Learn the basics about hedge funds and why hedge funds can be attractive investments that provide potential benefits of diversification.

Explore how qualified investors access hedge funds

Discover the potential benefits of fund of hedge funds

Examine various hedge fund strategies and examples
About Steben & Company

Steben & Company is a leading alternative asset manager. We specialize in multi-manager products including a fund of hedge funds and managed futures strategies. Our investment philosophy is defined by high conviction, actively managed exposures with a focus on more liquid, lower beta strategies. Our funds are designed to provide investors with the potential benefits of diversification and absolute returns regardless of market direction.

We seek to employ a repeatable investment process that incorporates rigorous due diligence, manager selection, portfolio construction and ongoing risk monitoring. Through our unique combination of resources and capabilities, Steben offers financial advisors and investors distinguished investment opportunities that have traditionally been limited to institutional investors.

Steben is an alternative investments innovator with more than 25 years of continuous operating experience.

The views in this material are intended to assist the reader in understanding various hedge fund investment strategies and do not constitute investment or tax advice (please consult your tax professional). Hedge funds have different characteristics from traditional equity investments and traditional mutual funds. Our review is intended to provide a general overview and some specific attributes associated with investing in a hedge fund structure. The views in this material were those of the Advisor as of the date of publication. Please refer to the Risks of Hedge Funds and Hedge Fund Investing as well as the Glossary for important disclosures.
What are Alternative Investments?

Alternative investments can refer to asset classes or strategies. Generally speaking, they are investments outside of long-only positions in traditional asset classes such as stocks, bonds and cash. Many alternatives have a low correlation to traditional assets and may provide investors with the potential benefits of diversification.

What is a Hedge Fund?

Hedge funds are a category of alternative investments. The roots of the modern day hedge fund industry date back to 1949, when Alfred Winslow Jones began employing an investment strategy that offset long equity positions with short positions in order to better manage overall portfolio risk.

Today, hedge funds utilize a number of different investment strategies and styles in order to generate returns, either on an absolute basis or on a relative basis (when compared against a specified benchmark).

Hedge funds can take both long and short positions, use arbitrage techniques, buy and sell securities in any asset class, trade options, and invest in any market where the fund foresees opportunities to generate attractive risk-adjusted returns. However, hedge funds tend to specialize in specific strategies and these strategies vary enormously. The primary aim of most hedge funds is to limit volatility and risk while attempting to preserve capital and deliver positive returns under a wide range of market conditions.

Let’s take a closer look…
What’s The Draw? Performance…

Over the last decade, the number of hedge funds and the amount invested in hedge funds has grown tremendously.¹

Historically, a key driver behind this growth of hedge funds has been their performance. The following chart shows what a hypothetical $10,000 investment in representative indexes of stocks, bonds and hedge funds² would have returned from January 1990 through December 2017. Hedge funds are represented by the HFRI Fund Weighted Composite Index, which is an equal-weighted index that tracks over 1,500 hedge funds’ monthly performance. Of course, each of the funds in the index performed differently from one another.

1. Source: Hedge Fund Research, Inc.
2. Hedge Funds = HFRI Fund Weighted Composite Index, Stocks = S&P 500 TR Index, Bonds = Barclays US Aggregate Bond Index.

Source: Bloomberg. Index returns are for illustrative purposes only and do not represent the performance of any fund. If other time periods were selected, index performance may have been higher or lower. HFRI Fund Weighted Composite Index, Barclays US Aggregate Bond Index and S&P 500 TR Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest in an index. See Glossary for information on the indexes. Hedge fund investing can involve risks materially different from other forms of investing. PAST PERFORMANCE DOES NOT NECESSARILY GUARANTEE FUTURE RESULTS.
...With Less Volatility Than Stocks...

Historically, hedge funds, as an investment class, produced these returns with less volatility than the overall stock market\textsuperscript{1}. Volatility shows how much the price of a security or benchmark moves up and down. As shown in the chart below, from January 1990 through December 2017, hedge funds were much less volatile than stocks.

1. Hedge Funds = HFRI Fund Weighted Composite Index, Stocks = S&P 500 TR Index, Bonds = Barclays US Aggregate Bond Index.

Source: Bloomberg. Index returns are for illustrative purposes only and do not represent the performance of any fund. If other time periods were selected, index performance may have been higher or lower. HFRI Fund Weighted Composite Index, Barclays US Aggregate Bond Index and S&P 500 TR Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest in an index. See Glossary for information on the indexes. **Hedge fund investing can involve risks materially different from other forms of investing. PAST PERFORMANCE DOES NOT NECESSARILY GUARANTEE FUTURE RESULTS.**
Perhaps the most compelling reason hedge funds have garnered so much interest is their potential diversification benefits. Although at times, the broad category of hedge funds can be closely correlated to the equity markets, it is possible — through careful research and selection — to find and invest in hedge funds with low correlations to both the stock and bond markets. These types of investments can bring broader diversification to a portfolio — potentially helping it weather sharp market reversals.

Over the past 27 years, even during the financial crisis of 2008, declines for hedge funds as an investment class were less severe than those for stocks as well as many other major asset classes. The chart below shows the worst declines and average annual returns for various asset classes from January 1990 through December 2017.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Average Annual Return</th>
<th>Worst Drawdown</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>6.03%</td>
<td>-5.15%</td>
</tr>
<tr>
<td>Managed Futures</td>
<td>5.64%</td>
<td>-14.09%</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>9.90%</td>
<td>-21.42%</td>
</tr>
<tr>
<td>US Stocks</td>
<td>9.81%</td>
<td>-50.95%</td>
</tr>
<tr>
<td>International Stocks</td>
<td>4.68%</td>
<td>-56.68%</td>
</tr>
<tr>
<td>REITs</td>
<td>10.19%</td>
<td>-67.89%</td>
</tr>
<tr>
<td>Commodities</td>
<td>1.08%</td>
<td>-80.90%</td>
</tr>
</tbody>
</table>

*Note: Largest Drawdown is the measure of the worst price decline from a security’s historical peak during a specified period using month-end data.

Source: Bloomberg. Index returns are for illustrative purposes only and do not represent the performance of any fund. If other time periods were selected, index performance may have been higher or lower. Bonds = Barclays US Aggregate Bond Index; Managed Futures = Barclay Systematic Traders Index; Hedge Funds = HFRI Fund Weighted Composite Index; US Stocks = S&P 500 TR Index; International Stock = MSCI EAFE TR Index; Commodities = S&P GSCI® TR Index; REITs (Real Estate Investment Trusts) = NAREIT All REITs Index. As with any investment, where there is potential for profit, there is risk of loss. Index definitions for asset classes shown can be found on page 18 and 19. HFRI Index, Barclays US Aggregate Bond Index and S&P 500 TR Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest in an index. Hedge fund investing can involve risks materially different from other forms of investing. PAST PERFORMANCE DOES NOT NECESSARILY GUARANTEE FUTURE RESULTS.
Manager Selection is Paramount

By its very definition, alpha — or that component of returns which is independent of market performance — is entirely dependent on manager skill. Therefore, the most important factor in seeking alpha when investing in hedge funds is manager selection.

Over the last three decades, assets in hedge funds have grown tremendously. According to Hedge Fund Research, Inc. (HFRI), which tracks the hedge fund industry, there are now an estimated 10,000+ hedge funds, managing over $3 trillion in assets.

With so many hedge funds in existence today, evaluating and categorizing managers is not easy. Investing directly into a single hedge fund can come with a high investment minimum and potentially long lock-up period (agreed upon length of time in which a new investor cannot take their money back out). Because of this, the implications of picking the wrong manager may have a detrimental long-term effect on an investment portfolio.

In addition, some hedge funds have historically high beta and correlation to the stock market. While they can potentially deliver market outperformance, they may do so by taking on higher risks and without providing the non-correlation and reduced volatility that investors often expect hedge funds to deliver.

Detailed manager research and selection is commonly called “due diligence” and typically encompasses the following:

- Reviewing the Hedge Fund’s Organizational Structure and Personnel
- Assessing the Investment Process and Portfolio Construction
- Analyzing Historical Performance and Risk/Return Metrics

While many professional and institutional investors have the expertise and experience to conduct this level of in-depth research, most individual investors do not. Therefore, investors may seek out professional assistance when deciding which hedge fund or type of hedge fund investment may be appropriate.
Accessing Hedge Funds

There are a number of ways investors can gain access to hedge fund strategies:

<table>
<thead>
<tr>
<th>Registered vs. Unregistered Funds (Private)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open-ended mutual funds are registered with the SEC and can provide non-accredited investors access to the diversification benefits of hedge funds with daily liquidity and 1099 tax reporting. However, the requirement for providing daily liquidity and the restrictions on leverage and performance fees may constrain mutual funds from fully implementing certain hedge fund strategies.</td>
</tr>
<tr>
<td>Funds of hedge funds can be structured as closed-end funds that are registered with the SEC. These funds of hedge funds are not subject to the same requirements as open-ended mutual funds, which can help to offset constraints presented by open-ended mutual funds. Registered funds of hedge funds provide accredited investors access to a diverse range of hedge fund strategies, typically with quarterly liquidity, convenient 1099 tax reporting and regulatory oversight.</td>
</tr>
<tr>
<td>Private hedge funds are not regulated in the same way as other types of investments and often are not required to be registered with the SEC or other governing body. Most private hedge funds have a substantial investment minimum – often $1 million or more and many hedge funds come with required holding periods or “lock-ups”. Furthermore, many hedge funds are only accessible to large institutions and wealthy investors who can meet stringent suitability requirements. Tax reporting for private hedge funds generally involves K-1s, which some investors find can delay and complicate their tax filings.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Single vs. Multi-Manager Funds</th>
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<tbody>
<tr>
<td>Selecting a private single manager hedge fund requires expertise, time-demanding manager due diligence and research. Investments in private hedge funds can also come with a number of requirements and restrictions (detailed above), including a high minimum investment. Because of high minimum investment requirements, it can be difficult to diversify across multiple funds and strategies.</td>
</tr>
<tr>
<td>Funds of hedge funds are funds that invest in multiple hedge funds. They can offer the diversification benefits of investing in a variety of strategies with a variety of managers. They may also have lower investment minimums than private single manager hedge funds, making them more accessible. In addition, they often have professional managers who conduct extensive research and due diligence on hedge funds. Funds of hedge funds are typically privately offered not registered, while some funds of hedge funds are structured as closed-end regulated investment companies, or RICs. It is best to verify this information with the product provider prior to investing.</td>
</tr>
</tbody>
</table>
Fund of Hedge Funds: A Closer Look

A fund of hedge funds is an investment vehicle that pools investor assets together and invests across multiple hedge funds. It offers investors a potentially lower minimum investment to access a professionally selected and managed portfolio of hedge funds. The sponsor of the fund of hedge funds is responsible for the due diligence, manager selection, portfolio construction, risk management, ongoing monitoring and rebalancing.

A fund of hedge funds will still seek to deliver absolute returns and diversification from stocks and bonds with reduced volatility. In some cases, the pooling of investor money together may allow a fund of hedge funds to access managers unavailable to most individual investors due to high investment minimums.

 Funds of hedge funds often offer quarterly liquidity, but can be subject to minimum initial holding periods of underlying hedge funds. In addition, most funds of hedge funds are still subject to the fee structure and transparency restrictions of the underlying hedge funds in which they are invested. In addition, the fund of hedge funds may or may not be registered with a regulatory agency. Some fund of hedge funds are structured as regulated investment companies, or RICs. The RIC structure allows for convenient 1099 tax reporting and provides regulatory oversight. Investors should check with their product provider prior to investing.

<table>
<thead>
<tr>
<th>Fund of Hedge Funds</th>
<th>Benefit</th>
<th>Challenge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Possibility of Generating Absolute Returns</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Potential for Lower Volatility</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Potential for Diversification</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Accessibility</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Minimum Investment Requirement</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Required Holding Periods (Lockups)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Transparency</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Fee Structure</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Manager Due Diligence</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Tax Reporting (RIC)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Regulatory Oversight (RIC)</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>
Hedge Funds Use Many Different Strategies

While each hedge fund may promote its unique investment strategy, the majority of hedge funds fall into one of three broad categories, and six sub-categories:

- **Tactical**
  - Equity Long/Short
  - Global Macro

- **Event-Driven**
  - Distressed Securities
  - Special Situations

- **Arbitrage**
  - Equity Market Neutral
  - Fixed Income
  - Relative Value

**Hedge Fund Strategies: Tactical**

Hedge funds that specialize in tactical trading strategies seek to profit through both security selection and forecasting the overall direction of the market. The success of funds focusing in these areas depends on how well the fund manager can predict the timing of their investments.

**Example: Equity Long/Short**

Equity long/short strategies (equity hedge strategies) seek to balance risk and return by taking both long and short positions in stocks, stock options and futures. They involve buying long positions in stocks that are expected to increase in value and selling short positions in stocks that are expected to decrease in value. The goal is to profit from both sides of the market (stocks going up or down). Equity long/short managers can vary their net exposure in an attempt to time directional trends in equity markets. Most managers are “net long”, but can potentially vary their exposure to be neutral or “net short” in a bearish environment.

**Example: Global Macro**

Global macro strategies look for up or down price movements created by economic, political and market trends. They may take long and short positions in any type of security, including equities, fixed income, currencies and commodities. They may also trade in any and all global markets.

Global macro managers look for opportunities in both bull and bear markets due to the unconstrained nature of the strategy, allowing them to be long or short in any market at any time.
Hedge Fund Strategies: Event Driven

Event driven strategies seek positions in securities of companies that are, or are expected be, involved in significant events, such as a merger, acquisition or restructuring. Hedge funds that follow this approach can profit from actions that occur over a relatively short period of time such as corporate stock buybacks, bond upgrades, earnings surprises, spin-offs, etc. They can also seek to profit from longer term developments such as corporate bankruptcy proceedings.

Example: Distressed Securities

This strategy focuses on the securities of companies experiencing financial difficulties. “Distressed” is a broad term that can refer to companies that have defaulted on their debt or filed for bankruptcy protection. Hedge funds following this strategy are not limited to a particular asset type. They are active in bonds, stocks, bank debt, private placements, warrants, etc. However, this tends to be an illiquid strategy as corporate turnarounds and recoveries can take long periods of time, if they happen at all.

Example: Special Situations

Special Situation managers focus mainly on the stocks of companies which are currently engaged in a corporate transaction, security issuance/repurchase, asset sale, division spin-off or other catalyst oriented situation.

One example of a special situation that may gain attention would be a large public company spinning off one of its smaller business units into its own public company. If the fund manager deems the soon-to-be-spun-off company to have a higher valuation after the spinoff than its present form, the fund manager might buy shares in the parent company prior to the spinoff in an attempt to benefit from a potential price increase.
Hedge Fund Strategies: Arbitrage

Arbitrage strategies seek to take advantage of price inefficiencies that may occur between related securities, such as a stock and a bond issued by the same company, bonds of two different companies that are potentially mispriced, or company stock prices that are over or undervalued relative to their sector.

**Example: Equity Market Neutral**

Equity market neutral is the original and classic hedge fund strategy. This was the strategy deployed by Alfred Winslow Jones. A market neutral strategy seeks to isolate informational inefficiencies in the market that have not been identified by a vast majority of investors, who may be more swayed by emotions or headlines.

For example, a quantitative equity market neutral manager may make systematic predictions of relative stock performance based on a number of fundamental and technical signals. They then use these signals, such as earnings expectations, price momentum, and insider transactions, to buy the stocks with the highest ratings, and sell short the lowest rated stocks. By both buying long and selling short hundreds or thousands of stocks at the same time, they seek to neutralize the macro effect of the market or sector as a whole. They simply seek to gain from the small pricing inefficiencies, not the overall direction of the market. As the name suggests, the goal of the strategy is to remain neutral to the market, neither net long nor net short.

**Example: Fixed Income Relative Value**

Fixed income relative value managers attempt to exploit mispricing among fixed income securities. Due to the large number of instrument types in the fixed income space, and the large number of possible strategies, this tends to be the most complex of the hedge fund styles.

Managers utilizing this strategy tend to seek returns through value convergence. Instruments with similar credit risk, maturities and other characteristics should have similar prices. Arbitrageurs look for price divergences due to buyer and seller imbalances. Examples can include newly issued government bonds versus ones issued in the past, or government bonds vs. interest rate futures of the same maturity. The fund manager would set up a trade that goes long the instrument perceived as undervalued, and sells short the instrument perceived as overvalued — hence betting that the values will reconverge in the future.
Hedge Funds: Where Do They Fit In Your Portfolio?

Hedge funds are not for everyone, but they can be a strategic addition to the portfolios of certain qualified investors. Hedge fund strategies, or alternative investments in general, can be components of already existing asset class allocations. For instance, an equity long/short hedge fund could be included within an equity allocation, or a relative value fixed income hedge fund could be included within a fixed income allocation.

On the other hand, hedge fund strategies capture different sources of return and could be a separate allocation as part of an overall allocation to alternative investments. This is especially relevant for hedge fund strategies that invest in multiple asset classes, such as global macro.

If you think hedge fund strategies might make sense for your portfolio, talk with your financial advisor about what role these strategies might play and where they might fit in your asset allocation strategy.

Risks of Hedge Funds and Hedge Fund Investing

Hedge funds and funds of hedge funds involve special risks and considerations. Each fund's investment program is speculative and involves risks inherent in an investment in securities, as well as specific risks associated with the use of leverage, short sales, options, futures, derivatives, junk bonds, emerging markets, illiquid securities and limited regulatory oversight.

Alternative investment products, including hedge funds and managed futures, involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not always required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager. Alternative investment performance can be volatile. An investor could lose all or a substantial amount of his or her investment.

Often, alternative investment fund managers have total trading authority over their funds or accounts; the use of a single advisor applying generally similar trading programs could mean lack of diversification and, consequently, higher risk. There is often no secondary market for an investor’s interest in alternative investments, and none is expected to develop. There may be restrictions on transferring interests in any alternative investment. Alternative investment products often execute a substantial portion of their trades on non-US exchanges. Investing in foreign markets may entail risks that differ from those associated with investments in US markets. Additionally, alternative investments often entail commodity trading, which involves substantial risk of loss.
This glossary is intended as a reference for commonly used investment terms but does not contain all relevant terms nor all possible definitions of any individual term. You may wish to contact your investment professional for additional information. The information set forth was obtained from sources believed to be reliable, but we do not guarantee its accuracy or completeness.

**Alpha**: A measure of risk-adjusted performance. A higher alpha indicates a security has performed better than expected with its given beta (or volatility.) See Beta.

**Alternative Investment**: An investment product other than traditional investments such as stocks, bonds, cash or property.

**Asset Class**: Category of different investment types, such as stocks, bonds, real estate, cash, etc.

**Barclay Systematic Traders Index**: An equal weighted composite of managed futures programs whose approach is at least 95% systematic. In 2015 there are 454 systematic programs included in the index. The performance of the index is net of management and incentive fees.

**Beta**: A measure of the degree in which a fund's excess return is expected to be above the market's excess return during a specific period of an investment, fund or commodity. A drawdown is usually quoted as the percentage between the peak and the trough.

Managed futures investments are subject to risks, including illiquidity, lack of a secondary market, and the volatility of the underlying commodities or futures markets traded by a particular program.

**Barclays US Aggregate Bond Index**: Provides a measure of the performance of the US investment grade bond market, which includes investment grade US Government bonds, investment grade corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the Index must have at least 1 year remaining to maturity. In addition, the securities must be denominated in US dollars and must be fixed rate, nonconvertible and taxable.

Bond investments are subject to risks, including: interest rate risk, call risk, credit risk and reinvestment risk. Bonds rated below investment grade may have speculative characteristics and present additional risks.

**Bear Market (Bear/Bearish)**: A market condition in which prices of securities are falling.

**Beta**: Measures a fund's sensitivity to market movements by comparing a fund's excess return (over a benchmark) to the market's excess return. By definition, the beta of the market is 1.00. For example, a beta that is lower than 1.00 would normally indicate that a fund's excess return is expected to be above the market's excess return in a down year and below in an up year. However, beta cannot predict a fund's future performance.

**Bull Market (Bull/Bullish)**: A market condition in which prices of securities are rising.

**Closed-End Fund**: A continuously offered registered investment company that is not a mutual fund or an exchange traded fund. They are publicly offered, but not listed on a securities exchange.

**Compound Return**: The rate of return, usually expressed as a percentage, that represents the cumulative effect that a series of gains or losses have on an original amount of capital over a period of time. Compound returns are usually expressed in annual terms, meaning that the percentage number that is reported represents the annualized rate at which capital has compounded over time.

**Correlation**: A measure of the degree to which two variables relate to each other.

**Derivative**: A contract whose value depends upon the price of an underlying commodity, security or index.

**Diversification**: A portfolio strategy designed to reduce exposure to risk by combining a variety of investments. The goal of diversification is to reduce the risk in a portfolio. Volatility is limited by the fact that not all asset classes or industries or individual companies move up and down in value at the same time or at the same rate. Diversification reduces both the upside and downside potential and allows for more consistent performance under a wide range of economic conditions.

**Drawdown**: The peak-to-trough decline during a specific period of an investment, fund or commodity. A drawdown is usually quoted as the percentage between the peak and the trough.

**Due Diligence**: An investigation or audit of a potential investment. Due diligence serves to confirm all material facts both prior to an investment and on an ongoing basis after investing.

**Exchange Traded Fund (ETF)**: ETFs combine features of an index fund and a stock traded on a major exchange.

**Funds of Hedge Funds**: An investment vehicle that invests entirely in other funds. It may be described in a way that indicates what type of funds it invests in. For example, a private equity fund of funds probably invests its capital in only private equity funds. A growing class of fund of funds invests primarily in hedge funds. This type of fund of funds is usually called a fund of hedge funds. Such a fund may have a much smaller minimum investment than the typical hedge fund, opening the door to this type of alternative investment to a much larger pool of investors.

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**Glossary**

**Hedge Fund**: A managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). Most hedge funds are often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment. Investments in hedge funds are illiquid as they sometimes require investors keep their money in the fund for at least one year.

**Hedging**: A protective procedure designed to reduce losses that may arise because of price fluctuations in an asset.

**HFR Fund Weighted Composite Index**: The HFR Fund Weighted Composite Index is a global, equal-weighted index of over 2,200 single-manager funds that report to the HFR Database. Constituent funds report monthly performance net of all fees in US dollars and have a minimum of $50 Million under management or a 12-month track record of active performance. The HFR Fund Weighted Composite Index does not include funds of hedge funds.

**Incentive Fee**: An incentive fee or performance fee is a fee that an investment fund may be charged by the investment manager that manages its assets, calculated by reference to the net profits achieved by the fund's investments. Performance fees are widely used by the investment managers of hedge funds, which typically charge a performance fee of 20% of the net profits of the fund.

**Interest Rate Future**: A financial derivative (a futures contract) with an interest-bearing instrument as the underlying asset. It is a particular type of interest rate derivative.

**Junk Bond**: High-yield or non-investment grade bond. Junk bonds are fixed-income instruments that carry a rating of 'BB' or lower.
by Standard & Poor's, or ‘Ba’ or below by Moody's. Junk bonds are so called because of their higher default risk in relation to investment-grade bonds.

K-1: A tax document used to report the incomes, losses and dividends of a business’s partners or S corporation's shareholders. Rather than being a financial summary for the entire group, the Schedule K-1 document is prepared for each partner or shareholder individually.

Leverage: The use of various financial instruments or borrowed capital, such as margin, to increase the risk and potential return of an investment.

Liquidity: The ability to convert an asset to cash quickly. Also known as “marketability.”

Lock Up: A hard lock up would prevent an investor from withdrawing capital from a fund before the expiration of the lock up period. Soft lock ups allow for a withdrawal upon payment of penalty prior to the expiration of a lock up period.

Long: A position that will profit from an increase in a security’s price.

Managed Futures: A form of alternative investment that takes long and short positions in futures contracts, currency forward contracts, government securities, and options on futures contracts. Managed futures are operated by licensed Commodity Trading Advisors, or CTAs, who are regulated in the United States by the Commodity Futures Trading Commission and the National Futures Association, or NFA.

Management Fee: A charge levied by an investment manager for managing an investment fund. The management fee is intended to compensate the managers for their time and expertise. It can also include other items such as investor relations expenses and the administration costs of the fund.

Momentum: The rate of increase or decrease of a security’s price or volume. The idea of momentum in securities is that their price may be more likely to keep moving in the same direction than to change direction. In technical analysis, momentum is used to help identify trend lines.

Morgan Stanley Capital International Europe, Australasia, Far East Index (MSCI EAFE Index)*: A capitalization-weighted index that is designed to measure the investment returns of developed economies outside of North America. The Index includes publicly traded stocks from 21 countries.

International investments may involve risk of capital loss from unfavorable fluctuations in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations.

Mutual Fund: An investment vehicle that is made up of a pool of capital collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets.

National Association of Real Estate Investment Trusts All REITs Index (NAREIT All REITs Index)*: An unmanaged total return index designed to measure the growth and performance of the real estate investment trust (REIT) industry. The Index includes all REITs currently trading on the New York Stock Exchange, the NASDAQ National Market System and the American Stock Exchange.

REITs are subject to risks similar to those associated with direct investments in real estate: property value fluctuations, lack of liquidity, limited diversification and sensitivity to economic factors such as interest rate changes and market recessions.

Option: The right, but not the obligation, to buy (for a call option) or sell (for a put option) a specific amount of a given stock, commodity, currency, index, or debt instrument, at a specified price (the strike price) during a specified period of time.

Position: A commitment, either long or short, in the market.

Private Placement: Sale of an entire issue of a security to a small group of investors who undertake not to resell it within a specified period. In the US, if the sale is made to less than 35 investors, it is exempt from Securities and Exchange Commission (SEC) registration requirements.

Return/Risk Ratio: A simple calculation meant to illustrate the amount of return achieved per unit of risk. It is derived by dividing the average annual return by the standard deviation of an investment. A higher number tends to signify a better return/risk relationship, whereas a lower number may be seen as unfavorable.

Securities and Exchange Commission (SEC): Established by Congress to help protect investors, administer the Securities Act of 1933, the Securities Exchange Act of 1934, as well as the Investment Company Act, among others.

Short: A position that will profit from a decrease in a security’s price.

Standard Deviation: Measures the dispersal or uncertainty in a random variable (in this case, investment returns). It measures the degree of variation of returns around the mean (average) return. The higher the volatility of the investment returns, the higher the standard deviation will be.

Standard & Poor's 500 Total Return Index (S&P 500 TR Index)*: The 500 stocks in the S&P 500 are chosen by Standard and Poor's based on market size, industry representation, liquidity and stability. The stocks in the S&P 500 are not the 500 largest companies; rather the Index is designed to be a leading indicator of US equities and is meant to reflect the risk/return characteristics of the large cap universe.

US equity index investments are subject to risks, including price fluctuations in response to news on companies, industries, government policies and the general economic environment.

S&P GSCI® Total Return Index (S&P GSCI® TR Index)*: A composite index of commodity sector returns representing a broadly diversified, unleveraged, long-only investment in commodity futures. The returns are calculated on a fully collateralized basis with full reinvestment.

Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

Transparency: The extent to which investors have ready access to view the portfolio holdings of a fund.

Treasury Inflation Protected Securities (TIPS): Inflation-indexed bonds issued by the US Treasury. The principal is adjusted to the Consumer Price Index (CPI), the commonly used measure of inflation. When the CPI rises, the principal adjusts upward. If the index falls, the principal adjusts downwards. The coupon rate is constant, but generates a different amount of interest when multiplied by the inflation-adjusted principal, thus protecting the holder against the official inflation rate.

Volatility: The relative rate at which the price of a security moves up and down.

Warrant: Long-term certificate issued by a firm giving the holder the right to purchase its securities at a stipulated price (exercise price) in the future. Warrants are negotiable instruments that usually serve to enhance the marketability of corporate bonds or preferred stock.

Yield: The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment’s cost, its current market value or its face value.

*One cannot invest directly in an index.
Before investing, you should carefully consider the Fund's investment objectives, risks, charges and expenses. For a prospectus that contains this and other information about the Fund, please visit our website at www.steben.com or contact Steben & Company at 800.726.3400 or info@steben.com. Please read the prospectus carefully before you invest.

Foreside Fund Services, LLC, Distributor