

Reporting Results in Side-Pocket Funds

It is customary for APM to provide two types of participant-oriented reports on funds we administer. One is the participant statement for the period that contains capital account values and other details unique to each investor. The other is the "Perf Rep" - a fund-level view of performance¹, usually from fund inception with selected statistics and comparisons with market indexes (plus all the notes that would be appropriate).

Side-pockets are investments that are accounted for separately within a fund. They are typically shared only by the investors who were present at the time the position was purchased. Due to illiquidity and lack of current pricing, future capital contributions don't participate in existing side-pockets.

Because side-pockets are not shared by all investors, they don't appear in a fund-level report of performance. An investor or prospect seeking information about side-pocket results would normally be shown more qualitative information plus economic outcomes for side-pocketed positions. While APM can help by providing returns on individual side-pockets, we don't have a format developed for a qualitative report of this type.

It is standard practice at APM to report "normal" capital and side-pocket capital separately on investor statements. If an individual percentage return number is provided, it will reflect only the changes in "normal" capital. There are several reasons that side-pocket capital is excluded:

- The percentage return on "normal" capital, while subject to adjustment, can be considered very accurate. Adding in side-pocket valuations - which are typically not accurate on an interim basis (this is why they were side-pocketed) - diminishes the value of the participant statement.
- As noted in the footnote, participant returns can vary slightly from fund return, but differences would magnify if side-pockets were included. Accordingly, in order to minimize confusion between investor statements and Perf Reps, side-pockets should be excluded.

- Side-pocket pay-offs (or write-downs) typically are event-driven: the company has an IPO; defaults; or there is a significant financing that justifies a price change. In many cases, a side-pocket that is held at a static value, or with just small adjustments at audit time, may rocket or plunge in a single month when valuation becomes apparent. Since it is likely that the result in question was actually earned over a longer time period, plugging that number into a monthly return for an investor may create some misunderstanding.

For these reasons, APM reporting defaults to showing a percentage return only on "normal" capital and properly noting that on statements. For special cases, where the above objections are deemed irrelevant, or legal counsel advises a different approach, APM can override its processes to include side-pockets in individual returns on participant statements. However, the Perf Rep - being a fund-level report and having statistics - does not have that capability.

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⁽¹⁾ It is worth noting that, due to incentive high water marks being tracked separately by participant, individual net performance can differ slightly from the fund. For more information, see the Hedge Fund Element called "Participant Performance."