JL CAPITAL & PARTNERS LTD

ALTERNATIVE INVESTMENT STRATEGY – INCOME, CASH FLOW

INVESTMENT RATIONAL AND OBJECTIVE

The strategy aims at achieving predictable, stable income independent from interest rate levels and fluctuations in bond markets or equity markets. Thus, the strategy is positioned as a substitute for/ supplement to cash deposits as well as bond portfolios or bond funds for investors aiming at

- regular cash flows of 4% - 6% p.a. (or to be defined individually)
- recommended minimum time horizon of 3 years
- moderate risk tolerance.

INVESTMENT STRATEGY — Summary

The main contribution to the target return will be collecting income from a disciplined and well executed option strategy (described below), with supplemental contributions from interest on cash holdings, fixed income and high dividend investments, dividends received from stocks assigned and income collected from selling call options on stocks assigned.

INVESTMENT STRATEGY — Detail

SHORT PUT OPTION STRATEGY (Selling Put Options):

Selling a put option gives the investor the right to collect a premium in exchange for the obligation to buy the underlying instrument (stocks)

- if the price of the underlying instrument falls below a specified level (strike price)
- after a specific time period (European style) or within a specific time period (American style)
- and a buyer of this option requires so.

The seller of a put option gets the comfort of making a limited but pre-defined profit in the amount of the premiums received which are paid upfront on opening a position (and so increasing cash holdings of the portfolio). If, at the time of expiration, the price of an underlying stock has gone up, sideways or even down (up to the predefined strike price) the put option sold by the investor expires worthless and the seller keeps the premium and pockets the profit.

The cash amount invested into the strategy acts as collateral for the possibility of getting the underlying stock assigned (having the obligation of buying it) at the defined strike price.

In an ideal world this will never happen, the strategy is just sitting on the original cash position, earning interest on it and additionally collects premiums from selling put options - which all expire worthless at the expiration date.

In a real world markets will sometimes move stocks below the strike prices of options sold, that is below the level with the strategy’s obligation to buy the underlying stock. Although assignments cannot be totally avoided the manager of the strategy has developed a number of measures to substantially reduce the probability for that to happen:

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- strict criteria for selecting top quality stocks as underlying for put options
- diversification of underlying instruments: selling put options on different stocks in different markets and industries, which usually do not move in concert
- diversification of maturities: selling put options with expiration dates ranging from one month up to one year (only in exceptional cases longer than one year)
- diversification of strike prices: laddering the strike price levels (obligations to buy) for each stock reduces the risk of being assigned the total position
- oversubscribing of positions to increase safety cushion (max. 1:2)

If market movements push some positions below the strike prices of sold options and the underlying stocks get assigned to the investor this will result in a temporary loss on that position. Under this scenario, there are again a number of possibilities to generate additional income to reduce/eliminate the loss and even turn it into a profit:

- if expiration dates are chosen well (e.g. before ex-dividend dates) dividends can be collected in addition to option premiums on stocks assigned
- selling call options as a way to dispose of assigned stocks (at the same strike price the stock was assigned) eliminates any loss and delivers additional income as opposed to paying commission for selling stocks directly in the market
- capital appreciation of stocks assigned or selling call options at a higher strike price compared to the assignment price provide additional profit potential

Important notice: it has to be emphasized that this strategy is NOT an equity strategy, therefore the goal is to unload assigned stock positions whenever reasonable and profitable.

ADDITIONAL INCREMENTAL RETURN (OPTIONAL):

- oversubscription of positions in the amount of 1:2 (for every 100 units of cash it is allowed to take on obligations/positions of up to 200 units). As target investors for this strategy are moderate risk investors oversubscribing will be used exclusively for increasing protection levels instead of improving returns. Thus, even if maximum oversubscription is employed, a minimum of 50% of all open put positions (holding the theoretical risk of getting assigned) is always covered by cash.

- Due to the disciplined process described above it has never happened in the past that all open positions at all expiration dates have ever been fully assigned. Therefore additional cash management strategies which are alligned with expiration dates of open put positions can be utilized to improve total returns on high cash levels held by the strategy.

Because of valuation characteristics of put options (falling prices of underlying stocks lead to increasing option premiums and result in higher income) this strategy is well positioned to deliver attractive overall risk reduction benefits for balanced portfolios with equity holdings.

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