

CLIFFWATER^{LLC}

INVESTMENT ADVISORY SERVICES

Los Angeles • New York

Hedge Fund Operations Due Diligence Report
Graham Global Investment Fund II – Discretionary 6V Portfolio
Graham Global Investment Fund Ltd – Discretionary 6V Portfolio

October 2011

Investment Due Diligence Report provided under separate cover.

Hedge Fund Operations Due Diligence Report

Firm Name:	Graham Capital Management, L.P.		
Fund Name:	Graham Global Investment Fund II – Discretionary 6V Portfolio Graham Global Investment Fund Ltd – Discretionary 6V Portfolio		
Style:	Global Macro	Location:	New York, NY
Review Date:	October 2011	Reviewer:	██████████

Operations Score: ██████████			
1. Business Management	██████	4. Valuation	██████
2. Trading and Investment Operations	██████	5. Risk Management	██████
3. Financing and Counterparty Risk	██████	6. Investor Related Practices	██████

Summary

Graham Capital Management, L.P. was founded by Mr. Kenneth G. Tropin in 1994 and is currently managing approximately \$8.0 billion of assets, of which approximately \$1.5 billion is proprietary capital. The fund focuses on macro-oriented quantitative and discretionary investment strategies in the global fixed income, equity, foreign currency and commodity markets. The manager has 205 full time business professionals located at their headquarters in Rowayton, CT and an additional 2 employees located in London. The non-investment team is headed by Paul Sedlack (CEO) and Robert Murray (COO).

Graham’s team of approximately 93 non-investment professionals effectively manages all trading and business operations and meets nearly all industry operational best practices except in two areas. First, Graham does not maintain a complete set of “shadow” books and records internally. The manager does not have an in-house accounting system, although the operational risk of this departure is mitigated as the manager reviews the portfolio profit and loss daily with ██████ the administrator. Graham also receives accounting files from ██████ each day which are verified and validated by the accounting team. Second, the manager does not have a formal Valuation Committee, however, this departure does not materially increase valuation risk as the administrator will review and validate all of the prices provided by the manager on a daily basis.

Section 1: Business Management

Score: ██████

Graham meets all business management best practices which assess firm organization, compliance, investor protections and disaster recovery.

Paul Sedlack serves as the firm’s Chief Executive Officer and General Counsel and Tim Sperry is the firm’s Chief Compliance Officer. Graham has established a Compliance Committee to ensure adherence to the policies outlined in the firm’s compliance manual. The firm has been registered with the CFTC since 1994 and is a member of the NFA as a Commodity Pool Operator and Commodity Trading Advisor. Graham maintains a Code of Ethics which outlines the employee personal trading policy. Employees are not allowed to trade futures, foreign exchange, swaps, commodity or FX ETFs or other derivatives. The compliance team utilizes the software application ████████████████████ to receive and monitor employee brokerage statements. The anti-money laundering screenings are performed by ██████ the independent administrator. ██████ will review all subscription documents to confirm the identity of potential investors to the AML or OFAC lists to ensure there are no reasons to prohibit an investment. The manager does not use expert networks although insider trading compliance policies have been established. There are no formal soft dollar agreements with any broker-dealer, although it does receive services and products from

This report reflects information only through the date hereof. Our due diligence and reporting rely upon the accuracy and completeness of financial information (which may or may not be audited by the fund manager) and other information publicly available or provided to us by the fund manager, its professional staff, and through other references we have contacted. We have not conducted an independent verification of the information provided other than as described in this report. Our conclusions do not reflect an audit of the investment nor should they be construed as providing legal advice. Past performance does not guarantee future performance. The information contained herein is confidential commercial or financial information, the disclosure of which would cause substantial competitive harm to you, Cliffwater LLC, or the person or entity from whom the information was obtained, and may be protected from disclosure by applicable law

executing brokers that fall within Section 28(e). Graham does not maintain any investments in side pockets.

Graham maintains a comprehensive business continuity and disaster recovery plan. Key server data is replicated on a near real time basis to Graham’s backup facility in Westport, CT. The Westport, CT disaster recovery facility includes 55 “warm seats”. The manager maintains a \$5 million insurance policy that is inclusive of E&O and D&O.

Best Practices Comparison

Organization and Governance		Yes	No
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Compliance			
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Investor Protections			
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24			
Disaster Recovery			
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27			

Background

Criteria	Cliffwater Comments
Firm structure:	

[Redacted]

[Redacted]

Fund structure and domicile

[Redacted]

[Redacted]

Compliance policies:

[Redacted]

[Redacted]

Specific policies:

[Redacted]

[Redacted]

Legal proceedings	
Regulatory authorities:	
Systems and platforms:	
IT staff size and turnover:	
Backup procedures:	
Business continuity and disaster recovery plan:	

Insurance coverage: [REDACTED]

Section 2: Trading and Investment Operations

Score: [REDACTED]

Graham meets all trading and investment operations best practices which assess outside service providers, infrastructure, trading and accounting processes, counterparty monitoring and cash management except Graham does not maintain an internal accounting system to “shadow” the books and records of the administrator. The operational risk of this departure is mitigated as the manager reviews the profit and loss daily with the administrator and also receives accounting files from [REDACTED] each morning which are verified and validated by the accounting team.

Graham’s Chief Financial Officer, Jeff Baisley, oversees the firm’s back office operations, which includes the financial reporting, middle office, treasury operations and corporate accounting teams. [REDACTED] Global Services is the independent administrator for the feeder funds and the master fund. [REDACTED] has a dedicated team of 25 who are responsible for maintaining Graham’s official accounting books and records including the individual investor capital accounts, as well as the processing of subscriptions and redemptions. Graham has primary clearing relationships with [REDACTED], [REDACTED] serves as the US legal counsel and [REDACTED] serves as the legal counsel for British Virgin Island matters.

Each of the discretionary portfolio managers are authorized to trade only for their respective fund. Trades are executed either electronically via [REDACTED] connections or via phone. Graham requires that all brokers provide a confirmation within one hour after trades are filled to assist in the reconciliation process. Trade data is provided from the firm’s trade repository, called [REDACTED], to the prime brokers and the administrator several times throughout the day. [REDACTED] will perform daily reconciliations of trades, positions and cash. Graham’s treasury operations team will investigate and review any reconciling items. Accounting records are maintained by [REDACTED] the portfolio accounting system.

All cash movements require dual authorization. A member of the treasury operations group or authorized approver (the Manager of Treasury Operations, Director of Corporate Accounting., CFO and the CEO) can create a wire and a second authorization must come from one of the authorized approvers.

Best Practices Comparison

Outside Service Providers		Yes	No
28	[REDACTED]		
29	[REDACTED]		
30	[REDACTED]		
Infrastructure			
31	[REDACTED]		
32	[REDACTED]		
33	[REDACTED]		
34	[REDACTED]		
35	[REDACTED]		
36	[REDACTED]		
Trading Practices			
37	[REDACTED]		

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Core Accounting Processes	
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Cash, Margin, and Collateral Management	
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Entity and Contact	Onshore	Offshore
Prime Broker (Clearing Brokers)		
Administrator		
Audit		
Legal		
Tax		
Other (including custodian if not PB)		
Changes in providers (3 yrs)		
Any issues encountered in audit of firm or its products?		

Criteria	Cliffwater Comments
Organizational Structure:	

Control structure and oversight	
Trading team:	
Types of securities traded	
Trade flow process:	

Trade confirmation and reconciliation:	
Specialized groups	
Reconciliation process with administrator:	
Cash movements:	

Section 3: Financing and Counterparty Risk

Score:

Graham meets all financing and counterparty monitoring best practices which assess how the manager finances its portfolio and manages its cash.

Jeff Baisley, Graham’s Chief Financial Officer, has oversight of the firm’s treasury and financing activities. The funds primary sources of financing are via the clearing brokers, repo and reverse repo transactions, and by engaging in over-the-counter transactions governed by ISDA master agreements. Each of the 14 master funds will establish their own financing agreements and terms with their respective counterparties. Leverage usage for each strategy is also determined by each of the portfolio managers. Repo and reverse repo financing transactions are executed daily with the firm’s 8 repo counterparties. Repos may be executed on either an overnight or a term basis. Overall, Graham has ISDA master agreements with approximately 11 counterparties. Additionally, there is a daily sweep of excess cash from each broker which is mostly invested (~80%) in government securities that are held in a custodian account. The remaining cash is diversified among four banking relationships. Graham’s Risk Committee meets on a daily basis to review exposures and market conditions surrounding current or potential counterparties, which may include monitoring counterparty CDS spreads and stock prices.

Best Practices Comparison

Financing and Counterparty Risk		Yes	No
57			
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Background

Criteria	Cliffwater Comments
Sources of financing: [Redacted]	[Redacted]
Counterparties and terms of arrangements: [Redacted]	[Redacted]
Prime broker financing: [Redacted]	[Redacted]
Repo agreements [Redacted]	[Redacted]
ISDAs [Redacted]	[Redacted]

Other (i.e. CDOs, debt offerings, etc.)	

Section 4: Valuation

Score:

Graham meets all valuation best practices except the firm does not maintain a formal Valuation Committee. However, the lack of a formal Valuation Committee does not materially increase valuation risk because the entire portfolio is valued or validated independently by the administrator, [REDACTED] at the end of each trading day.

The valuations for each position are determined by the internal financial reporting team intraday and by [REDACTED] at the end of each day. The manager provides their valuations to [REDACTED] which will perform reconciliation and validation procedures on the prices. The various portfolio managers do not have any input related to the pricing of the positions within their respective portfolio. Exchange listed securities are generally priced by vendors including [REDACTED]. The manager will obtain three broker quotes for any swap or bond instruments. The portfolio is highly liquid as all positions are priced off public exchanges or via multiple broker quotes, thus there are currently no Level 3 assets under ASC 820 (formerly FAS 157). As of June 30, 2011, Graham has 1% Level 1 assets and 99% Level 2 assets.

Best Practices Comparison

Valuation Personnel		Yes	No
66			
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Valuation Policy			
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Pricing Sources and FAS 157 Companies			
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Positions with No Readily Ascertainable Market Value	
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Valuation Committee	
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Background

Criteria	Cliffwater Comments
Month end closing process	
Valuation of exchange traded (level 1) assets:	
Valuation of OTC / illiquid instruments / private placement (level 2 and 3) assets	

Section 5: Risk Management

Score:

Graham meets all risk management best practices. Bill Pertusi, Chief Risk Officer and his team are responsible for monitoring risk. The risk team uses [REDACTED] as well as proprietary risk applications to run stress analysis and to perform other risk analysis on the portfolio. The Risk Committee includes Ken Tropin (Chairman), Paul Sedlack (CEO) and Bill Pertusi, as well as other senior level employees. The Risk Committee monitors market developments, position limits, exposures, counterparty risk and liquidity on a continuous basis each day.

The discretionary portfolio managers are subject to pre-defined risk parameters which includes drawdown limits that apply to each manager. When any of the individual limits are breached, the portfolio manager will discuss the appropriate course of action with the Risk Committee, which may include significantly reducing portfolio risk and exposure. Each portfolio manager has a quarterly review with Pablo Calderini (CIO), Bill Pertusi and Ken Tropin to discuss recent performance and identify the resources necessary to meet future performance targets.


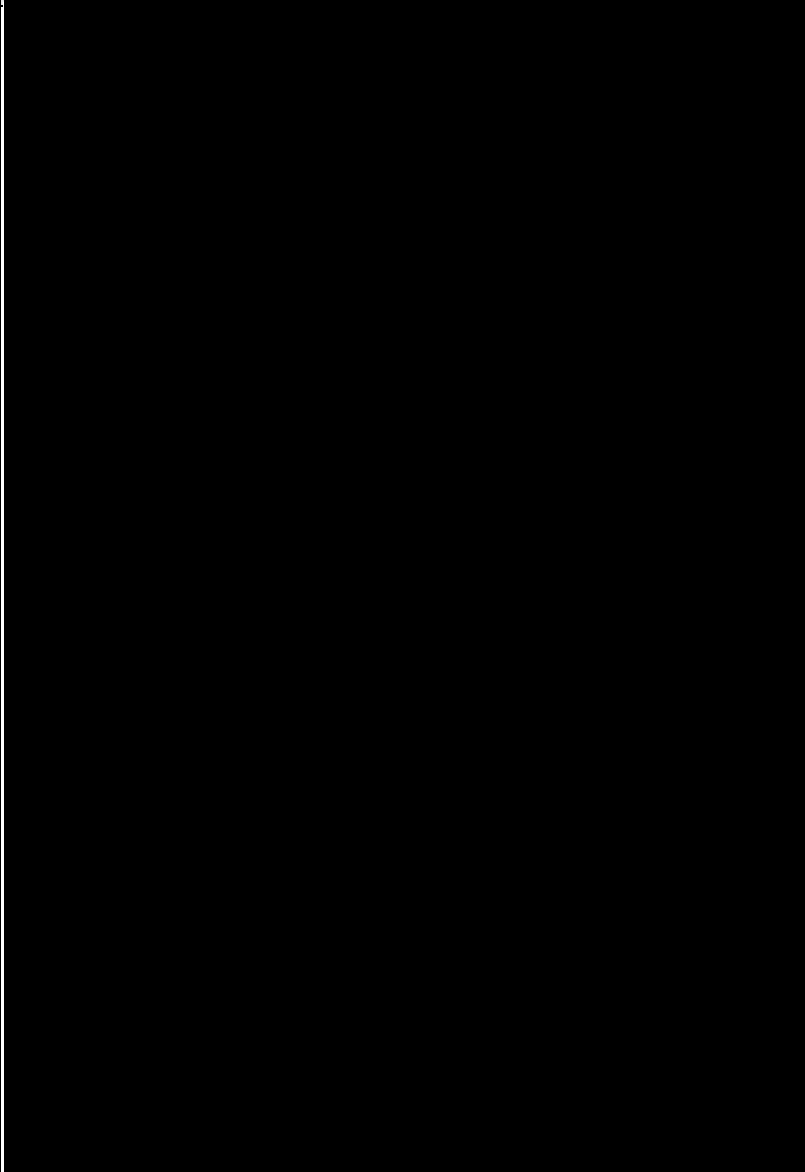
Graham uses minimal leverage and monitors liquidity on an ongoing basis. The firm believes that a vast majority of the portfolio could be liquidated within a week. On a daily basis, excess cash is sent from its broker accounts to Graham Cash Assets LLC. Approximately 80% of this unencumbered cash is invested in government securities, including Treasuries and FDIC insured debt which is held in a custody account at [REDACTED]. The other 20% of the unencumbered cash is deposited between four major banks [REDACTED].

Best Practices Comparison

Structure	Yes	No
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Risk Manager		
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123		
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Risk Limits and Testing		
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Leverage and Liquidity Risk	
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Background

Criteria	Cliffwater Comments
Structure of risk management group: 	

Liquidity risk and funding: <div style="background-color: black; height: 50px; width: 100%;"></div>	

Section 6: Investor Related Practices

Score:

Graham meets all disclosure and investor terms best practices. The PPM details the investment terms, fees, and conditions. The fees are calculated based on the audited financial statements and based on the dollar of value added. The lock-up and gate provisions protect the fund from having to liquidate the portfolio at a discount to meet investor redemptions.

Graham is extremely transparent and provides investor return information on a very timely basis. The manager provides daily and weekly estimated performance reports. Additionally, the manager provides daily, weekly and monthly risk reports that encompass gross attribution by strategy, stress testing results and VaR exposure analysis. Graham includes full position transparency on a 60 day lag on the monthly risk reports. Investor letters are provided monthly which include market commentary and statistics related to fund performance and portfolio composition. The onshore fund expenses averaged 21 basis points from 2008 to 2010, which is slightly lower than the average of 30 basis points for Cliffwater’s approved global macro managers. The fund expenses include fund administration, audit, tax, and director fees. Legal fund expenses are nominal as Graham has an in-house legal department.

Graham’s financial statements are audited by [REDACTED] The audited financial statements are sent to investors within 90 calendar days of year end, which is slightly timelier than the industry standard. The onshore and offshore funds have a calendar year end. Schedule K-1 tax information is usually distributed to investors by the end of March.

Best Practices Comparison

Initial Disclosures	Yes	No
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Fees and Expenses	
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Ongoing Information Provided to Investors	
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157	
158	
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160	
Financial Statement and Tax	
161	
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163	
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Investor Terms	
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Background

Criteria	Cliffwater Comments

Criteria	Cliffwater Comments
Fund financial and tax statements: <div style="background-color: black; width: 100%; height: 50px; margin-top: 5px;"></div>	

Meeting History

Date	Location	Cliffwater Attendees	Manager Attendees
October 3, 2011	New York, NY		Robert Galeano (IR), Leigh Lower (IR), Timothy Sperry (CCO), Thomas DeBow (CTO), William Pertusi (CRO), Jeff Baisley (CFO)

Appendix: Glossary

Administrator	A service provider such as Citco or International Fund Services that handles administrative responsibilities such as calculating the fund's NAV on a monthly basis, sending the investors performance reports, and maintaining the official books and records of the fund.
Fair Value (FAS 157)	FASB Statement No. 157, Fair Value Measurements ("FAS 157"), defines fair value as <i>"the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."</i> Cliffwater reviews valuations according to the Fair Value hierarchy established by FAS 157, the three levels of which are described below.
Level 1 assets	Liquid assets with readily observable prices, and therefore a reliable market value. Level 1 assets typically include stocks, bonds, mutual funds, and any other assets that have a regular "mark to market" pricing mechanism.
Level 2 assets	Assets with a value based on market inputs that are not directly observable on a central exchange. These assets are often priced via quotations from dealers. An example of a level 2 asset is a credit default swap which is typically priced via indicative quotations from broker dealers.

Level 3 assets	Illiquid assets with a value that cannot be determined by observable measures. The fair value of a Level 3 asset can only be estimated by using significant assumptions as inputs to the valuation model. Illiquid private equity investments are an example of this type of asset. Each manager may derive its own internal valuation policy regarding the classification of Level 3 assets depending on available pricing sources, or other factors, however.
Leverage	<p>The use of explicit debt (i.e. borrowing) or implicit debt (i.e. derivatives) to achieve investment positions that exceed invested capital (NAV), thereby amplifying return but also increasing risk. A common leverage calculation is the ratio of gross notional exposure to invested capital. For example, a \$100 investment in BP stock coupled with a \$100 short sale of Exxon stock yields gross notional exposure of \$200. Leverage in this example can be described in at least two ways:</p> <ol style="list-style-type: none"> The portfolio has 200% gross exposure (equal to \$200 gross notional exposure divided by \$100 NAV) The portfolio is one time (1x) levered (equal to \$100 in debt divided by \$100 NAV) <p>As illustrated in the example, the \$200 gross notional exposure equals the absolute value total of both \$100 long (“gross long”) and \$100 short (“gross short”) asset exposures. The measurement of gross notional exposure varies by asset class:</p> <ul style="list-style-type: none"> <i>Equities</i> – the market value of long and short positions <i>Corporate Debt and Municipal Bonds</i> – the market value of long and short positions <i>US Treasuries (and other highly rated government debt)</i> – the market value of long and short positions, adjusted to a 10 year bond equivalent maturity (approximate 9 year duration), so that a \$100 exposure to a 2 year duration bond is recognized as a lower risk compared to a \$100 20 year duration bond. The \$100 3 year duration bond is said to have a \$33 10 year bond equivalent exposure (\$100 times 3, divided by 9) while the \$100 20 year duration bond is said to have a \$222 10 year bond equivalent exposure (\$100 times 20, divided by 9) <i>Options</i> – the delta adjusted exposure rather than the total notional value of the underlying reference asset. Delta adjusted exposure represents the implied shares/holdings necessary to hedge the options position <i>Credit Default Swaps</i> – total notional exposure of the underlying reference credit <i>Interest Rate Swaps</i> – total notional exposure (expressed as 10-year bond equivalent, per the duration adjustment process described above) to reference security or index <i>Futures/Forwards</i> – total notional exposure to reference security or index
Net Asset Value (NAV)	A fund’s total assets less total liabilities.
Notional Exposure	The total dollar exposure represented by a position. Due to leverage, this amount may be greater than the equity in the position. For example, a CDS contract offering \$1 million of protection has a notional value of \$1 million even though the cost of the contract itself is likely to be a small fraction of that amount.
Gross Long	The total notional exposure of all long positions in a portfolio. Long positions benefit from increases in securities prices.
Gross Short	The total notional exposure of all short positions in a portfolio. Short positions benefit from decreases in securities prices.
Net	The difference between a portfolio’s gross long and gross short exposures. A net long position indicates a higher portion of long positions in the portfolio, and that the portfolio should generally benefit from an increase in asset prices. A net short position indicates the opposite.
Total Gross	The sum of a portfolio’s gross long and gross short exposures.
Operations Score	A measure of how well the firm meets best practice standards on a scale of A (meets all best practice standards) to F (does not meet several best practice standards). A rating of “C” or lower indicates Cliffwater believes the firm’s departure from best practices could hurt returns or lead to the misappropriation of firm assets.
Prime Broker	A prime broker custodies assets, provides settlement services, facilitates the borrowing of securities for short positions, and may provide performance reporting for hedge funds. JPMorgan, Goldman Sachs, Morgan Stanley and UBS are large prime brokers.
Side Pocket	A segregated portion of a portfolio that may be used to hold illiquid, less frequently priced securities. Once a holding is placed in a side pocket, only current investors participate in its performance. Subsequent investors do not share in the gains/losses associated with assets previously placed in side pockets. Performance fees are paid when side pocket investments are realized. Assets placed into side pockets are not available for withdrawal

	until the investments are realized.
Soft Dollars	Commission credits from trading securities that can be used to pay for research or other services that brokers provide to hedge funds and that are intended for the benefit of investors. Most funds operate under the SEC 28e safe harbor rules that restrict soft dollar use to research only.
Unencumbered Cash	Unencumbered cash is equal to cash holdings less margin requirements.