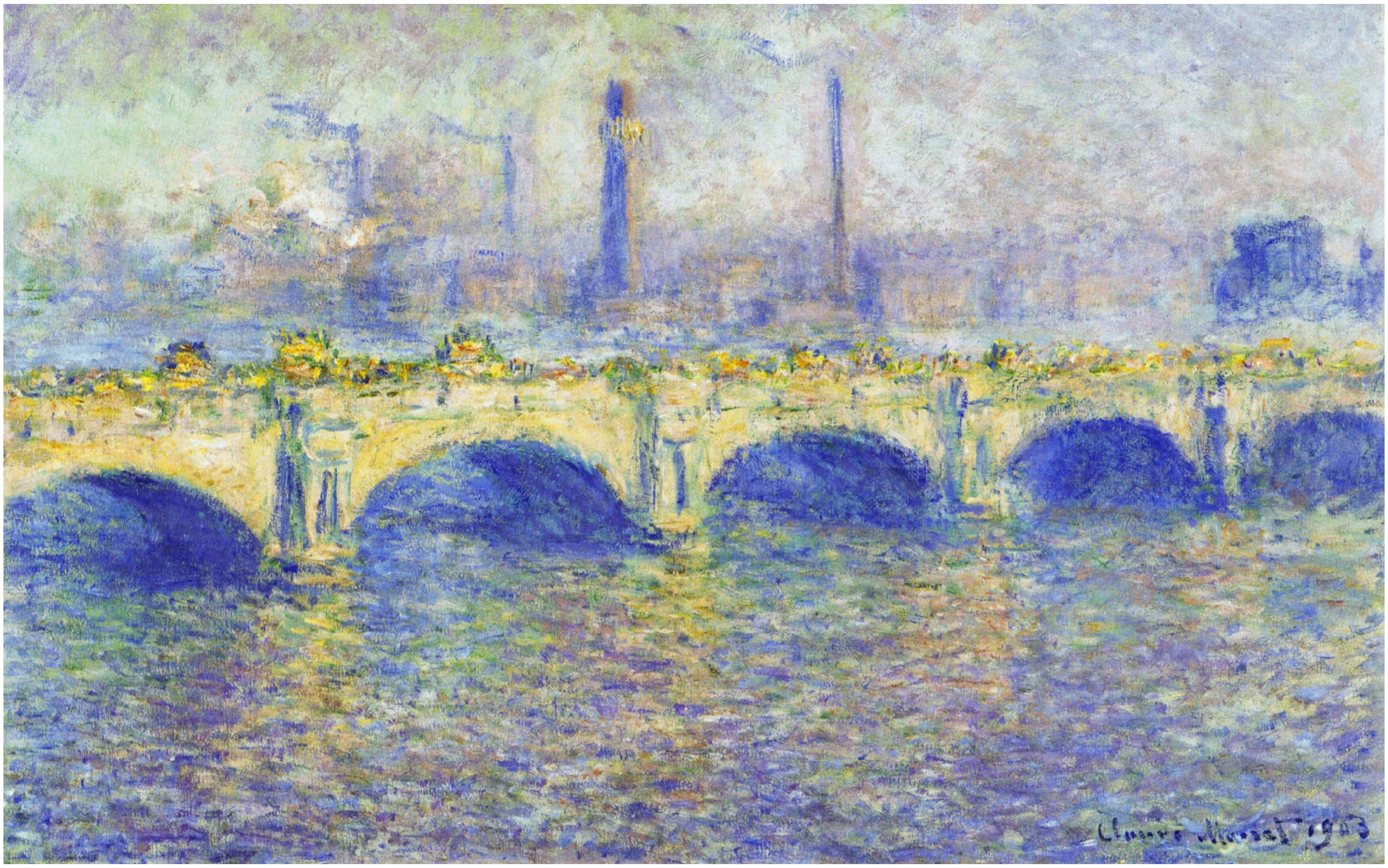

Hedge Funds Explained

Hedge Funds Explained

Introduction

Hedge funds have grown significantly in popularity over the past decade. Total hedge fund industry capital has reached a record level of $2.41 trillion as of Q2 2013.[1]

Originally, hedge funds offered little transparency and were limited to sophisticated institutions and ultra-high net worth individuals. Today, hedge funds have become widely accepted among qualified investors. Hedge fund transparency has increased while hedge funds have become a top performing asset class with a low correlation to traditional markets.

Hedge funds vary enormously in terms of investment strategy, return profile, volatility and risk. Understanding these characteristics is essential to capitalizing on the various investment opportunities that exist.

This analysis highlights some of the fundamentals of hedge fund investing. Contact us for assistance with your hedge fund portfolio needs.

(1) HFR Global Hedge Fund Industry Report 8/2013

What are hedge funds and how do they differ from traditional investments?

A hedge fund is a private pool of capital managed by an investment advisor. Hedge funds are similar to mutual funds in that they are pooled and professionally managed, but differ in that the funds cater to sophisticated investors and have far more flexibility in their investment strategies.

Hedge funds vary enormously in terms of investment strategies, returns, volatility and risk. Hedge fund managers typically are highly specialized and trade within their areas of expertise and competitive advantage.

Hedge funds invest in a broad range of assets including stocks, bonds, options, currencies and commodities and may utilize a variety of financial instruments to reduce risk, enhance returns and minimize the correlation with equity and bond markets.

Hedge funds have the ability to deliver non-correlated returns due to their use of flexible investment options and methods such as short selling and derivatives (e.g., puts, calls, options, futures, etc.) that may reduce risk or even achieve positive returns when markets are falling.

One of the main differences between traditional and hedge fund investments is that the skill of the manager (alpha) rather than the performance of the market or asset class (beta) drives hedge fund returns.

Hedge fund managers often invest a significant amount of their own money in their fund giving them “skin in the game”. There is an incentive for managers to deliver returns as the managers compensation is typically heavily weighted towards performance incentives. However there is a business incentive to seek to preserve capital during riskier times.

How Investing in Hedge Funds May Enhance a Traditional Investment Portfolio[2]

Adding hedge funds to an investment portfolio can provide diversification not otherwise available in traditional investing. There is a wide variety of hedge fund investment styles – many uncorrelated with each other – providing investors with a choice of distinct strategies to meet their investment objectives.

- Many hedge fund strategies have the ability to generate positive returns in both rising and falling equity and bond markets.
- Inclusion of hedge funds in a balanced portfolio may reduce overall portfolio risk and volatility and increase returns.
- Hedge funds are a long-term investment solution, minimizing the need to correctly time entry and exit from markets.

(2) Source: Hedge Fund Association

Misconceptions about Hedge Funds

Misconception: Managers are unregulated	The majority of the larger hedge fund managers are registered with the SEC, CFTC, FSA and/or other regulatory organizations. CrystalResearch™ tracks these registrations and provides relevant information to our users.
Misconception: Hedge funds are volatile and take large directional bets	While strategies vary significantly, hedge funds typically offer more diversification and downside protection to long-only investments. CrystalAnalytics™ allows users to easily analyze manager performance against certain benchmarks.
Misconception: They are highly leveraged	While hedge funds typically have the ability to leverage, many banks' trading desks use significantly more leverage. It is important to understand the nature of the strategy, as some strategies (e.g., arbitrage) will use leverage, while others may not.
Misconception: They charge excessive fees	Compensation is often heavily weighted on performance so that a manager only gets paid well if investors do well. Managers' performance should always be monitored on a net basis. CrystalAnalytics™ allows users to easily analyze fund performance against other investments, net of fees.
Misconception: Hedge funds are illiquid and have long lock up periods	While some managers do have long lock up periods, many investments can be liquidated quarterly. It is important to understand that liquidity typically goes hand-in-hand with a strategy's investment horizon. CrystalResearch™ details the manager strategy, liquidity and terms. CrystalPortfolios™ allows users to build portfolios specific to their liquidity needs.

Hedge Fund Strategies

Hedge funds use one or more of the following investment strategies:[5]

Activist: Activist strategies may obtain or attempt to obtain representation of the company's board of directors in an effort to impact the firm's policies or strategic direction and in some cases may advocate activities such as division or asset sales, partial or complete corporate divestiture, dividend or share buybacks, and changes in management. Strategies employ an investment process primarily focused on opportunities in equity and equity related instruments of companies which are currently or prospectively engaged in a corporate transaction, security issuance/repurchase, asset sales, division spin-off or other catalyst oriented situation. These involve both announced transactions as well as situations which pre-, post-date or situations in which no formal announcement is expected to occur. Activist strategies are distinguished from other Event Driven strategies in that, over a given market cycle, Activist strategies would expect to have greater than 50% of the portfolio in activist positions, as described.

Credit Arbitrage: Credit Arbitrage strategies employ an investment process designed to isolate attractive opportunities in corporate fixed income securities; these include both senior and subordinated claims as well as bank debt and other outstanding obligations, structuring positions with little or no broad credit market exposure. These may also contain a limited exposure to government, sovereign, equity, convertible or other obligations but the focus of the strategy is primarily on fixed corporate obligations and other securities are held as component of positions within these structures. Managers typically employ fundamental credit analysis to evaluate the likelihood of an improvement in the issuer's creditworthiness, in most cases securities trade in liquid markets and managers are only infrequently or indirectly involved with company management. Fixed Income - Corporate strategies differ from Event Driven: Credit Arbitrage in that the former more typically involve more general market hedges which may vary in the degree to which they limit fixed income market exposure, while the latter typically involve arbitrage positions with little or no net credit market exposure, but are predicated on specific, anticipated idiosyncratic developments.

Distressed Securities: Distressed/Restructuring strategies employ an investment process focused on corporate fixed income instruments, primarily on corporate credit instruments of companies trading at significant discounts to their value at issuance or obliged (par value) at maturity as a result of either formal bankruptcy proceeding or financial market perception of near term proceedings. Managers are typically actively involved with the management of these companies, frequently involved on creditors' committees in negotiating the exchange of securities for alternative obligations, either swaps of debt, equity or hybrid securities. Managers employ fundamental credit processes focused on valuation and asset coverage of securities of distressed firms; in most cases portfolio exposures are concentrated in instruments which are publicly traded, in some cases actively and in others under reduced liquidity but in general for which a reasonable public market exists. In contrast to special situations, distressed strategies employ primarily debt (greater than 60%) but also may maintain related equity exposure.

Emerging Markets: An emerging market hedge fund specializes its investments in the securities of emerging market countries. Although there is no exact definition of "emerging market countries," these countries are in the process of developing. They typically have per-capita incomes on the lower to middle end of the world range, and are in the process of moving from a closed market to an open market. Examples of emerging markets include China, India, Latin America, much of Southeast Asia, parts of Eastern Europe, and parts of Africa.

Equity Market Neutral: Equity Market Neutral strategies employ sophisticated quantitative techniques of analyzing price data to ascertain information about future price movement and relationships between securities, select securities for purchase and sale. These can include both Factor-based and Statistical Arbitrage/Trading strategies. Factor-based investment strategies include strategies in which the investment thesis is predicated on the systematic analysis of common relationships between securities. In many but not all cases, portfolios are constructed to be neutral to one or multiple variables, such as broader equity markets in dollar or beta terms, and leverage is frequently employed to enhance the return profile of the positions identified. Statistical Arbitrage/Trading strategies consist of strategies in which the investment thesis is predicated on exploiting pricing anomalies which may occur as a function of expected mean reversion inherent in security prices; high frequency techniques may be employed and trading strategies may also be employed on the basis on technical analysis or opportunistically to exploit new information the investment manager believes has not been fully, completely or accurately discounted into current security prices. Equity Market

Neutral Strategies typically maintain characteristic net equity market exposure no greater than 10% long or short.

Event Driven: Event Driven Managers maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

Global Macro: Global macro strategies trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top down and bottom up theses, quantitative and fundamental approaches and long and short term holding periods. Although some strategies employ relative value techniques, macro strategies are distinct from relative value strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments, rather than realization of a valuation discrepancy between securities. In a similar way, while both macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposed to long/short equity, in which the fundamental characteristics on the company are the most significant and integral to investment thesis.

Long/Short Equity: Long/short equity strategies (a/k/a equity hedge strategies) maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. Long/short equity managers would typically maintain at least 50% exposure to, and may in some cases be entirely invested in, equities, both long and short.

Managed Futures: Managed futures strategies include both discretionary and systematic commodity strategies. Systematic commodity have investment processes typically as function of mathematical, algorithmic and technical models, with little or no influence of individuals over the portfolio positioning. Strategies employ an investment process designed to identify opportunities in markets exhibiting trending or momentum characteristics across commodity assets classes, frequently with related ancillary exposure in commodity sensitive equities or other derivative instruments. Strategies typically employ quantitative process which focus on statistically robust or technical patterns in the return series of the asset, and typically focus on highly liquid instruments and maintain shorter holding periods than either discretionary or mean reverting strategies. Although some strategies seek to employ counter trend models, strategies benefit most from an environment characterized by persistent, discernible trending behavior. Systematic Commodity strategies typically would expect to have greater than 35% of portfolio in dedicated commodity exposure over a given market cycle. Discretionary Commodity strategies are reliant on the fundamental evaluation of market data, relationships and influences as they pertain primarily to commodity markets including positions in energy, agricultural, resources or metal assets. Portfolio positions typically are predicated on the evolution of investment themes the Manager expect to materialize over a relevant time frame, which in many cases contain contrarian or volatility focused components. Investment Managers also may trade actively in developed and emerging markets, focusing on both absolute and relative levels on equity markets, interest rates/fixed income markets, currency; frequently employing spread trades to isolate a differential between instrument identified by the Investment Manager to be inconsistent with expected value. Discretionary Commodity strategies typically would expect to have greater than 35% of portfolio in dedicated commodity exposure over a given market cycle.

Multi Strategy: The investment objective of multi-strategy hedge funds is to deliver consistently positive returns regardless of the directional movement in equity, interest rate or currency markets. In general, the risk profile of the multi-strategy classification is significantly lower than equity market risk. By definition, multi-strategy funds engage in a variety of investment strategies. The diversification benefits help to smooth returns, reduce volatility and decrease asset-class and single-strategy risks. Strategies adopted in a multi-strategy fund may include, but are not limited to, convertible bond arbitrage, equity long/short, statistical arbitrage and merger arbitrage.

Relative Value Arbitrage: Relative Value investment managers maintain positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk adjusted spread between these instruments represents an attractive opportunity for the investment manager. RV position may be involved in corporate transactions also, but as opposed to ED exposures, the investment thesis is predicated on realization of a pricing discrepancy between related securities, as opposed to the outcome of the corporate transaction.

(5) Source: Hedge Fund Research, Inc. and Eurekahedge Pte Ltd.

IMPORTANT DISCLOSURE

This Document is for informational purposes only and is not an offer to sell or the solicitation of an offer to buy an interest in any of the Funds managed or advised by Crystal Capital Partners, LLC ("Crystal"). This document contains only summary information about the Funds and is qualified in its entirety by, and should be read in conjunction with, the more detailed information contained in the Offering Memorandum for each Fund.

The interests in the Fund have not been registered with the SEC under the Securities Act, or under the securities laws of any state of the United States or under the securities laws of any other jurisdiction, and the Funds have not been registered as an investment company under the Investment Company Act of 1940, as amended, and are being offered and sold in reliance on exemptions from the registration requirements of such laws.

The information contained in this Document has been prepared to assist interested parties in making their own evaluation of the opportunity and does not purport to be complete or to contain all of the information that a prospective investor might consider important in connection with an investment in the Fund. In all cases, interested parties should conduct their own investigation and analysis of the Fund, the data set forth in this Document and such other data as they may consider relevant to an investment decision. Not all hedge funds/Candidates may be available at all times due to capacity or for other reasons. The information contained in this Document does not constitute legal, tax, accounting, regulatory or investment advice, and persons considering an investment in the Fund should consult their own legal and financial advisors with respect to the application of United States securities, tax or other laws and accounting and regulatory provisions to their particular, as well as any consequences arising under the laws of any other jurisdiction.

The liquidity schedule constitutes the "best available" liquidity as of the date hereof. The liquidity terms described are for a particular exposure. From time to time, the Fund and/or the Outside Portfolio Manager may offer different liquidity terms. "Best available" liquidity assumes availability when soft lock terms are applicable.

The pro forma results are based on simulated or hypothetical performance results that have certain inherent limitations. Unlike the results shown in an actual performance record, these results do not represent actual trading. Also, because these trades have not actually been executed, these results may have under-or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated or hypothetical trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to these being shown.

THE PRO FORMA COMPOSITE PERFORMANCE RECORD IS HYPOTHETICAL AND THESE TRADING ADVISORS HAVE NOT TRADED TOGETHER IN THE MANNER SHOWN IN THE COMPOSITE. HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY MULTI-ADVISOR MANAGED ACCOUNT OR POOL WILL OR IS LIKELY TO ACHIEVE A COMPOSITE PERFORMANCE RECORD SIMILAR TO THAT SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD AND THE ACTUAL RECORD SUBSEQUENTLY ACHIEVED.

ONE OF THE LIMITATIONS OF A HYPOTHETICAL COMPOSITE PERFORMANCE RECORD IS THAT DECISIONS RELATING TO THE SELECTION OF TRADING ADVISORS AND THE ALLOCATION OF ASSETS AMONG THOSE TRADING ADVISORS WERE MADE WITH THE BENEFIT OF HINDSIGHT BASED UPON THE HISTORICAL RATES OF RETURN OF THE SELECTED TRADING ADVISORS. THEREFORE, COMPOSITE PERFORMANCE RECORDS INVARIABLY SHOW POSITIVE RATES OF RETURN. ANOTHER INHERENT LIMITATION ON THESE RESULTS IS THAT THE ALLOCATION DECISIONS REFLECTED IN THE PERFORMANCE RECORD WERE NOT MADE UNDER ACTUAL MARKET CONDITIONS AND, THEREFORE, CANNOT COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FURTHERMORE, THE COMPOSITE PERFORMANCE RECORD MAY BE DISTORTED BECAUSE THE ALLOCATION OF ASSETS CHANGES FROM TIME TO TIME AND THESE ADJUSTMENTS ARE NOT REFLECTED IN THE COMPOSITE.

The Fund and/or the Fund Manager use several sources of information to support the analysis in this Document, including information provided by investment managers, third party databases, and other public and non-public sources. The Fund and/or the Fund Manager will make commercially reasonable efforts to ensure the reliability of the information, but make no warranty as to the accuracy, completeness or suitability of the information. Such information is further subject to the qualifications and limitations contained in the Terms of Use Agreement and the Disclaimer made part of each fund report.

The interests in the Fund are speculative, illiquid, involve substantial risk, and are a suitable investment only for a limited portion of an investor's portfolio. Investors could lose all or substantially all of their investment in the Fund. Neither the delivery of this Document nor any offers or sales hereunder shall create an implication that there has been no change since the date of this Document or the Offering Memorandum in the matters disclosed herein. Before you decide to invest, read the entire Offering Memorandum for the specific fund of interest carefully, and in particular, consider the "Risk Factor" section. If you, or your advisors, have questions concerning the operations, you should contact the Fund Manager at the address or phone number included in the Offering Memorandum.

None of the directors, officers, employees or advisers of Crystal or its affiliates or any other person makes any promise, guarantee, representation or warranty (expressed or implied) to any person as to the fairness, accuracy or completeness of this Document or the information contained herein, or of any other information, materials or opinions, whether written or oral, that have been, or may be, prepared or furnished by any of those companies, including, without limitation, economic or financial projections, if any, or risk evaluations.

The recipient acknowledges and agrees that all of the information contained herein is confidential, and if the recipient has previously accepted this Document, signed or agreed to Crystal's Terms of Use Agreement or Non-Disclosure Agreement, is subject thereto. Without limiting the generality of the foregoing: (1) the recipient will not reproduce this Document, in whole or in part; (2) if the recipient does not wish to pursue this matter or is not an "Accredited Investor" within the meaning of Rule 501(a) under the Securities Act of 1933 and/or a "Qualified Purchaser" as such term is defined in the Investment Company Act of 1940, as amended and (the "Securities Act"), it must return this Document to Crystal, as soon as practicable, together with any other materials relating to the Fund, which the recipient may have received, or must destroy this Document and such other materials as soon as practicable and, in each case, must destroy, as soon as practicable, all copies of analyses, compilations, studies or other documents prepared by it in connection with any information in this Document or such other materials.

Please see the Help Section of the website (? Icon) for additional disclosures and definitions of certain terms and comparison indices.

For more information please contact:

Waterloo Capital Management

John Chatmas
jchatmas@waterloocap.com
(512) 693-4363