



# ESM Management LLC

SEC Form ADV Part 2A

Firm Brochure (“Brochure”)

262 38<sup>th</sup> West Street, New York, NY 10018

Telephone: 1-646-927-6089

[www.esminvestors.com](http://www.esminvestors.com)


March 19, 2020

This Brochure provides information about the qualifications and business practices of ESM Management, LLC, a Registered Investment Advisor. If you have any questions about the contents of this Brochure, please contact the firm by telephone at 646-927-6089. The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.

ESM Management, LLC is a Registered Investment Advisor. Registration of an Investment Advisor does not imply any level of skill or training.

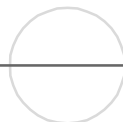
Additional information about ESM Management, LLC also is available on the SEC’s website at [www.adviserinfo.sec](http://www.adviserinfo.sec).

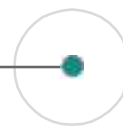
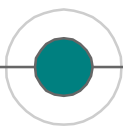
This Brochure does not constitute an offer to sell or the solicitation of an offer to buy any securities. Prospective investors should refer to the offering documents of the applicable private fund client prior to considering an investment in such private fund client.



## Item 2 - Material Changes

There have been no material changes to this Brochure since the last annual update on March 23, 2019. Other non-material changes not specified in this summary may have been made to this Brochure. Consequently, we encourage you to read this Brochure in its entirety.





## Item 3 – Table of Contents

|   |    |
|---|----|
| Item 2 - Material Changes   | 2  |
| Item 3 – Table of Contents  | 3  |
| Item 4 - Advisory Business  | 4  |
| Item 5 - Fees and Compensation  | 5  |
| Item 6 – Performance-Based Fees and Side-by-Side Management                                     | 6  |
| Item 7 - Types of Clients   | 6  |
| Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss                            | 6  |
| Item 9 - Disciplinary Information   | 8  |
| Item 10 - Other Financial Industry Activities and Affiliations                                  | 8  |
| Item 11 - Code of Ethics, Participation or Interest in Client Transactions and Personal Trading | 8  |
| Item 12 - Brokerage Practices   | 9  |
| Item 13 - Review of Accounts  | 10 |
| Item 14 - Client Referrals  | 11 |
| Item 15 - Custody   | 11 |
| Item 16 - Investment Discretion   | 12 |
| Item 17 - Voting Client Securities  | 12 |
| Item 18 - Financial Information   | 12 |



## Item 4 - Advisory Business

ESM Management LLC (“ESM”, the “Firm” or “we”) was founded in January 2009. The Firm’s principal owners are William Van de Water and Eric Meyer. ESM provides investment advice on acquiring, analyzing, or liquidating portfolios consisting primarily of mortgage related securities and derivatives.

ESM currently manages one hedge fund and is the subadvisor to one fund registered under the Investment Company Act of 1940. Additionally, ESM has several client relationships where the client has established a managed account rather than investing in the hedge fund managed by ESM. For these managed accounts, ESM has discretionary trading authority and generally builds and maintains, and at times partially or fully liquidates, an investment portfolio according to the client’s investment objectives and risk tolerance. ESM works with each client to understand the risks and opportunities involved in the mortgage-backed securities (“MBS”) market and generally provides each client with periodic reports and market commentary.

ESM’s minimum investment requirement is \$10,000,000 for the managed accounts (while reserving the right to lower or waive this requirement). Investors seeking to invest less than this amount may consider investing in the hedge funds managed by ESM. Existing client relationships are not subject to this higher minimum investment.

As of December 31, 2019, ESM managed approximately \$150,000,000 on a discretionary basis.





## Item 5 - Fees and Compensation

ESM charges the hedge fund it manages a no annual management fee.

For managed accounts, ESM has historically charged a fee based on assets under management, which is an annual percentage of assets under management (“AUM”) that may range from 1% to 2%. The fee was determined based on the size and term of the account and the complexity of its investment constraints. AUM for a particular account is determined by the book value of the portfolio on a daily basis (with adjustment to market value at the start of each calendar year) plus any cash that is available for investment, which could be less or more than the total cash in the client’s broker account.

For certain managed accounts, ESM charges an incentive fee based on the profits that are generated in the account, on a realized basis. The incentive fees are subject to hurdles that are applicable to the account. The exact calculation of the incentive fee is outlined in the account management agreement between ESM and its client.

ESM may, at its discretion, agree to enter into alternative fee arrangements, which could include a performance-based fee, or an incentive fee coupled with a AUM-based management fee. Incentive fees are accrued as a percentage of the absolute return, and may be either measured against a mutually agreed upon benchmark, or against a hurdle rate. ESM bills clients directly for management fees in arrears. Generally, ESM bills clients semi-annually; however, some clients are billed quarterly and others annually.

Nothing restricts ESM from or requires ESM to agree to any particular fee structure.

Fees paid to ESM are exclusive of all custodial fees, brokerage commissions and transaction costs paid to the client’s custodian, brokers, or other third parties, as well as any fees and taxes on brokerage accounts and securities transactions. The client should review all fees charged by funds, brokers, ESM, and others to fully understand the total amount of fees paid by the client for investment and financial related services.



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

As mentioned above, ESM may enter into performance-based fee arrangements. As such, potential conflicts may arise and ESM may have an incentive to favor accounts for which the Firm receives a performance-based fee. ESM is committed to treating all accounts fairly and equitably. Investment opportunities are allocated first and foremost according to the needs of each client's portfolio. For example, when determining allocations, ESM weighs various factors against each other when determining how to make allocations among client accounts for bonds such as the amount of free cash available for investment in the type of bond for sale, whether the bond is a match for an odd lot position of a client and, whether or not the bond provides diversification for the client. ESM has developed and implemented an allocation policy further detailing its methodology for allocating trades across the various accounts and funds that it manages. However, our main goal is to treat all clients on an equal footing without regards to fee arrangements or personal relationships. Please see Item 12 "Brokerage Practices" for additional information on our trade allocation procedures.

## Item 7 - Types of Clients


ESM provides investment management services to institutional clients, such as pension funds, mutual funds, family offices, high net-worth individuals and hedge funds.

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

ESM's main goal is to introduce and expose clients to the mortgage-backed securities market with an emphasis on non-agency mortgage backed securities. Our strategy is long-only. Investment horizons can vary from days to years. We do not generally hedge. We reinvest principal pay downs and interest payments opportunistically, seeking to increase positions in the strategies we believe have the highest expected return based on our own modeling.

Most of our modeling work is done for three purposes:

1. To estimate whether the investment expected to get absolute return is reasonable given the portfolio's investment objectives;
2. To determine whether the investment is attractive relative to similar opportunities within the same asset class; and
3. To assess risk and attempt to limit losses due to a market downturn or a catastrophic change in factors affecting the outcome of the particular investment.



The key advantages we believe we have over other market participants are i) we are focused on a very particular segment of the MBS market where few others are looking for investment opportunities and ii) we are very experienced in and diligent about analyzing and understanding the operating documents behind every security.

## Risk of Loss

The following risk factors do not purport to be a complete list or explanation of all the risks associated with ESM's investment strategies, methods of analysis or types of investment instruments utilized.

### ESM Investment Activities

ESM's investment activities involve a significant degree of risk. The analysis of mortgage based securities and even more so non-agency mortgage backed securities is complicated and requires consideration of various risks, such as interest rate risk, prepayments and credit risk (default and recovery). Despite efforts exerted by individuals at the Firm, the performance of any investment is subject to numerous factors, which are neither within the control of, nor predictable by, the Firm. Such factors include a wide range of economic, political, legal, competitive and other conditions that may affect investments in general or specific industries or companies. The markets may be volatile, which may adversely affect the ability of the Firm to realize profits on behalf of its clients. As a result of the nature of the Firm's investing activities, it is possible that the client's results may fluctuate substantially from period to period.

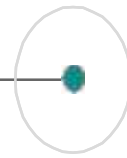
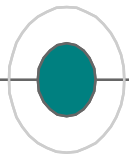
### Interest Rate Risk

The price of most fixed income securities generally move in the opposite direction of the change in interest rates. For example, as interest rates rise, generally the prices of fixed income securities fall.

If the Firm holds a fixed income security to maturity, the change in its price before maturity may have little impact on the Firm portfolios' performance. However, if the Firm identifies a need to sell the fixed income security before the maturity date, an increase in interest rates could result in a loss.

### Credit Risk

While loans are intended to be collateralized, ESM portfolios may be exposed to losses resulting from loan defaults and foreclosure. Therefore, the value of the underlying collateral, the creditworthiness of the borrower and the priority of the lien are all of great importance.



ESM cannot guarantee the adequacy of the measures taken to protect its interests, including the validity or enforceability of the loan and the maintenance of the anticipated priority and perfection of the applicable security interests.

## Item 9 - Disciplinary Information

This section is not applicable to ESM.

## Item 10 - Other Financial Industry Activities and Affiliations

This section is not applicable to ESM.

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

ESM's Code of Ethics ("Code") is designed to help ensure that ESM conducts business consistent with high standards of personal and professional conduct. ESM demonstrates this commitment through its procedures addressing insider trading and market manipulation, gifts and entertainment, political donations, personal investments and other outside activities of employees.

ESM's principal business is advising clients on investments and trading in mortgage-backed securities. ESM does not permit any direct trading in such products by any of ESM's principals or employees, or by ESM itself, except on behalf of ESM clients.

ESM requires quarterly reporting of its employee's personal trading activity, which is reviewed by the Firm.

ESM's Code is reviewed periodically by the principals, specifically the Chief Compliance Officer. A copy of the Code is available to any prospective or existing client upon request.







## Item 12 - Brokerage Practices

### **Research and Other Soft Dollar Benefits:**

ESM receives research, market analysis, and even the use of certain proprietary models from brokers. This creates a benefit for ESM and may create a conflict of interest as the Firm may have an incentive to select or recommend a broker based on its interest to receive research services, rather than on clients' interest to receive the most favorable execution. Because our focus asset class (non-agency mortgage-backed securities), and attractive offers or bids for securities of the right sized position appear sporadically, we tend to do the most business with brokers who have an extensive and active client base of investors and managers with similar portfolio holdings to the funds and accounts we manage.

### **Brokerage for Client Referrals:**

ESM may recommend specific brokers to clients. Generally, this occurs when the client needs to establish a brokerage account suitable of trading and holding mortgage backed securities. ESM does not receive any compensation for these referrals; however, such referrals may earn us good will with the referred broker and may incentivize that broker to provide research and other services to us, which research or services may not directly benefit all clients of ESM.

### **Directed Brokerage:**

Clients may request that ESM use a particular broker-dealer to effect transactions in their accounts. In some cases, using a particular broker-dealer may result in clients paying more for such services than if brokers were chosen based on price or ability to aggregate trades with those of other clients.

### **Trade Aggregation:**

ESM strives to ensure that each client with substantially similar investment objectives is treated on an equal basis, regardless of that client's relationship with ESM and the nature or level of fees paid to ESM by that client.

With regards to trade aggregation, when an eligible bond from that asset class appears on a bid list or a dealer inventory list, ESM determines the suitability of the investment for ESM's clients. If ESM obtains the bond, ESM will allocate the bond in accordance with its allocation policy. ESM will generally allocate the eligible bonds on a pro rata basis, based on the pre-trade allocation, subject to rounding, cash balances, investment restrictions, and other factors. A copy of the allocation policy is available to any prospective or existing client upon request.



## Item 13 - Review of Accounts

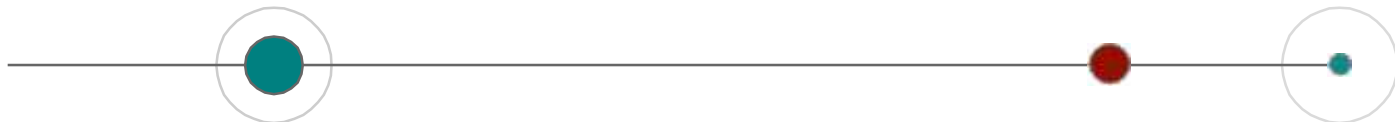
Generally, ESM reviews client accounts on a daily basis, as new price information becomes available concerning any securities in the client's portfolio.

Each morning, the principals review how much cash each client has to invest, and whether there are any good candidate bonds on bid-wanted-in-competition lists (i.e., auctions).

Every month, the principals review the principal pay downs and loan performance of each portfolio as detailed on Bloomberg and in master servicer remittance reports. Also, each client portfolio is priced monthly using our internal valuation methodology, which is designed to consolidate and consider all publicly available and internal information on the value of portfolio securities. A copy of the pricing policy is available to any prospective or existing client upon request.

ESM provides clients with periodic reports and market commentary, at least quarterly, but generally whenever a client requests. Clients are also invited to contact ESM at any time to review their accounts, preferences, and goals.





## Item 14 - Client Referrals

As disclosed in Item 12, ESM may refer clients to specific brokers when the client needs to establish a brokerage account suitable for trading and holding mortgage backed securities. ESM does not receive any compensation for these referrals, however such referrals may earn us good will with the referred broker, as more particularly described in Item 12.

## Item 15 - Custody

ESM does not have direct custody of any client assets. ESM may be deemed to have custody of assets for the hedge fund that ESM manages. Where a client grants trading authority to ESM, the client assets remain in the client's own brokerage account, and ESM has no authority to withdraw cash or any other assets, including ESM's annual incentive fee, at any time. Clients will receive statements directly from the custodian at least quarterly. We urge clients to review the statements carefully and compare them to any reports provided by or requested from ESM.

Each fund with assets over which ESM is deemed to have custody is audited annually by a PCAOB registered independent accounting firm in accordance with Rule 206(4)-2 under the Investment Advisers Act of 1940 and such firm distributes audited financial statements, prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), to investors no later than 120 days after the end of each fund's fiscal year.





## Item 16 - Investment Discretion

ESM has discretionary authority, pursuant to its written or oral investment management agreements with clients, to determine, without obtaining specific client consent, the securities to be bought or sold, the amount of the securities to be bought or sold, the brokers or dealers through which transactions will be executed, and the amount of commissions or mark ups or mark downs paid. Clients may impose reasonable restrictions on the investment decisions made by ESM. Any restrictions or limitations on ESM's discretionary authority must be made in writing and contained in the private fund client's offering memorandum, and/or in the investment management agreement between ESM and the client.

## Item 17 - Voting Client Securities

From time to time, ESM may be required to vote proxies for client securities. However, given that the instruments ESM trades often do not have voting rights and do not require voting frequently, this is not a likely occurrence. In the event that ESM is required to vote proxies for a client account, ESM has procedures designed to help ensure that such decisions are made in accordance with ESM's fiduciary obligation to act in the best interests of its clients.

Any material conflicts of interest that may arise between the interests of ESM or its supervised persons and those of its clients when voting proxies are addressed in a transparent manner. Clients do not have the ability to direct how we vote proxies, but clients can obtain information on how their proxies were voted by contacting us. ESM's policies and procedures are available to any client, prospective client, and investor upon request.

## Item 18 - Financial Information

This section is not applicable to ESM.