

April 2022

Dear Fellow Investors,

The Fund¹ returned approximately -26.5% net in the first quarter. Individual returns will vary by class and date of investment, so please check your statements. Against a backdrop of rising rates, investors continued to shun “growth” companies during the first quarter. While we do not own the highest-multiple and highest-flying growth companies, our portfolio was not spared. With the vast majority of my liquid net worth invested in our funds, I felt every percentage tick down right alongside you.

You may be surprised by the optimistic tone in portions of this letter. Rest assured, I have not been immune to current events. When the Russians were shelling Europe’s largest nuclear power station and TV commentators were discussing what happens when power goes out to the pumps cooling the nuclear rods, the fear was almost paralyzing. I just started eating ice cream sandwiches and thinking about my children. As tensions mounted between Russia and the West and the U.S. began leading the imposition of financial sanctions, I thought about Andy Greenberg’s book “Sandworm: A New Era of Cyberwar and the Hunt for the Kremlin’s Most Dangerous Hackers,” which details the cyberattack tools Russia has used in the past. The darker parts of my mind envisioned Russia employing them against U.S. financial institutions in retaliation for freezing Russian foreign reserves, so I went to the bank and took out enough physical cash to endure a prolonged cyberattack on the U.S. financial system. When my family went on spring break, I took half of it with me in my backpack. None of this is standard operating procedure – these are not normal times; it is not all blue skies.

WHAT DO WE HAVE TO BELIEVE?

I spent more than a decade on the operating side of business wearing several hats including CFO, chief strategy officer, and board member for Acelero Learning, an early learning education company. Since I co-founded Acelero, it has grown to employ over 1,500 people and generate \$100M per year in revenue. As we operated and grew, we ran through a thought exercise for every major decision: what do we have to believe for this initiative to be a good idea? The answer to this question is different for each situation, but often has to do with factors like: Is the opportunity enduring? Do we have the right people? Can we get to sustainable margins? Are there regulatory tailwinds?

I often run our Greenhaven Road portfolio through the same thought exercise. What do we have to believe for this to be a good investment? The answer here is also different for each situation, but I find it striking that the “problems” that seem to consume investors’ mindshare and appear to be driving share prices are not the factors I would deem critical for the success of the companies we hold. The three big factors that currently appear to be dominating investors’ focus – and therefore short-term stock performance – are rising interest rates/inflation, rising oil prices, and war in Ukraine. If there is a silver lining in this cacophony of worry, it is that, while each one of these factors represents rising uncertainty and would be detrimental to the economy when taken to an extreme, at current levels they individually have little impact on the intrinsic value of our holdings over a multi-year period.

¹ Greenhaven Road Capital Fund 1, LP, Greenhaven Road Capital Fund 1 Offshore, Ltd., and Greenhaven Road Capital Fund 2, LP are referred to herein as the “Fund” or the “Partnership”

Jeff Immelt, CEO of industrial conglomerate GE, used to say that he could grow revenue by GDP growth +5%. In contrast, our portfolio companies rely on more narrow secular tailwinds and organic growth factors. Our investments do benefit from a stronger economy, but they are not predicated on a strong GDP

In my opinion, the dynamic of mispricing pervades all of our top five holdings. While there have been large downward movements in price, the threats are not existential. The tailwinds remain in place. The fundamentals remain intact. We don't see large shifts in the competitive landscapes, operational snafus, or fraud. Our portfolio is not reliant on cheap debt or low oil, can pass on inflation to end customers, and has no material exposure to Russia/Ukraine. Management has not turned sour on the opportunities in front of them.

Yes, interest rates are rising, which will likely slow the economy. For now, this shift also has decimated investor appetite for "long duration growth assets." This is different than the companies we own being screwed: **the valuations have compressed, not the fundamentals.** This is not to say that mistakes have not been made – they have. This is also not to say that none of our business have experienced any issues such as missed earnings. Outside of the top five holdings, some have, but within our top five holdings, I believe the share price moves continue to be driven by multiple compression and have little relation to the changes in the future prospects of the businesses. Although this has produced unrealized losses in the interim, I continue to believe that, given the growth embedded in our portfolio, we don't need multiples to revert to previous levels in order for us to earn attractive returns.

KKR (KKR) – Let's look at our investment in the private equity firm KKR through the lenses of rising rates, rising oil prices, and conflict in Ukraine. Keep in mind, KKR was down more than 20% in Q1. KKR has close to zero revenue or holdings in Russia or Ukraine. The war is a human tragedy but does not impact the durability of KKR's asset management business. Regarding the impact of higher oil prices, a weakened consumer may be bad in the short term, but this is in part off set by the massive \$100B+ pile of "dry powder" that KKR has available to invest on weakness in the economy and the markets. As for rising interest rates, one could argue that because KKR uses debt to finance some of their private equity deals, rising rates make it harder to do new deals and make the debt more burdensome for existing holdings. That said, when you look at the mix of funds they manage and their investment strategies, rising rates are a manageable headwind that may impact the structure of some future deals. Rising rates will not grind the investment process to a stop, and they will be a tailwind for the capital markets business. In my opinion, for our investment in KKR to be successful, we do not have to believe that there will be peace in Ukraine, low oil, or low rates.

What we do have to believe is that KKR will continue to attract assets and maintain an economic structure that does not just reward employees, but shareholders (us) as well. From an asset-gathering perspective, I believe KKR is as strong as ever. The recent volatility only makes their private funds more attractive to large allocators for whom the muted volatility of private investments extends personal career longevity. A recent Goldman Sachs survey confirmed that private equity is an area where investors expect to increase their allocation in 2022. In addition, KKR is expanding distribution by opening their funds up to a larger base of retail investors. The fundraising parade is alive and well.

Could the employees capture all of the economic benefits? Let's examine the facts. Compensation as a percentage of revenue has been trending down, not up. There are strong independent directors. Employees own approximately 40% of the outstanding shares, and the co-CEOs' gargantuan compensation packages are tied to the equity price. These factors all tilt the odds in favor of common shareholders (us) reaping some of the benefits of the firm's continued growth. Despite recent price volatility, the foundations of why we own KKR remain firmly in place.

KKR's share price ended the quarter at \$58.47. In round numbers, they last reported \$28 per share in book value, which included \$18 per share in cash and investments, \$7 in unrealized incentive fees, \$5 in Global Atlantic insurance investment, and some debt. Forty-four percent of the fee-paying AUM is perpetual (non-redeemable), management fees grew by 44% last year, and there is over \$100B in callable capital (the aforementioned "dry powder") that is not yet providing any fee income. The company had \$4.44 in distributable earnings last year. Given the continued AUM growth and the improving economics of funds as they mature and layer in follow-on funds, it is quite unlikely that 2021 was peak earnings.

In summary, we have a stock at ~\$55 (as of Friday, April 14) with \$28 per share in book value that has compounded in the teens. If you back that out, we are paying a single-digit multiple of a growing earnings power on a core business that is incredibly durable and scalable with persistent secular tailwinds. For KKR, if I am forced to choose between the markets efficiently pricing the company or the markets overly focusing on extraneous events and mispricing it, I will choose the latter and continue owning shares.

PAR Technology (PAR) – PAR was down almost 25% in the first quarter. The company has hundreds of millions of dollars of cash on their balance sheet and no apparent near-term need to tap the debt markets, so rates are not a factor here. They have had some programmers in Ukraine but no end customers in that part of the world, so the actual impact there is negligible too. Their primary business is POS (point of sale) for QSRs (Quick Service Restaurants like Dairy Queen), and the vast majority of revenue is derived from each QSR location being open for business. Like an electric utility, PAR will get paid if a Dairy Queen location is open. While rising wages and food costs (the latter of which are also impacted by fuel prices) complicate operations for QSRs, there is no indication that there is going to be a step function decline in the number of Dairy Queens open for business. In fact, in harder economic times, consumers typically "trade down" to cheaper options and, within the hospitality sector, QSRs can be a preferred place for investors to "hide out."

The headwinds of the day appear manageable for PAR, so maybe there are PAR-specific issues? At an investor conference in March, the CEO said, the product lines "are all doing really, really well, and you know a lot of this is a result of us having great products, but also the market we serve continuing to grow and look for the market leader." He went on to indicate that growth this year would likely be higher than last year.

PAR has extended their product to convenience stores and alluded to two customer wins, and the job postings for a 500-unit convenience store chain indicate that they are currently hiring to implement PAR products. Even more encouraging, the company is gaining traction in their payments business, which should generate tens of millions of dollars of very high margin revenue over the next few years. At PAR, the payments division currently consists of a five-person team, indicative of the operating leverage one has when building on top of an existing POS system.

The company ended the quarter with a market capitalization of approximately \$1.1B. When you back out the hardware and defense businesses, we are paying a mid-single-digits multiple of year-end recurring revenue for a business with a very long runway for growth (the POS system is currently in 16,000 locations). It is very possible that, despite the difficult environment, they will accelerate growth this year to exceed 35%. At the foundation of our ownership of PAR, I believe that the company has an exceptional CEO (jockey bet) who has a winning product (enterprise-grade POS) with many potential adjacent products (e.g., payments), a long runway for growth, ample capital to execute the plan, and an attractive competitive landscape. Despite what Mr. Market is saying, I believe that PAR is in an unequivocally better and stronger position now than at any point which we have owned it. We bought more during the quarter.

Elastic Software (ESTC) – Elastic’s share price, too, was down more than 20% in the first quarter. CEO Shay Bannon stepped down during the period, which certainly spooked investors. However, he did not leave the company but instead became the Chief Product Officer. He did not sell any of his more than \$500M worth of stock; he just changed his role. He is not the first CEO who has dreamed of simplifying their role to focus on the part of the business they enjoy and leave the rest to others, he is just one of the few to actually do it. I do think that in the long term the role change will prove to be the best use of his unique talents. Understandably, some investors were concerned that the CEO was being pushed down because of operational issues, but if there *were* issues, they have not appeared in the results. One service that tracks earnings and metrics had Elastic beating analyst estimates on 18 of their 20 metrics, including all of the important ones. Elastic grew revenue at 42% in the last quarter and their cloud-hosted version, the most important piece of business, grew at 79%. Elastic has no known material exposure to Russia or Ukraine, no known material exposure to oil, and is very well-equipped to navigate an inflationary environment.

The beliefs underlying our investment in Elastic remain intact. People want to find information quickly, Elastic will be able to maintain leading products, and Elastic will build a viable business as an open-source software company. All indications are that data is still being generated. Statista estimated that 74 zettabytes of data were going to be created in 2021, up from 59 zettabytes in 2020 and 41 zettabytes in 2019. I don’t know exactly what a zettabyte is either, but suffice it to say, data volume is increasing and parsing it effectively is as important as ever. As for the leadership and relevance of Elastic’s products, the growth rates of new products and their ability to cross sell provide evidence of success. Lastly, I think the question of the open-source business model’s viability has been put to bed. I believe Elastic will generate over \$1B in revenue this year and has also changed the licensing model to encourage paid versions, successfully fought Amazon and their trademark infringement, and could be profitable tomorrow were they to dial back their very substantial investments in sales, marketing, and new product development. Everything I think we have to believe to own Elastic remains in place.

Teladoc Health (TDOC) – Yes, Teladoc was a Covid beneficiary, and right now, it seems as if all Covid beneficiaries are easy targets... perhaps we should be relieved that shares were not down more. These days, Covid beneficiary = bad stock. This would imply that having received a benefit from something in the past precludes the business from continuing to grow and expand. Shares traded at 10 times forward revenue at the end of 2019 before Covid froze the world and drove demand. During the peak of Covid multiple expansion, Teladoc shares traded at more than 25 times revenue. We own shares at approximately 4.5 times this year’s revenue, or less than half the multiple before Covid and less than 80% of the peak multiple. Given the company’s 30% growth rate, we don’t need multiple expansion to make money.

For our investment in Teladoc to be successful, we have to believe that Teladoc can continue to grow and that scale matters. As for future growth, the CEO said at a recent conference, “What’s important is, when it comes to revenue (growth), everything that we are talking about is under contract. So when I say we have high visibility, it is because of that. It’s already contracted.” Rest assured, none of those contracts were voided this quarter, and the path to 30% growth this year remains intact.

Will scale continue to matter for Teladoc? The short answer, I believe, is yes. Teladoc benefits from scale in many ways. For the portion of their business that is a two-sided marketplace matching doctors to patients for telemedicine visits, scale provides a better experience for both doctors and patients. Scale in terms of the breadth of offerings matters to employers as they are choosing providers. Financial scale allows a more robust product development pipeline. From a data AI perspective, scale provides larger data sets. From a business development perspective, scale provides cross-selling opportunities. Scale still matters, and Teledoc still has it.

We bought during the quarter, which is not a popular decision and not yet a profitable decision. The company is not consuming cash, does not need to raise capital, and will grow 30% per year for some time, just by cross selling existing products into their existing base.

Digital Turbine (APPS) – Digital Turbine has effectively zero exposure to oil or Ukraine, is well equipped to deal with inflation as all of its inputs and outputs are digital, and should have zero issues with rising rates. Shares got hammered with the decline in “growth stocks” as well as a concern that Google would change its policies on Android device IDs that are used for advertising targeting and attribution (a change that wasn’t put in place but was discussed in a blog post). Given that Digital Turbine has software on devices and is not reliant on the Android device IDs for attribution, it is more likely they would be a beneficiary of this change than a victim. Add in the fact that the European Union is progressing towards a Digital Markets Act that would compel Apple to allow for competing app stores, the regulatory landscape is favorable to Digital Turbine. The decline is exceedingly frustrating.

Our investment in Digital Turbine is predicated on three beliefs. The first is that companies will continue to want direct relationships with their customers via apps. The second is that companies will go to where the eyeballs are, which means mobile phones for the foreseeable future. The third belief is that Digital Turbine can carve out a durable and profitable niche between end users and app developers/carriers/handset manufacturers. All of these beliefs remain in place; nothing has changed. Digital Turbine’s software is installed on over 1.5 billion devices and growing, and they work with more carriers and companies every quarter.

In terms of valuation, management has guided to tripling revenues and 10Xing profits over the next three to five years. Yes, that is a long time and a lot can go wrong, but we are not paying for that level of upside. If you take the last quarter’s run rate earnings, adjusting for one-time expenses related to acquisitions and the amortization of intangibles, you get an adjusted net income of approximately 43 cents per share or \$1.72 per share annualized. This is for a core legacy business that grew 43% with large wins for the MobilePosse business and a SingleTap business with a bright future. Unlike many high growth companies, Digital Turbine is profitable while growing and has a PEG ratio below 1.

SHORTS

During the quarter, the Fund remained short major indices, a recent electric car IPO, and initiated a short position in a SPAC which under optimistic projections will not have meaningful revenue for years.

ANNUAL MEETING

It is with great pleasure that I invite you to our annual meeting in NYC on the evening of Thursday, October 13th. Details on the precise location and timing will follow, but I wanted to give as much notice as possible. Given that we have limited partners living on six continents, we will record the meeting for those who cannot attend. Please be on the lookout for communication from Ally via Paperless Post over the coming weeks.

OUTLOOK

In every letter, I reiterate that we will have down months, quarters, and years – and nothing has changed, we will have more down periods. However, as war rages, the Fed raises interest rates, and we just had a very rough quarter as a partnership, I

think it is worth emphasizing that we should also have UP months, quarters, and years going forward. A portfolio manager friend likes to call on days where our stocks are up substantially and scream, “it’s GO Time!!!” There have been fewer of those calls lately. The odds of recession have increased, multiples have compressed, rates are rising, and investor appetite is waning. Given the uncertainty in the world, the bottom may not be in sight, even if our portfolio companies’ fundamentals remain strong. Multiples can compress further and/or companies may stumble – we are not owed an immediate snapback like we saw in Q2 2020.

We are in a period where the macro picture (inflation, rates, and fed balance sheet) is trumping the micro. Pessimism has won the day, particularly for more growth-oriented companies. However, as Lachlan Morgan pointed out in an excellent piece looking at Amazon and the challenges it faced over a twenty-year period ([link](#)), “the pessimists sounded smart... while the optimists made the money.” At the risk of sounding Pollyanna-ish, many inputs to inflation – including oil, used cars, and freight rates – are currently off their highs, and while supply chain issues are not solved, they are solvable. Additionally, the West’s reaction to Russia’s invasion of Ukraine may give pause to China, which relies on exports, from taking action in Taiwan. While Putin seems determined and it is certainly possible that this becomes a protracted war, there is also a reasonable possibility of Russia finding a semi-face-saving solution.

This is clearly a darker period and the range of potential outcomes is wider. My mother was a refugee, and I have great empathy for Ukrainians as well as people living closer to Russia and/or relying on it as a trading partner. The status quo has changed for the worse, and the likelihood of very negative outcomes has increased. I certainly would not want to be sitting in Berlin trying to figure out a back-up plan for heat next winter if gas is cut off, but I also suspect this is a large bump along the path described by Lachlan Morgan, where pessimism sounds smart but optimism generates returns. We are invested with very talented management teams benefitting from strong secular tailwinds. The market may ignore the value being created this week, month, quarter, or even this year – but over time I will take creativity, ingenuity, and the incentives of capitalism.

When I look in the mirror, I see a guy who was down 26.5% in the first quarter, and my first reaction is one of disgust, but when I look at our holdings, I see a bunch of potential doubles, triples, and even quadruples. Morgan Housel wrote a great piece in 2016 called “The Agony of High Returns” ([link](#)) where he noted, “It’s hard to grasp how the best-performing stock of the last 20 years could spend the majority of that time with returns that would make you want to vomit.” We are not guaranteed great returns, but as Morgan points out, periods like this are the cost of admission for the chance at them. The war is halfway around the world, employment statistics are strong, and the quality of the teams we are backing remains steadfast. Multiples can only compress so far. If the companies continue to execute, eventually we get paid.

As I end every letter... as volatility arises, I will attempt to take advantage of the opportunities it creates. We will continue to invest with a long time horizon, and we will continue to invest like it is our own money – because it is. Thank you for the opportunity to grow your family capital alongside mine.

Sincerely,



Scott Miller

NEW INVESTMENT – CANNABIS BASKET

Given the volatility in the markets, I spent a lot of time looking at potential new investments over the past several months. The primary companies that are “working” have been resource companies from oil and gas to mining. This is largely driven by macro forces – rising commodity prices lift all resource-related shares. However, these tend to be capital intensive businesses where earnings are driven by commodity price, which is out of the operators’ control, and high prices generally create additional supply leading to a boom/bust cycle. Fortunes have and will be made, but in general these resource companies are not good businesses, and we have not invested in one yet.

This quarter, our largest new investment is in a basket of cannabis stocks, or more accurately, companies that happen to sell cannabis. The investment thesis is not predicated on a strongly held belief in the benefits of marijuana – rather it is a much more cynical belief that there is an investment opportunity created because of a broken regulatory framework that has distorted the earnings and valuations for cannabis companies. With more than two-thirds of Americans supporting the legalization of adult-use cannabis and 18 states already adopting it, I believe it is a matter of when, not if, full legalization happens. There is too much potential tax revenue at stake and too much popular support. When legalization is formally addressed, valuations may dramatically improve. In the meantime, valuations are quite reasonable for profitable growing businesses. The most knowledgeable and vocal investor on this topic is Aaron Edelheit of Mindset Capital, which has a cannabis-dedicated fund. I would not have ended up in this corner of the financial markets without his writing, podcasting, and general proselytizing.

At a federal level, marijuana is classified as a Schedule 1 drug. This means that, even though it is completely legal in 18 states, cannabis is treated the same as heroin. Being a Schedule 1 drug at the federal level has implications in both the “real” world and the financial world. In the financial world, where we invest, any company that “touches the plant” faces the following challenges:

- 1) **Cannot be listed on U.S. stock exchanges:** The leading cannabis companies selling product in the United States cannot list on the U.S. stock exchanges. The only companies able to list in the U.S. are those that do not “touch the plant” or those that operate only outside of the U.S. such as Tilray (TLRY), Canopy Growth (CGC), and Aurora (ACB). There are large valuation gaps between those listed in the United States (higher) and those listed in Canada. If the laws change at the federal level, a company that touches the plant will be able to both operate in the U.S. and list on U.S. exchanges.
- 2) **Shares cannot be held at many brokers:** Even if you are willing to purchase the Canadian-listed shares of the U.S. operators, many of the largest U.S. prime brokers such as Pershing, JPMorgan, and Credit Suisse do not allow accounts to hold shares in companies that touch the plant. The net result of these regulations is that shares in leading U.S. cannabis companies have virtually no institutional or passive ownership.
- 3) **Severe banking restrictions:** Companies that touch the plant have difficulty accessing the interstate U.S. banking system, including the credit card networks. As a result, business is conducted in cash and multi-state operators have overly complex financial operations as they need accounts in every state. In addition, cannabis companies have very high cost of capital – it is common to see profitable operators paying interest rates in the mid-teens.
- 4) **Overtaxed:** Today, even though 18 states have legalized adult use of cannabis and 32 other states permit medical use in some form, cannabis retailers must pay taxes under a regulation called 280E. This tax code essentially makes cannabis companies pay taxes on *gross* revenue – a huge financial burden that makes it difficult to turn a profit. The law defies common sense and addressing this would dramatically reduce the tax bills / increase the earnings of the U.S. operators selling products legally.

- 5) **Massive Black Market:** The illegality of cannabis products at the federal level, as well as in many states, creates a massive “black market” that has effectively developed consumers. As legalization happens, assuming the taxation is not overly aggressive, legal players can take share from this already built market.

Beyond the nonsensical laws and the distortions that they create, cannabis companies may not actually be “good businesses” or good investments. In fact, I would be surprised if many of today’s listed cannabis companies are enduring businesses. I am highly skeptical that the growers are going to earn supersized returns over time. In a fully legalized environment, the smaller farmers without regulatory protections may look a lot like grape growers – in a decidedly mediocre business. Similarly, while I believe that brand will matter over time (as it does in all consumer package goods categories), I am skeptical that there is enduring brand equity built up yet by any of the current operators. Of more promise, in my opinion, are retailers that operate in states with limited license opportunities.

Currently, retail licenses are typically granted at the state level and individual cities and towns determine if they want dispensaries in their communities, and how many they may allow. Many communities have voted against having any dispensaries in their community while others are limiting the number to one or two. The net result is that local regulations artificially limit the number of retailers (supply). This dynamic of constrained supply leads to a 4,000-square-foot dispensary in the Chicago suburb of Naperville, IL doing over \$12M in revenue last year. That is clearly an outlier, but the notion of local regulations creating local monopolies for retailers is an attractive set-up.

Cannabis investors have been waiting for years for regulatory change at the Federal level. Various legislation has been proposed, but nothing has passed the House and Senate. Proposed changes range from sweeping legalization including interstate commerce to more modest proposals addressing banking. Given the gridlock in Washington, it may take a long time to see any real shifts. At the state level, some of the adult use rollouts have been slow, in part because many states are awash in federal stimulus dollars and do not have financial holes to fill. When budgetary issues do arise, cannabis is an attractive place to look. In 2020, Illinois took in \$205 million in tax revenue from cannabis vs. \$72 million from alcohol. In my opinion, even if federal legislation continues to stall, the siren songs of tax revenues and public opinion will lead to further legalization in more states. The existing U.S.-focused multi-state operators are best equipped to navigate the patchwork regulations and the logical acquisition targets when the federal laws change.

A few years ago, there was a frenzy where anything marijuana related got “bid up” because there was a core group of enthusiasts who wanted exposure to the market and there was a limited supply of public equities to own. Investor enthusiasm has waned since. We now own a basket of Canadian-listed, U.S. focused cannabis companies. They have high growth rates (20%+) with mid-single digit EBITDA multiples and are generating cash. They have long runways for profitable growth driven by licenses in soon-to-be adult use markets such as New York, New Jersey, Connecticut, Pennsylvania, and eventually Florida. They should be very profitable for the foreseeable future even without federal law changes. If and when federal changes do occur, they could see a dramatic re-rating of their valuations.

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