also allows the lender to lock in an interest rate for the borrower. Changes in interest rates and/or mortgage refinancing activity will affect the value of TBAs, that is, an increase in interest rates generally will cause their values to decline. In addition, because TBAs can be acquired with small amounts of margin, the effect of such leveraging could exacerbate losses to the Fund. However, because the actual mortgage pools comprising a given TBA contract are guaranteed by Ginnie Mae, Fannie Mae and/or Freddie Mac, the risk of counterparty default which is so material to an investment in other mortgage-related securities should not affect the Fund’s transactions in TBAs. In addition, because the mortgages underlying each TBA contract are not specified until the time of sale, the prepayment risk associated with other mortgage-related securities do not affect TBAs to the same extent.

Designated Investments. Designated Investments are subject to the same risks as other types of illiquid investments, including the risk that the Fund will be unable to sell such Designated Investments at a favorable time or price. The fair value of a Designated Investment may differ materially from its actual or realizable value. As a result, there can be no assurance that Limited Partners will not experience substantial or complete losses upon the Disposition of Designated Investments. In addition, Limited Partners generally may not withdraw the portion of their Interests participating in Designated Investments prior to Disposition of the underlying Designated Investments and, therefore, may have to retain their interests in such investments for years after they have otherwise entirely withdrawn from the Fund and irrespective of changes in their own or general economic conditions.

The Investment Adviser generally expects the Designated Investments to consist of small companies that the Investment Adviser believes that it can cause to be managed more effectively. There can be no assurance that the Investment Adviser is correct in its determination or that the Investment Adviser will successfully cause such companies to be more effectively managed. Further, to the extent that the companies that the Fund buys are originators or servicers, such firms themselves (and thus the Fund) may be exposed directly to the risks discussed in “Risks Relating to Investments in Mortgage-Backed Securities (“MBS”) – Originators and Servicers of Mortgage-Related Securities May Experience Financial Difficulties” above. In addition to limited liquidity, the possibility of limited information regarding such investments may make it difficult for the Administrator or the Investment Adviser to accurately value the underlying investment and may cause any resulting valuations to be inaccurate. Such inaccuracies could result in a higher amount of management fees payable by Limited Partners.

Additional Risks Associated with Originating Loans and Other Lending-Related Investments.

- (xxvi) *Credit Risks* — Through the purchase of loan originators, the Fund may indirectly originate loans. Extending credit involves the risk that some loans will not be repaid. The Investment Adviser will attempt to reduce its risk of loss, however, if the underlying company ultimately was forced to liquidate collateral, there could be no assurance that sufficient funds would be collected to avoid a loss.
- (xxvii) *Weak Economy Could Trigger Defaults* — Any substantial economic slowdown could increase delinquencies, defaults and foreclosures and reduce the originator's ability to originate loans. Periods of economic slowdown or recession may be accompanied by decreased demand for credit, decreased asset values and an increased rate of delinquencies, defaults and foreclosures. Any material decline in asset values would increase the loan-to-value ratios on loans that the Fund holds, weaken the Fund's collateral coverage and increase the possibility and severity of a loss if a borrower defaults. A lack of equity in a property may reduce the incentive a borrower has to meet its payment obligations during periods of financial hardship, which might result in higher delinquencies, defaults and foreclosures. These factors would reduce the originator's ability to originate loans and increase its losses on loans.
- (xxviii) *Risks of Extending Credit* — The risks associated with originating loans include the possible invalidation of a transaction as a fraudulent conveyance under creditors' rights laws, lender-liability claims by the issuer of the obligations and limitations on the ability of the originator to directly enforce its rights with respect to borrowers.

The originator and the Fund may incur lender liability as a result of its lending activities. In recent years, a number of judicial decisions have upheld the right of borrowers to sue lending institutions on the basis of various evolving legal theories, collectively termed “**lender liability**.” Generally, lender liability is founded on the premise that a lender has either violated a duty, whether implied or contractual, of good faith and fair dealing owed to the borrower or has assumed a degree of control over the borrower resulting in the creation of a fiduciary duty owed to the borrower, its other creditors or shareholders or third parties harmed by the borrower. The originator and the Fund may be subject to allegations of lender liability, which could result in significant liability.

- (xxix) *Litigation and Collection Costs* — Should the originator need to collect on a defaulted loan, litigation could result. There is a high cost associated with any litigation and the results of litigation are always uncertain. Even before litigation is commenced, the originator (and thus, indirectly, the Fund) could experience substantial costs in trying to collect on defaulted investments, such as legal fees, collection agency fees or discounts related to the assignment of a defaulted loan to a third party.

Usury Limitations. Interest charged on loans owned by the Fund (which may include amounts received by the Fund from appreciation interests) may be subject to state usury laws imposing maximum interest rates and penalties for violation, including restitution of excess interest and unenforceability of debt.

Model Risk. Given the complexity of the investments and strategies of the Fund, the Investment Adviser relies on analytical models. Models are used to value investments or potential investments (whether for trading purposes or, potentially, for the purpose of calculating part of the Net Asset Value of the Fund and also in connection with the hedging of the investments of the Fund).

When models prove to be incorrect, misleading or incomplete, any decisions made in reliance thereon expose the Fund to potential risks. For example, by relying on models, especially valuation

models, the Investment Adviser may be induced to buy certain investments at prices that are too high, to sell certain other investments at prices that are too low or to miss favorable opportunities altogether. Similarly, any hedging based on faulty models may prove to be unsuccessful. Furthermore, when calculating the Net Asset Value of the Fund, any valuations of the Fund's investments that are based on valuation models may prove to be incorrect.

Some of the risks of relying on analytical models are particular to analyzing many mortgage-related products. These risks include, but are not limited to, the following: (i) collateral cash flows and/or liability structures may be incorrectly modeled in all or only certain scenarios, or may be modeled based on simplifying assumptions that lead to errors; (ii) information about collateral may be incorrect, incomplete, or misleading; (iii) collateral historical performance (such as historical prepayments, defaults, cash flows, etc.) may be incorrectly reported, or subject to interpretation (e.g., different issuers may report delinquency statistics based on different definitions of what constitutes a delinquent loan) or (iv) collateral information may be outdated, in which case the models may contain incorrect assumptions as to what has occurred since the date information was last updated.

Some of the analytical models used by the Investment Adviser may be predictive in nature. The use of predictive models has inherent risks. For example, such models may incorrectly forecast future behavior, leading to potential losses. In addition, the predictive models used by the Investment Adviser may differ substantially from those models used by other market participants, with the result that valuations based on these predictive models may be substantially higher or lower for certain investments than actual market prices. Furthermore, since predictive models are usually constructed based on historical data supplied by third parties, the success of relying on such models may depend heavily on the accuracy and reliability of the supplied historical data.

All valuation models rely on correct market data inputs. If incorrect market data is entered into even a well-founded valuation model, the resulting valuations will be incorrect. However, even if market data is entered correctly, "model prices" will often differ substantially from market prices, especially for securities with complex characteristics, such as derivatives.

Data Security. Big Bear relies on information technology and data management systems (the "Systems") of a third-party provider. The Systems have a back-up in another country, which Big Bear believes makes them resilient to interruption or destruction caused by natural or man-made occurrences such as extreme weather, fires, earthquakes, power loss, telecommunications failures, terrorist attacks, sabotage, intentional acts of destruction, vandalism, or similar events or misconduct. Nonetheless, any failure, interruption, or destruction of Big Bear's information technology systems or data could have a material adverse impact on Big Bear's operations and client accounts. In addition, a breach in the security of Big Bear's systems could result in the theft, disclosure, or loss of client, proprietary, and other sensitive information.

Limited Diversification. The Fund's portfolio may not be as diversified as other investment vehicles. Because the Investment Adviser from time to time may concentrate the Fund's investments in a limited number of industries or issuers and/or strategies, the Fund's performance may become more susceptible than a diversified portfolio to fluctuations in value or loss resulting from adverse economic or business conditions that affect those industries, issuers or strategies. Accordingly, investors should expect that the Fund's performance may be subject to high volatility.

Limited Investment Opportunities. The Investment Adviser at times may be unable to identify suitable investments for the Fund, or the Fund may be unable to purchase suitable investments in periods of market volatility or disruption or for any number of other reasons. As a result, the Fund may not always be fully invested.

Turnover. The Fund's capital may be invested on the basis of short-term market considerations. The portfolio turnover rate of those investments may be significant, potentially involving substantial brokerage commissions, mark-ups and fees. These commissions and fees will reduce the Fund's profits.

Leverage. The Fund may "leverage" investment returns with options, other derivative instruments and borrowing. As a result of trading with a high degree of leverage, a relatively small price movement in a financial instrument may result in immediate and substantial losses to the Fund. Thus, like other leveraged investments, any trade may result in losses in excess of the amount invested. The Fund may lose more than its initial margin deposit on a trade. In addition, if the Fund is in a leveraged position, any losses would be more pronounced than if leverage were not used and, under particularly adverse circumstances, could exceed its capital.

In general, the Fund's use of margin and other borrowings results in certain additional risks to the Fund. For example, should the financial instruments purchased by the Fund on margin or using other borrowings decline in value, the Fund could be subject to a "margin call" or other collateral call, pursuant to which the Fund, respectively, must either deposit additional funds or assets with the Broker (as defined below) or lender or suffer mandatory liquidation of the relevant financial instruments. In the event of a sudden precipitous drop in the value of the Fund's assets, the Fund might not be able to liquidate assets quickly enough to cover a margin call or other collateral call.

ITEM 9 – DISCIPLINARY INFORMATION

On 2/26/2016, without admitting or denying the findings, Bret Ackerman consented to the sanction and to the entry of findings that he failed to appear and provide testimony sought by the Financial Industry Regulatory Authority, Inc. (“FINRA”) during an investigation to obtain information regarding certain corporate bond transaction executed by Bret Ackerman while he was employed at a broker-dealer member firm. Subsequently, Bret Ackerman is permanently barred from associating with any FINRA member. FINRA is a private corporation that acts as a self-regulatory organization governing brokerage firms and related exchange markets. No fine was imposed related to this sanction.

This sanction is not related to any investment related activity.

This sanction is related to not appearing at a mandatory interview with FINRA relating to activities while he was employed at a FINRA member broker dealer. Bret Ackerman was last employed by a FINRA regulated broker-dealer on March 10, 2014, almost 2 years prior to this sanction.

There are no other legal issues or disciplinary events to report that would be material to a Client’s or prospective Client’s evaluation of Big Bear’s advisory business or the integrity of its management. To the best of our knowledge, there have never been any securities-industry related criminal or civil actions or administrative proceedings involving Big Bear or any of its personnel.

ITEM 10 – OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS

Neither Big Bear nor its management persons, other than Basil Christakos (CRD#: 2290795) who is the Chief Compliance Officer of Paulson Investment Company, LLC (CRD#: 5670), are registered or have an application pending to register as a broker-dealer or a registered representative of a broker-dealer. Neither Big Bear nor its management persons are registered or have an application pending to register as a futures commission merchant, commodity pool operator or a commodity trading advisor. With respect to the Fund, Big Bear is exempt from regulation as a commodity pool operator with the Commodity Futures Trading Commission (“CFTC”) pursuant to CFTC Rule 4.13(a)(3).

Big Bear does not recommend other advisors to its clients or investors.

Paulson Capital Holding Company, LLC, an affiliate of Big Bear, serves as the General Partner of the Fund. Any individuals acting on behalf of the General Partner are subject to the supervision and control for regulatory purposes through Big Bear policies and procedures and code of ethics.

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

Big Bear has adopted a Code of Ethics and has developed Policies and Procedures pursuant to SEC Rule 204A-1 and similar state rules. A copy of Big Bear's Policies and Procedures and Code of Ethics are available to any client or prospective client upon request.

The Policies and Procedures and Code of Ethics of Big Bear, in summary, require each employee and access person of the following:

- Each employee of Big Bear sets a high ethical standard of business conduct reflecting the adviser's fiduciary obligations,
- Each employee of Big Bear must comply with all federal and the applicable state securities laws and regulations,
- Each access persons to periodically report personal securities transactions and holdings, with limited exceptions,
- Each employee is prohibited from Insider Trading (see below), and
- Each employee treats investors' identities and non-public information with utmost care and confidentiality.

Personal Trading

For purposes of complying with Big Bear's Policies and Procedures and Code of Ethics, all employees of Big Bear are generally regarded as access persons and are therefore subject to all applicable personal trading policy, its procedures and reporting obligations. Generally,

- No access person may directly or indirectly purchase for any personal account any shares of a security that the access person knows will be, or currently is being, recommended for purchase or sale or is being purchased or sold for the Fund.
- No access person may directly or indirectly purchase for any account for which the access person has trading authority any shares of a security that the access person knows will be, or currently is being, recommended for purchase or sale or is being purchased or sold for the Fund.
- No access person may knowingly sell for any personal account any security, directly or indirectly, in such a way as to adversely affect the Fund's value.
- No access person may use his or her knowledge of the Fund's transactions to cause any personal account to profit from the market effect of such transactions (or give such information to a third person who may so profit, except to the extent necessary to effectuate the Fund's transactions).
- No access person may purchase any security in an initial public offering ("IPO") or in a private offering conducted pursuant to Section 4(2) or 4(6) of the Securities Act of 1933 or Regulation D thereunder for any personal account without prior approval from the Compliance Team.

At a minimum, every access person shall provide initial and annual holdings reports and quarterly securities account activities/transactions reports to the Compliance Team of Big Bear.

Insider Trading

No employee may trade, either personally or on behalf of others (such as investment funds or private accounts managed by Big Bear), while in the possession of material, nonpublic information, nor may any personnel of Big Bear communicate material, nonpublic information to others in violation of the law.

By the nature of Big Bear's activities, an employee of Big Bear may have access to material non-public information. Big Bear has designed and implemented policies and procedures to reasonably monitor employees' access to material, nonpublic information and to monitor possible trading by employees of public securities based on material, nonpublic information.

Big Bear does not buy or sell for client's account securities in which Big Bear or a related person has a material financial interest.

Confidentiality

Big Bear maintains safeguards to comply with federal and state standards to guard each investor's nonpublic information. Big Bear does not share and will not share any nonpublic information with any nonaffiliated third parties, except in the following circumstances:

- As necessary to provide the service that the investor has requested or authorized, or to maintain and service the investor's account;
- As required by regulatory authorities or law enforcement officials who have jurisdiction over Big Bear or as otherwise required by any applicable law; and
- To the extent reasonably necessary to prevent fraud and unauthorized transactions.

The Compliance Team maintains lists of employees permitted to access investor information. Big Bear restricts access to nonpublic personal information to those employees who need to know such information to provide services to our investors. Any employee, who is authorized to have access to nonpublic personal information, is required to keep such information in a secure, nonpublic area. All electronic files containing such information shall be secured and protected from access by unauthorized persons. Any conversations involving nonpublic personal information, if appropriate at all, must be conducted by employees in private, and care must be taken to avoid any unauthorized persons overhearing or intercepting such conversations.

An affiliate of Big Bear acts as the General Partner of the Fund that is managed by Big Bear. Additionally, employees of Big Bear have invested substantial amounts in the Fund and therefore have a financial interest in the Fund. Investments made by Big Bear's affiliates and its employees are generally made on the same terms as other investors in the Fund; fees and investment minimums may be waived or reduced. We do not believe this arrangements presents any material conflicts of interest since our interests are aligned with the interests of the Fund investors.

ITEM 12 – BROKERAGE PRACTICES

Though Big Bear has discretionary investment authority as it relates to the Fund, it is Big Bear's stated policies and procedures to place the interests of the investors of the Fund first and foremost and to avoid conflict of interests or the appearance thereof. As a fiduciary, many conflicts of interest may arise in trading activities on behalf of our investors. As such, Big Bear has adopted various policies and procedures to prevent and avoid conflicts of interest. They include:

- Best Execution & Soft Dollar Policy,
- Principal Transaction Policy,
- Cross Trading Policy,
- Soft Dollar Policy, and
- Directed Brokerage Policy.

Best Execution & Soft Dollars

As an investment advisory firm, Big Bear has a fiduciary and fundamental duty to seek best execution for the Fund. Currently, the Fund expects to trade securities and other financial instruments primarily through its Prime Broker. The Fund also may utilize one or more other prime brokers, U.S. and non-U.S. securities and futures brokers or clearing firms, introducing brokers, executing brokers, dealers, custodians and counterparties (collectively, "**Brokers**") in connection with the Fund's portfolio transactions. In selecting Brokers to execute transactions, the Investment Adviser need not solicit competitive bids and does not have an obligation to seek the lowest available commission cost. The Investment Adviser will take into account the Broker's reliability, reputation, financial responsibility, stability, ability to execute trades, nature and frequency of sales coverage, commission rate, if any, and responsiveness. The Fund may not negotiate "execution only" commission rates; therefore, the Fund may be deemed to be paying for other services provided by the Broker with so-called "soft dollars" included in the commission rate. If the Investment Adviser uses "soft dollars," the Investment Adviser will only enter into "soft dollar" arrangements that fall within the "safe harbor" provided by Section 28(e) of the Securities Exchange Act of 1934, as amended (the "**1934 Act**"). Furthermore, to the extent that any incidental benefits (such as research) are provided to the Fund, the General Partner, the Investment Adviser, and their respective principals and affiliates in connection with trading futures or options on futures, it is expected that such incidental benefits would fall within the safe harbor provisions of Section 28(e) of the 1934 Act as if such benefits were being provided in connection with the trading of securities. Although research and brokerage services obtained by the use of commissions arising from the Fund's portfolio transactions could be used by the Investment Adviser for other investment activities in the future, currently, the Fund is the sole recipient of the Investment Adviser's investment advice.

To date, the Investment Adviser has not received any products or services outside of Section 28(e). However, in the future, the Investment Adviser may receive a product or service that may be used only partially for functions within Section 28(e). In such case, the Investment Adviser will make a good faith effort to determine the relative proportion of the product or service used to assist the Investment Adviser in carrying out its investment decision-making responsibilities and the relative proportion used for administrative or other purposes outside Section 28(e). The proportion of the product or service attributable to assisting the Investment Adviser in carrying out its investment decision-making responsibilities will be paid through brokerage commissions

generated by client transactions and the proportion attributable to administrative or other purposes outside Section 28(e) will be paid for by the Investment Adviser from its own resources.

To date, the Fund has not utilized any Broker-provided financing in connection with its trading. However, in the future, the Fund may utilize Broker-provided financing in connection with its trading and, accordingly, the Fund may pledge its assets held at such Brokers as collateral to secure such financing arrangements.

Big Bears's investment team, which consists of Bret M Ackerman and Jui Chiew (JC) Tan, analyses each Fund transaction prior to execution to evaluate the execution for such trade and, as necessary, adjust the brokers used by the Fund.

Principal Transactions

Big Bear's policy and practice is to prohibit principal transactions to avoid conflict of interests or the appearance thereof. Principal transactions are generally defined as transactions where Big Bear, acting as a principal for its own proprietary account, buys any asset or security where the Fund may invest in.

Big Bear currently doesn't have any proprietary account and therefore Big Bear doesn't engage in Principal Transactions and does not intend to do so. The Chief Operating Officer is responsible for the implementation and monitoring of this policy and disclosures reflecting that Big Bear does not engage in any principal transactions.

Cross Trading

It is Big Bear's policy and practice to prohibit any cross trading unless best execution price is obtained among the funds advised by Big Bear. At this juncture, Big Bear only advises one fund. As such, cross trading doesn't occur.

Brokerage for Client Referrals

Big Bear does not select or recommend broker-dealers to advisory clients based on Big Bear's receipt of client referrals from the broker-dealer or other third party.

Directed Brokerage

It is Big Bear's policy and practice not to accept and will not accept directed brokerage instructions of any kind for itself, on behalf of the Fund or for the Fund's investors. Big Bear has adopted this policy and internal reviews to monitor and confirm that this policy is observed, implemented properly and amended or updated, as appropriate, which include the following:

- Big Bear's policy of prohibiting the acceptance of client instruction for the direction of brokerage transactions has been communicated to relevant individuals including management, traders, and portfolio managers, among others.
- Big Bear's Advisory Agreements and Disclosure Document disclose that Big Bear's selection of brokers/dealers is based on its Best Execution Policy.
- Semi-annually, the CIO monitors Big Bear's trading practices to help confirm no directed brokerage instructions exist or are accepted from Fund's investors by Big Bear.

Aggregation and Allocation of Investment Opportunities and Orders

Big Bear currently advises only one fund – Anato Opportunity Fund I, LP. As such all investments and orders are for the benefit of this fund.

Accurate and Timely Trade Recordkeeping

It is Big Bear's policy that trade recordkeeping is accurate and timely. In this effort, Big Bear has retained a prime broker and a fund administrator (the "Administrator") to ensure the integrity and accuracy of each trade. Once a trade is confirmed, the COO will enter the trade into the prime broker's trade capture system for settlement and reconciliation. And, at the same time a record is sent to the administrator to track this asset for the Fund.

Trade Error Prevention and Resolution

The SEC has stated a general view that an adviser has a fiduciary duty to place trades accurately. In resolving trade errors, Big Bear will endeavor to minimize the loss to the Fund.

As a matter of good business practice and fiduciary, Big Bear endeavors to prevent trade errors from occurring and detect trade errors prior to settlement should an error occur.

In the effort to prevent trade errors, Big Bear employs two sets of eyes to cross-check trade confirmations. After Jui Chiew (JC) Tan, the Portfolio Manager, has made a decision to trade, these cross-checks come from Jacob Gamble, the COO.

In the effort to detect trade errors before settlement (and thereby incurring no loss to the Fund), the Fund's prime broker and COO will perform daily reconciliation to confirm that trade captures are done accurately.

In the event of a trade error that is not detected pre-settlement, except to the extent required by non-waivable provisions of federal or state securities laws, the Fund (and not the Investment Adviser) will bear any losses resulting from portfolio management, trading or administrative errors in connection with the Fund's investment activities in the absence of fraud, willful misconduct or gross negligence by the Investment Adviser or its affiliates or personnel. Any gains or benefits that result from trade errors will also accrue to the Fund.

ITEM 13 – REVIEW OF ACCOUNTS

Positions in the Fund's portfolio are reviewed on a daily basis. The review of the positions in the portfolio is performed by the Investment Committee, which consists of Bret M Ackerman and Jui Chiew (JC) Tan (Portfolio Manager). Among other criteria, the positions are assessed in the context of the Fund's investment strategies and objectives.

All investors in the Fund receive monthly reporting for their individual investments and for the Fund overall. This reporting includes a capital statement distributed by the Fund administrator reflecting the net asset value of their individual investment, their individual returns for the month and year to date. In addition, all investors receives market updates, Fund's overall size and net returns from Big Bear. Investors also have the opportunity to have conference calls with a member of Big Bear's Investment Committee for detailed updates as needed.

Additionally, tax reports and annual audited statements on the Fund are issued no later than 120 days following the end of the calendar year.

ITEM 14 – CLIENT REFERRALS AND OTHER COMPENSATION

Big Bear does not receive any economic benefit from anyone other than its clients for providing investment advice or advisory services to its clients.

Neither Big Bear nor its affiliates provide compensation to any person or entity for client referrals, and have not utilized any placement agents or solicitors.

ITEM 15 – CUSTODY

All Fund securities and assets are held at an unaffiliated qualified custodian. Big Bear does not have physical custody of any client assets. However, Big Bear is deemed to have custody of the assets of the Fund because (i) its related person, the GP, serves as general partner of the Fund; and (ii) it deducts fees directly from the Fund's account.

The assets of the Fund are held in accounts maintained by a qualified custodian, and Anato causes certain account statements detailing holdings and transactions to be sent to Clients at least quarterly.

Additionally, Anato has engaged an independent accounting firm registered with the Public Company Accounting Oversight Board to conduct an annual audit of the financial statements of the Fund, which it intends to distribute to all investors within 120 days after the Fund's fiscal year end.

ITEM 16 – INVESTMENT DISCRETION

Subject to the Fund's governing documents, Big Bear has full discretionary investment authority as it relates to the Fund. This discretionary authority is assumed at the time when an investor subscribes to the Fund via a subscription agreement and the subsequent deposits into the subscription account.

This discretionary authority means that Big Bear has the authority to determine (1) the type of securities and assets to invest/sell, (2) amount and price of each security or asset to invest/sell, and (3) which broker or dealer to use.

ITEM 17 – VOTING CLIENT SECURITIES

The Fund invests mostly in Structured Products securities, and Big Bear as the investment adviser to the Fund may on occasion be asked to vote on matters relating to the trusts of these securities. Big Bear, as a matter of policy and as a fiduciary to our clients, is responsible to vote in such a way that attains maximum economic value for the related investments in the Fund.

Big Bear, as in its research practice, conduct a thorough review and due diligence to come to a decision that maximizes economic value for the Fund on every vote.

Big Bear will identify any conflicts that may exist between the interests of Big Bear and the Fund by reviewing the relationship of Big Bear with the issuer of each security to determine if Big Bear or any of its employees has any financial, business or personal relationship with the issuer. If a material conflict of interest exists, the CIO will determine whether it is appropriate to disclose the conflict to the Fund, to give the investors an opportunity to vote as a consensus group. Big Bear will maintain a record of the voting resolution of any conflict of interest.

ITEM 18 – FINANCIAL INFORMATION

Big Bear does not require or solicit prepayment of fees.

Big Bear is not aware of any financial condition affecting the firm that is reasonably likely to impair Big Bear's ability to meet its fiduciary and contractual commitments to the investors. Big Bear has never filed for bankruptcy.