Fundamental Research Corp.
Investment Analysis for Intelligent Investors

Siddharth Rajeev, MBA, CFA

Rob Stitt, CAIA

June 1, 2016

Lightwater Long Short Fund – A Traditional Hedged Fund

Sector/Industry: Hedge Funds **www.lightwaterpartners.com**

Offering Summary	
Issuer	Lightwater Long Short Fund
Manager	Lightwater Partners Ltd
Date of OM	17-Sep-15
Offering	Open-Ended
Securities Offered	Unincorporated Trust Units
Minimum Subscription	$25,000
Restrictions	Accredited Investors
Management Fees	1% - 2% depending Class
Performance Fees	20%
Hurdle Rate	Zero
High Water Mark	Yes
Gate	Yes
Lock-ups	No
Valuation	Monthly
Notice Period	15 days
Tax Status	Qualifies as Registered
Auditor	Goodman & Associates LLP

*Details regarding the size of the fund and related metrics have not been disclosed in this report, as per the issuer's request, to maintain confidentiality.

Investment Highlights

- The Lightwater Long Short Fund ("the Fund") is an unincorporated open-ended trust created under the laws of the Province of Ontario pursuant to a declaration of trust dated as of December 3, 2012. Lightwater Partners Ltd. is the trustee and manager of the Fund.
- Lightwater Partners Ltd. was incorporated in 2007, and the investment team has significant institutional investment experience.
- The Fund qualifies as a quasi-mutual fund trust for the purposes of the Income Tax Act (Canada).
- The Fund employs a classic equity long short approach that invests in a concentrated portfolio of high conviction ideas and makes substantial use of hedging strategies to limit market risks.
- <u>The Fund is a top performer over the past 3 years beating 95% of all Canadian hedge funds.</u>
- Most of the Fund's back office operations have been outsourced to accredited service providers. We conducted a due diligence review of the Fund's operations and were satisfied with the result.

General Risks

- The manager is a connected issuer of the Fund.
- Unit-holders' principal is not guaranteed as the Fund's net asset value can decrease from current levels.
- There is no guarantee that redemptions will be fulfilled on an immediate basis.
- A detailed discussion of the specific risks relating to the Fund and hedge fund investing in general can be found at the back of this report.

FRC Rating	
Rating	3+
Risk	3

*see back of report for rating definitions
**the rating system above is only relevant to hedge funds

Overview

The Fund has a classic investment strategy which employs extensive internal fundamental research in equity securities which are primarily Canadian of mid-capitalization size. The fund manager focuses on stocks which do not have a large following by traditional analysts, seeking undervalued or overvalued opportunities, to buy or short stocks that they believe will rise or fall in price. The Fund makes concentrated bets on a limited number of stocks and attempts to limit overall market exposure by maintaining a fairly even ratio of longs versus shorts, and limiting the total number of positions to approximately 40. The Fund limits the use of leverage, currently carries a high cash reserve, and invests across multiple industry sectors.

Manager Profile

Lightwater Partners Ltd. has been in business since 2007. They hold registration as Portfolio Manager, Investment Fund Manager, and Exempt Market Dealer. We have confirmed the registration status of the firm and all of their investment partners and employees. They have also been registered as a Trustee since November 2011.

We believe management is qualified and aligned. The portfolio managers of the Fund each hold the Chartered Financial Analyst ("CFA") designation, each team member has significant institutional investment experience, and the partners have what we consider to be a significant amount of their own money in the funds that they manage. The Lightwater partners own approximately 8.8% of the firm's funds, and are the fund's largest unit-holder. We have conducted reference checks on the portfolio managers and are satisfied with the results. The management firm has 4 principals active in day to day management, 1 passive principal and 1 analyst.

Brief biographies of the managers follow:

Jerome Hass, CFA
Jerome joined Lightwater as a Portfolio Manager in 2007 and has over 20 years experience in the financial industry. Previously, he worked as a Portfolio Manager at Epic Capital Mgmt in Toronto and Montrusco Bolton Investments in Montreal. Mr. Hass also worked as a Portfolio Manager in London, England for Canada Life Assurance Company. He started on the buy-side at Scottish Amicable Investment Managers in Scotland. Mr. Hass also worked as a sell-side Analyst with HSBC Investment Bank in Singapore and Malaysia. He began his career as an Economist with the Ministry of Finance. He holds a Bachelor degree in Economics from the University of Western Ontario, a Master of Arts in Applied Economics from the University of Victoria as well as a Master of Science degree in Economics from the London School of Economics, and is a holder of the CFA designation.

Jimmy Chu, CFA
Jimmy joined Lightwater in 2009. He is a Portfolio Manager with fifteen years of experience in the financial services industry. Previously, he was a Senior Analyst at Investor Economics Inc., a private Toronto-based research and consulting firm where he was an industry voice on various facets of the Canadian financial services industry. He holds a Bachelor of Commerce degree from the University of Toronto, and is a holder of the CFA designation.

Mike Baker
Mike has twenty years experience in the financial services industry. Previously, he was an Institutional Equity Trader and Partner at Fraser Mackenzie Ltd. and Vice President, Institutional Equity Trader at Jennings Capital Inc. where he also served on its Management Committee. His duties at Lightwater are focused on trading as well as our sales and marketing initiatives. He spent his first twelve years employed by some of Canada's largest banks: Royal Bank, CIBC Mellon and Scotia. He was recognized as one of Scotia's "Best of the Best." Mr. Baker holds a Bachelor of Arts in Economics from Bishop's University.

Tom Eveson
Tom joined Lightwater Partners full-time in April 2016 but has served on the Fund's Advisory Board since 2011. Tom has more than a decade of experience in institutional equity and fund sales with Actuity Assets Mgmt., Fraser Mackenzie, and Cantor Fitzgerald. Most recently, he was Director of Business Development with OMX marketplace. Tom has also served as a Paratrooper in the Canadian Armed Forces, is a long-serving Reservist with the Queens Own Rifles of Canada.

Investment Objective

The investment objective of the Fund is to deliver absolute returns to unit holders over the long term through superior securities selection, and taking advantage of opportunities arising from inefficiencies and imbalances in markets, and individual securities pricing.

Investment strategies
The Fund's strategy emphasizes mid-cap stocks, although it may hold stocks of any capitalization. The manager uses bottom-up fundamental analysis methodology in selecting investments for the Fund, both long and short. They seek to identify and buy shares in companies which they believe are undervalued in the marketplace, and short sell shares in companies which they perceive as overvalued in the market place on either a relative valuation basis or an outright valuation basis.

The Fund's investment process combines both bottom up fundamental analysis and tactical trading using its in-house research capability and its assessment of corporate management to both generate and evaluate investment ideas. Specific strategies may include:

- Pair trades.
- Core conservative holdings.
- Catalyst investing. Examples of catalysts might include but not be restricted to earnings events, restructurings, management changes and corporate spin-offs.
- Opportunistic trading.

Trade ideas generated internally
Approximately 90% of the fund manager's trading ideas are their own. This, we believe, is important; because often fund managers who buy popular growth investment themes can get

caught in crowded trades whereby reversals can occur quickly. Lightwater Partners' competitive advantage is in obtaining an informational edge by researching un-crowded or little followed companies to buy. Internally generated ideas on both the short and the long side help lower the Fund's risk profile and are one of the qualities that, in our opinion, make them a true hedge fund. According to the firm, their research seeks to answer the following questions when selecting an investment:

- What is the market perception of the stock?
- How does their view differ from the market? and
- How can they benefit from this difference?

Many of the companies they follow are Canadian and of small to mid size in terms capitalization that tend to have little or no coverage by sell side analysts. These investments consist of about 450 companies with sizes ranging from $200 million to $2.5 billion. According to Mr. Hass, they also spend time thinking strategically about how they may be able to exit positions in their portfolio prior to making an investment. This entails looking at factors such as average daily and weekly trade volumes to estimate how long it may take to exit a position.

For short positions, they search for the opposite and like crowded or overhyped stocks to short sell. One of their big winners for 2015 - 2016 was the heavily followed Valeant Pharmaceuticals (TSX: VRX). Their investment thesis was that Valeant was a serial acquirer (of other companies) whose capacity for debt was stretched too far. The company became so big, and its stock so dominant, that index fund managers had to own it. To do otherwise would nearly ensure underperformance. "It was a Nortel-like situation," Mr. Hass said. "Institutional managers were plugging their noses and buying Valeant because they couldn't afford not to." Ultimately, Valeant started to crumble as its high debt model was a symptom of other more significant problems. This included aggressive revenue recognition which led to regulatory action, and price hikes on certain drugs which drew attention from the United States Congress. The Fund short sold the stock at approximately $289, and closed its position at approximately $50, leading to gains of over 80% on the position, and some degree of media attention which should help their marketing efforts.

The portfolio managers believe that the Canadian investment community is consistently overly optimistic in that it has the most buy recommendations, the least sells and the highest average consensus among analysts. Further, they believe that the interests of sell-side brokerages are aligned with issuers, and long-only mutual fund companies, breeding inefficient market opportunities. Lightwater uses their short book to earn profits on an absolute basis; not just for hedging. Big American hedge funds often look to the Canadian equity markets for shorting opportunities, the Fund's smaller size can be a benefit to their existing investors in that they can find niche trades that may be too small for some of their big American competitors.

Cash

The Fund tends to hold relatively large amounts of cash on hand from time to time. As of the end of Q1 2016, the fund held a ratio of approximately 75% cash vs. its net investments. While this cash buffer serves to lower the Fund's risk profile, it does not mean that an investor's cash is sitting idle. Firstly, the high cash ratio gives the manager a high degree of flexibility in acting on new trade ideas and potentially capitalizing on extreme moves in the market. Secondly, the high cash ratio lowers the likely volatility of returns to investors. While the Fund's current net exposure is approximately 25%, its average net exposure is 48% with a maximum allowed of 150%.

Leverage

While leverage takes many forms in investing, in the most basic sense, the Fund does not borrow money to invest. According to Mr. Hass, the Fund has never in its 8 year history borrowed money to invest nor will it do so in the future. The Fund has employed modest levels of leverage in its history in the form of borrowed stock, largely for hedging purposes. Borrowed stock has among the lowest borrowing rates.

As of the end of Q1 2016, the Fund gross positions equaled approximately 103% of the Fund's assets. A review of the Fund's position report confirms that it holds no derivative positions currently and Mr. Hass has stated that they do not use derivatives. The Fund's mean gross exposure is about 125% with a maximum allowed of 250%. Leverage in this context means the market value of the Fund's securities both long and short divided by the Fund's capital. The Fund's leverage is slightly below the average for other equity long short fundamental funds of 130%. Source: NEPC, LLC

Market Timing

2015 was a difficult year for Canadian equity markets and it illustrated the benefits of holding hedged long short funds in one's portfolio. The portfolio managers do not make directional calls on the market direction. Instead, their philosophy is to always have insurance in place in the form of short positions. This allows them to remove certain elements of industry specific risk in the portfolio, while potentially reducing its overall volatility. The Fund does not engage in market timing.

Trading

The Fund typically makes less than 30 trades per month on average. The typical time horizon for long positions will be 1 – 3 years, although they have positions that are over 5 years in duration. The typical hold period for a short position is less, although they had short positions on for over 5 years. Mr. Hass has significant experience shorting stocks and crafting hedged portfolios having worked for hedge fund firms for many years.

Investment Risk Management

The Fund holds a maximum of 40 positions (long and short positions combined). The managers' concentrated approach to portfolio composition is common among equity long short fundamental funds. This high conviction approach is a hallmark of a true hedge fund. There are no sector restrictions but they avoid direct investments in the resource sectors. The managers constantly monitor their position weights on a risk adjusted basis such that

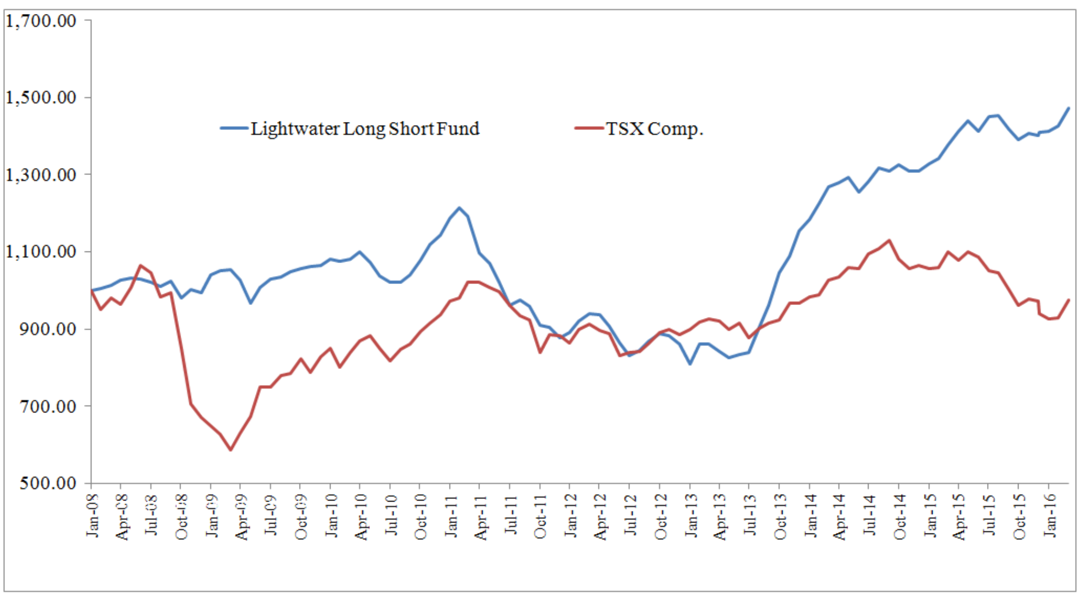
75% of its value may be liquidated in an orderly manner within 5 trading days.

In addition to attempting to generate alpha with absolute long and short positions, the Fund typically holds 10 to 15 positions in pairs of longs with offsetting shorts in the same industry. One example recently highlighted by Mr. Hass was their pair of long Air Canada (TSX: AC) stock in order to take a safer or hedged position in Transat AT (TSX: TRZ), a stock they do not like on account of thin margins and very high sensitivity to economic activity. A hedged position in the airline industry makes a lot of sense due to the sector being notoriously difficult to invest in.

A paired position within an industry makes intuitive sense as both market and industry risk can be reduced leaving the pool with more of a pure exposure to the companies involved in the trade. Mr. Hass indicates that other factors beyond just industry go into their process in determining how to pair up trades. However, sometimes these options are limited by lack of companies to choose from within an industry, and the Canadian airline industry is a perfect example. While Air Canada and Transact AT both fly planes, clearly they are very different companies in many other respects.

Performance Review

In general, the Fund's performance has been positive with strong performance even during the market losses of 2008. The Fund has returned an average annual return of 4.75% since its inception on January 1st 2008.



As with most hedge funds, the Fund is priced on a monthly basis. The Fund's percentage of winning months is higher than losing months (63% up vs. 37% down) with an arithmetic average return of 0.43% per month; however, the Fund has tended to lose slightly more during losing months (-2.57% losses vs. 2.15% gains). In 2012, the Fund had a significant drawdown in value which took 8 months to recover. We calculate a since inception Sharpe ratio of 0.59 for the Fund.

The Fund's recent performance has been very strong beating 95% of Canadian hedge funds over the past 3 years.

Lightwater Long Short Fund Monthly Return Data

Returns	2008	2009	2010	2011	2012	2013	2014	2015
Jan	0.43%	1.19%	-0.45%	2.24%	3.56%	6.17%	3.64%	1.19%
Feb	0.97%	0.14%	0.48%	-1.64%	2.04%	0.17%	3.39%	2.52%
Mar	1.16%	-2.60%	1.61%	-8.10%	-0.47%	-2.40%	0.89%	2.52%
Apr	0.75%	-5.71%	-2.47%	-2.43%	-3.14%	-1.79%	1.07%	2.06%
May	-0.51%	4.18%	-3.30%	-4.57%	-4.85%	0.88%	-2.91%	-1.84%
Jun	-0.56%	2.01%	-1.53%	-5.76%	-3.76%	0.78%	2.16%	2.67%
Jul	-1.27%	0.54%	0.15%	1.27%	1.82%	7.65%	2.72%	0.04%
Aug	1.36%	1.31%	1.76%	-1.63%	2.71%	6.38%	-0.68%	-2.28%
Sep	-4.04%	0.86%	3.65%	-4.92%	2.20%	8.66%	1.34%	-1.96%
Oct	2.11%	0.61%	3.83%	-0.64%	-0.64%	4.36%	-1.21%	1.20%
Nov	-0.84%	0.06%	2.14%	-2.96%	-2.41%	5.92%	0.01%	-0.42%
Dec	4.57%	1.72%	3.72%	1.30%	-5.85%	2.44%	1.32%	0.63%
Annual	3.98%	4.06%	9.68%	-24.99%	-8.98%	46.02%	12.17%	6.32%

Source: Canadian Hedgewatch, Internal Database

Comparison to Barclay Long Short Index of 415 Funds

Returns	2008	2009	2010	2011	2012	2013	2014	2015
Index	-11.88%	14.42%	7.27%	-4.58%	6.35%	13.85%	2.94%	2.49%
Fund	3.98%	4.06%	9.68%	-24.99%	-8.98%	46.02%	12.17%	6.32%

Comparison to Scotiabank Canadian Hedge Fund Index of 82 Funds

Returns	2008	2009	2010	2011	2012	2013	2014	2015
Index	-22.64%	26.31%	14.78%	-9.17%	-2.28%	4.38%	5.44%	0.62%
Fund	3.98%	4.06%	9.68%	-24.99%	-8.98%	46.02%	12.17%	6.32%

Correlations

The Fund's correlation to the TSX Composite Index since inception is 0.28 indicating that it offers a significantly distinct return pattern from the index, a positive trait for investors seeking diversification.

Investment Summary - Since Inception	Details
Inception Date	Jan-08
Compounded Annual Return	4.75%
Compounded Annual Return 2014, 2015, 2016	20.88%
% of Winning Months	62.70%
% of Losing Months	37.30%
Average Monthly Gain	2.15%
Average Monthly Loss	-2.57%
Average Monthly Return	0.43%
Largest Drawdown	-31.30%
Months to Recover	8
Correlation to TSX Comp.	0.28
Correlation to Scotia Hedge Index	0.30
Volatility Monthly	2.93%
Volatility Annual	11.74%

Downside Capture	31.00%
Sharpe Ratio	0.59

Draw downs

In 2011 and 2012, The Fund had some poor months largely due to pair trades in the resource space. With most pair trades, you can eliminate most of the market risk and industry-specific risk and are left with company-specific risk. In the case of resource stocks, the fund managers found the company-specific risk to be very large relative to non-resource names. Towards the end of 2012, the fund managers sat down and asked themselves how to avoid a recurrence of this performance. Once they reviewed where they had lost the most money over the past couple years, it became clear that they needed to avoid resource pair trades. Consequently, since the end of 2012, they have avoided long or short positions in oil & gas, mining, forestry, or agricultural stocks. From a risk management point of view, they think it was a very prudent decision. Even if WTI oil prices fall to $10 per barrel, they said they will not go back into the resource space. We feel this is a strong statement coming from a Canadian fund manager and it demonstrates a willingness to learn from past mistakes and to take the path less travelled. To put this into context, by contrast, a typical Canadian mutual fund equity manager has very little leeway to avoid volatile resource stocks.

Peer Group Comparison

In making a comparison to over 300 North American long short equity funds from March 2014 to March 2016, we noted the following: the Fund has achieved significantly higher returns than its peers and has done so with less market risk.

A significant improvement in the Fund's Sharpe ratio from 0.59 to 1.81 (last 3 years) is a positive signal going forward. Sharpe, one of the most common fund analysis risk metrics, is the ratio of returns over the risk free rate over volatility as measured by standard deviation. Sharpe ratios above 1.0 are generally considered good and above 2.0 are considered excellent.

The Fund's high alpha indicates it is adding substantial value in terms of risk adjusted market returns. Taken together, the Fund's positive skew and excess kurtosis means that its returns are biased to the upside during the past 3 years - a positive trait.

Risk Metrics - 3 Year	Lightwater LS Fund	Peer Group Median
Annual Return	17.88%	4.10%
Beta	0.17	0.47
Alpha	15.14%	-0.40%
Volatility Annual	9.63%	10.03%
Maximum Drawdown	-4.21%	-11.83%
Sharpe Ratio	1.81	0.50
Correlation - Russell 1000	0.20	0.51
Sortino Ratio	6.18	0.78
Skew	0.75	-0.24
Kurtosis	0.53	-0.21

Current Portfolio Holdings

We have reviewed the Fund's current holdings from reports produced by their third party fund administer. We are not disclosing the Fund's investment positions to maintain confidentially. The Fund portfolio currently holds 21 long position and 13 short positions.

No derivatives were held by the Fund as of March 31st 2016. Our reconciliation of the Fund's audited financial statements against the Fund's investment position reports did not identify any issues. The Fund's exempt distribution filings have also been crossed referenced with the Fund's audited financial statements and the figures are congruent.

Summary of Due Diligence Checks and Documentation Reviewed

Operational Summary	Details
Audit Statements	2014 & 2015 Reviewed
Legal Operating Doc	Master Declaration of Trust
DD Questionnaire	Updated as of May, 2016
Financial Statements	NAV Confirmed
Investment Portfolio	Positions Confirmed
Registration Check	Confirmed: PM, IFM, EMD
Reference Checks	Completed
OSC Filings	Exempt Dist. Reports
SEC Filings	None required
Sedar Filings	None required

Document Summary	Cross Referenced With
Audit Statements	Financial Position Report
Exempt Dist. Reports	Audit Statements
Offering Memorandum	Declaration of Trust
Marketing Deck	Performance Reports
Subscription Agreement	Offering Memorandum

Documentation Reviewed

We have conducted a complete review of the Fund's offering, operating document, subscription document and marketing documents and did not identify any inconsistencies or cause for concern.

Qualified Service Providers

We have reviewed all the Fund's third party service providers. Each of them is known to us, has a solid reputation within the industry, and to our knowledge, they have not changed in the past 5 years with the exception of their prime broker. The Fund's current prime broker and custodian is a Schedule 1 Canadian bank and posses no counterparty risk.

Compliance Program

The Fund's performance calculations and methodology has been reviewed by the Ontario Securities Commission in both 2009, and 2011, as part of regular compliance audits. Hedge funds tend to be the targets of audits every 3 years. No significant deficiencies were identified during these examinations, and no sanctions have been levied in the firm's 8 year history. In recognition of the fact that investors prefer to see a separation of the roles of chief investment officer, chief compliance officer and chief operating officer, the firm recently undertook measures to remedy this issue. Jimmy Chu has been appointed chief compliance officer, thus separating the role of chief compliance officer from chief investment officer. In addition, Lightwater has engaged a third party compliance firm (ARA Compliance) to assist the chief compliance officer in the ongoing compliance obligations of the firm. The Principals regularly attend Ontario Securities Commission compliance seminars to maintain and update their compliance procedures. Their

Compliance Manual was thoroughly revised and updated in 2016. Moreover, all of Lightwater's staff and partners must follow the company's policy with respect to personal account dealing which requires pre-authorized trading approval from a portfolio manager. A portfolio manager cannot approve his own trade; it must be approved by another. Personal trades must wait for a period of 3 trading days after the fund has ceased trading in the stock. Personal trades are not allowed if the Fund has a reasonable intention of trading that position. The firm itself has not taken positions in any stocks, or other securities, but it does have holdings in the units of its funds.

No significant conflicts of interest identified

The manager also operates the Lightwater Nimble Fund, a more concentrated version of the Lightwater Long Short Fund. Much of the research that is conducted for the Fund is reflected in the trading decisions for the Nimble Fund, which is a more concentrated version of the firm's flagship fund - Long Short Fund. While the Nimble Fund benefits from the research that goes into the Fund, it does not benefit at the detriment of the Fund.

Marketing

An important consideration for any fund investment is whether the Fund is gaining new investors and whether they are doing so in a responsible and considered manner. As a general rule, some firms are overly concerned with gaining assets to manage at the expense of their existing investor base. However, managed growth is critical to any investment firm's success, and therefore, long term investors should give this element some consideration. While Lightwater Partners may not be natural marketers, we think their campaign of business television appearances is a cost effective way to showcase the firm's positive attributes and gives us confidence in the firm's ability to grow its asset base going forward. The firm has recently added Tom Eveson, a dedicated salesperson, to the team, and we view this as a positive signal for investors. We are not disclosing the Fund's assets under management and net investor growth to maintain confidentially.

Gate

The fund does not have any lockups but it does have a gating provision which could prevent redemptions if, in the opinion of the manager, they are detrimental to the remaining unit-holders. In the past, gating has been a generally accepted industry practice; however, many investors do not welcome the possibility of their redemptions being delayed. Investors need to be aware of this right.

Fees

The Fund's service provider fees are approximately 1.52% plus the management fees range from 1.0 - 2.0% depending on unit class. The Fund also levies a 20% performance fee. Our research indicates that management fees of Canadian hedge funds range from 0.6% to 2.66%, with either 1% or 2% most common. Our calculations indicate that the average Canadian hedge fund management fee is 1.56%. Their fees are in line with other similar funds.

Conclusion and Rating

The Lightwater Long Short Fund's investment strategy is of moderate risk and the firm operational risk is also of moderate risk. The Fund's improving investment performance is a positive sign. We give the Fund a rating of 3+ (good return to risk ratio) and a risk rating of 3 (average risk). The small size of the management firm increases the Fund's risk profile while the Fund's limited use of leverage, use of hedged pair trading and limited currency risk (to Canadians) improves the Fund's risk profile. We believe that the Fund's risk level is in line with return expectations, we like the fund's management and think that the strategy offers the potential for impressive performance gains and diversification from market returns going forward as per past performance.

Fund Operational Risks

- The Fund has a small management team with each of them wearing multiple hats.
- Key man risk, natural disaster risk and technology risk are present as they are in most small businesses.
- Fund reporting, valuation and counterparty are ever present risks in hedge fund investing.
- The Fund's manager believes that the investment risk profile is lower than the market overall due to the un-crowded nature of their investment positions.

Fund Investment Risks

- The Fund is concentrated in terms of number of position held which may increase the risk profile.
- The Fund invests in small capitalization stocks which can have more volatility than the overall market. Moreover, small capitalization stocks have larger bid ask spreads making them more difficult to trade over short time periods without affecting the market prices. This liquidity risk may manifest itself in particular during times of market stress.
- The Fund takes short positions which can have a higher degree of risk than long only investments.
- Take-over bids on short positions are a particular concern as are short squeezes – a situation in which a heavily shorted stock moves sharply higher, forcing more short sellers to close out their short positions and adding to the upward pressure on the stock. A short squeeze implies that short sellers are being squeezed out of their short positions, usually at a loss.
- Stock loans on short positions can get called and stock loans on small capitalization stocks can be difficult to find and more expensive.
- Pair trades may not work out as planned.

Risks of Hedge Fund Investing

- In a broad context, there are many different risks confronting hedge fund managers and investors to varying degrees. Though there may be different types of risk, they are interdependent. The following are some key types and factors that hedge funds and their investors should consider: direct market related risk including interest rate risk, liquidity risk, volatility risk, credit risk, equity risk, currency risk, commodity risk, correlation risk, counterparty risk, basis risk, crowded trade risk, event risk, reputational risk and qualitative risks of people making mistakes.

Criteria Analyzed	Points Available	Risks Analyzed	Flags Possible
Management Strength and Alignment of Interest	4	Interest rate risk	2
a. Structure and ownership of firm		Liquidity risk	3
b. Assets and products managed		Volatility risk	2
c. Skin in game		Credit risk	3
Analysis of Investment Returns Since Inception and Past 36 months	12	Equity risk	5
a. Sharpe Ratio (Monthly return / monthly Vol.)		Currency risk	5
b. Correlation of Returns to Benchmark		Commodity risk	3
c. Drawdown		Correlation risk	2
d. Returns		Counterparty risk	2
Downside Protection	4	Crowded trade risk	3
a. Does the stated strategy attempt to protect during declines?		Event risk	3
b. Performance during declines		Operational risk	7
Quality of Investor Communication	4		
a. Fund Reports		Leverage levels factor in throughout each flag	
b. Other reports / research / media coverage			
Fund Structure and Terms	4		
a. Fees and conditions of investing			
b. Legal structure			
c. Investor base			
Quality of Fund Operations	12		
a. Legal Documentation Review			
b. Audit Review			
c. Administration and Valuation			
d. Compliance Program			
e. Custody of assets and trading			
TOTAL POINTS AND FLAGS	**40**		**40**
Fundamental Research Corp. Rating Scale:	**Points Needed**	**Fundamental Research Corp. Risk Rating Scale:**	**Flags Assessed**
Rating – 1: Excellent Return to Risk Ratio	>35	1 (Low Risk)	< 8
Rating – 2: Very Good Return to Risk Ratio	31 - 35	2 (Below Average Risk)	8 - 16
Rating – 3: Good Return to Risk Ratio	26 - 30	3 (Average Risk) 17 – 25 flags	17 – 25
Rating – 4: Average Return to Risk Ratio	21 - 25	4 (Speculative)	26 – 34
Rating – 5: Weak Return to Risk Ratio	16 - 20	5 (Highly Speculative)	> 34
Rating – 6: Very Weak Return to Risk Ratio	Nov-15		
Rating – 7: Poor Return to Risk Ratio	< 11		
A "+" indicates the rating is in the top third of the category			
A "-" indicates the lower third			
No "+" or "-" indicates the middle third of the category			

*the rating system above is only relevant to hedge funds

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