How to Buy a Tail Risk Hedge Before Volatility Strikes
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Risk Factors

It is not possible to list and describe all the risk factors that an investor incurs when investing in the strategy discussed in this presentation. For a more complete description, refer to the Warren Dividend Hedge Strategy investment memorandum, section on “Certain Risk Factors”. These factors include but are not limited to the following kinds of risks:

Economic and Market Risks, Recession, General Investment Risk Factors, Suspensions of trading, lack of liquidity, risk of price movements, Competition, Inadvertent concentration, leverage, hedging and arbitrage, short selling, derivatives, options, futures, volatility of financial markets, lack of control over portfolio companies, competitive market, non-United States investment risks, Management risks, Dependence on the General Partner, Discretion of the General Partner and Investment Manager, other activities of the General Partner, Conflicts of Interest, Members do not participate in management, Regulatory review and Audit, Fund Structure Risk, Lack of Operating history, Withdrawal and transferability of interests, no participation by investors, Institutional risk, Portfolio turnover, Valuation risk, business and regulatory risks, Control positions, material non-public information, changes in investment strategy, General Partner’s return, Lack of registration, Securities laws, Investment Company Act, Contingency reserves, Statutory liability of Limited Partner, Soft dollar arrangements, possible adverse tax consequences, and no separate legal counsel.

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Certain statements contained in this Memorandum, including without limitation, statements containing the words “believes,” “anticipates,” “intends,” “expects,” and words of similar import constitute “forward-looking statements.” Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Fund to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Certain of these factors are discussed in more detail elsewhere in this Memorandum, including without limitation under “Description of the Fund,” “Certain Risk Factors” and “Investment Objective and Strategies.” Given these uncertainties, prospective investors are cautioned not to place undue reliance on such forward-looking statements. The General Partner, the Investment Manager and the Fund disclaim any obligation to update any such factors or to announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.
Two Common Ways to Hedge a Portfolio

Door #1 Diversification and hyper diversification

Diversification failed as a basic hedging method in 2008 as all assets became highly correlated. During the Financial Crisis there was no place to hide. Gold was down -20% or more; Corp bonds -20% or more; Stocks down -39%; real estate dropped -30% or more in many markets; etc. The response to the failure of diversification as a hedge should not be to seek ever higher levels of diversification, such as collections of classic cars or timberland. These seem attractive because they are not valued on an exchange every minute of every day, however, assets must be marked to market realistically.

Door #2 Buy SP Put Options, or ETFs that short the SP (x2, x3), ETFs that buy vol futures

These hedging methods tend to be very expensive, requiring a sizable amount of capital to adequately hedge downside risk. When buying puts on the SP, the underlying is an index that behaves linearly as opposed to a volatility index that behaves exponentially.

ETFs that short the SP have the same linear problem as above. In addition, they have considerable tracking error and fail to deliver the expected values.

ETFs that buy volatility VIX futures are very expensive, and fail to deliver a multiple of VIX upside surprise, instead delivering only a fraction of VIX upside movement. These ETFs underperform because of the embedded futures roll costs.
Cost Effective Tail Risk Hedging

**Warren Tail Risk Hedge = Warren Macro VIX Indicator + WFS Quant Model + Human Capital**

The **Warren Tail Risk Hedge** can be deployed to hedge virtually any type of equity exposure. We utilize a proprietary market indicator that guides hedging decisions called the **Warren Macro VIX Indicator** (MVI). Constant hedge protection is not necessary as opposed to typical ETF vol strategies that employ short, mid-term or mixed futures holdings. The Warren Tail Risk Hedge utilizes options on VIX futures in an attempt to hedge away black swan or fat tail risk.

Warren Tail Risk Hedge = Warren Macro VIX timing indicator + WFS Quant Model + Human Capital

Warren Financial has been utilizing the Warren Tail Risk Hedge since 2010 layered on top of our own hedge fund, the Warren Dividend Hedge Fund (better than a 10%+ annualized ROI thru first 5 years).

The key advantage of the Warren Tail Risk Hedge is it’s high effectiveness yet low cost. The Warren Macro VIX Indicator combined with the low cost of the hedge ensures that the hedge minimizes drag on equity performance. Yet the high effectiveness of the hedge in a crisis or market pull-back ensures that the hedge protects the equity from steep drops commonly experienced in the marketplace. The hedge manufactures and realizes ALPHA in down markets so that your equity can still capture the entire bounce-back.

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Downside Catalysts

The Imperfect Storm. The reasons change every year, but the storms still arrive

- August 2011 Greek-Exit fueled a -17% SP drop in one month
- Fed Quantitative Easing smoothed out volatility from 2012 thru summer 2014
- October 2014 (SP drops -10% in 1 month), August 2015 (SP drops -8% in one month)
- Hedging must be done systematically, via a pre-established quantitative model, not at the last minute when a crisis hits.

Why the Institutional Marketplace

- With the advent of volatility options and futures (2007), hedging has been improved and become more cost effective. Warren Financial has been trading VIX Options live since 2010 giving us unparalleled experience.
- The institutional market is ready for “safer” equity investing. This hedging product creates the ability for institutions to move away from relatively overvalued bond assets and allows an overweight in equity assets, yet smooth out the traditional volatility found in equity markets. **It is no longer necessary to accept lower bond returns to cushion equity volatility.**
TAIL RISK HEDGING

Requirement for a Cost Effective Hedge

• Must be effective in times of market stress

• Must minimize performance drag in an up market and create alpha in a down market

• The smaller the percentage of portfolio capital required, the better (target < 2%)

• A smaller hedge investment implies the need for a large upside hedge potential

• Timing rules must be implemented to reduce costs/drag
TAIL RISK HEDGING

The Case for VIX Options

• Near 100% directional inverse correlation to the equity markets

• Large scale upside appreciation potential (a multiple of VIX % movements and also a multiple of VIX Futures % movements)

• Increasing liquidity in a crisis
Why VIX options are the better vehicle than VIX ETFs or VIX futures...

VIX Options vs. VIX Index

- 2010 Flash Crash: 60% VIX, 800% Options on VIX
- Financial Crisis 10/24/08: 32% VIX, 600% Options on VIX
- Financial Crisis Sept 2008: 340% VIX
- Avg SP drop -3% or more: 400% Options on VIX

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Warren Financial has developed a proprietary index to identify warning flags serving as a “reading” that gauges the likelihood of a market-moving event occurring within the near future (next 30 days).

<table>
<thead>
<tr>
<th><strong>Warren Macro VIX Indicator (MVI)</strong></th>
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<tbody>
<tr>
<td>[Flag] 0</td>
<td>All Clear – no need to adjust risk</td>
</tr>
<tr>
<td>[Flag] 35</td>
<td>Yellow Flag – prepare to adjust risk</td>
</tr>
<tr>
<td>[Flag] 65</td>
<td>Orange Flag – begin to reduce portfolio risk</td>
</tr>
<tr>
<td>[Flag] 90</td>
<td>Red Flag – reduce portfolio risk</td>
</tr>
<tr>
<td>[Flag] 100</td>
<td>Black Flag – critical stage...black swan event more likely to occur; last chance to reduce risk</td>
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AFTER Warren MVI tops 100, Average 20 day SP loss = -10.31%

SP History AFTER Warren MVI tops 100 "Black Flag"
The Warren Macro VIX Indicator (MVI) is a common sense statistical method that answers the question, “When” to hedge. The MVI is the answer to avoid constant hedging, which is a non-starter since it creates excessive drag on the upside of your equity portfolio.

Hedging is a way to avoid market timing. Warren Tail Risk Hedging is a way to cost effectively hedge equity exposure while simultaneously creating ALPHA.
The Warren Tail Risk Hedge Quant Model picks the right VIX call options to buy/sell in all market conditions. The model is fully quantitative providing the best option deltas, and maturity dates to purchase. The model selects the contract, maturity date, moneyness, strikes, and quantity of options (scalable) to purchase. These decisions are fully automated and updated continuously.

There is no need to sell any derivative product, so losses are contained to the amount of premium paid. There is no unbounded downside risk. This is typically not true of the many VIX Futures products we have reviewed over the past few years.

Hedging is a way to avoid market timing. Warren Tail Risk Hedging is a way to cost effectively hedge equity exposure while simultaneously creating ALPHA.

VIX options capture the exponential movements of the VIX.

The Warren TRH Quant Model calls for protection of unrealized option hedges via selecting the purchase of SP call options.
TAIL RISK HEDGING

Model Inputs and Outputs

SP500, VIX moving avgs
   Vix vol of vol

Equity beta and
   Equity $size

Warren Macro VIX Indicator
   Warren MVI determines correct hedge purchase
timing and vol of vol

Warren Tail Risk Hedge
   Quant Model selects contract, strike, delta depending on
time-to-maturity, Warren fair value pricing model vs. real-time CBOE option prices,
and the vol of vol based on Warren MVI

Human Capital, Trading
   Committee
   Option trades placed on CBOE to create
   Warren Tail Risk Hedge, best purchase prices
determined via comparison between Warren
   pricing models vs CBOE real time trading.
Tail Risk Hedging

Hedge Sell Rules

- The Warren Quant Model sell trigger is when the intraday spot VIX tops 40.


- Societe Generale VIX desk: “For true crash protection, there is not a better product to own than a low-delta VIX call option.”

- The Warren Quant Model protects the profits from unrealized hedges by purchasing call options on the SP. October 2014 intra-month 10% decline and subsequent snap-back rebound is the classic example of where this strategy is necessary.
MVI rules with options avoid VIX futures expensive roll costs.
Disclosures: back tested data. Using the latest current model and running the model backwards against the actual SP500, the actual VIX, and the actual VXTH. Option prices are generated using a Warren Financial calculation model that takes into account the vol of the futures, vol of the options, vol of the VIX, time to maturity, moneyness, etc.
TAIL RISK HEDGING

Tail Risk Hedge Management Team

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Thank You!

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