

Options

The Multi-Strat Funds may write (*i.e.*, sell) and purchase put and call options. Sales of options where the Multi-Strat Funds does not own the underlying asset to which the option is referenced can involve theoretically unlimited risk.

The seller (writer) of a call option which is covered (*e.g.*, the writer holds the underlying security) may hedge its long position in the underlying security by earning premium upon the sale of the option. In exchange for the premium, the seller assumes the risk of a decline in the market price of the underlying security below the purchase price of the underlying security (to the extent the decline exceeds the premium received), and gives up the opportunity for gain on the underlying security above the exercise price of the option. The seller of an uncovered call option assumes the risk of a theoretically unlimited increase in the market price of the underlying security above the exercise price of the option. The securities necessary to satisfy the exercise of an uncovered call option may be unavailable for purchase, except at much higher prices, thereby reducing or eliminating the value of the premium. Purchasing securities to cover the exercise of an uncovered call option can cause the price of the securities to increase, thereby exacerbating the loss. The buyer of a call option assumes the risk of losing its entire premium investment in the call option.

The seller (writer) of a put option which is covered (*e.g.*, the writer has a short position in the underlying security) may hedge its short position in the underlying security by earning premium upon the sale of the option. In exchange for the premium, the seller assumes the risk of an increase in the market price of the underlying security above the sales price (in establishing the short position) of the underlying security (to the extent the increase exceeds the premium received), and gives up the opportunity for gain on the underlying security if the market price falls below the exercise price of the option. The seller of an uncovered put option assumes the risk of a decline in the market price of the underlying security below the exercise price of the option. The buyer of a put option assumes the risk of losing its entire investment in the put option.

Volatility is a principal component of options pricing. If the volatility in the market for the asset underlying the options held or sold by the Multi-Strat Funds changes materially, the Multi-Strat Funds directly could incur substantial losses even if the options in question would have generated substantial profits if the current price levels had been in effect at expiration.

Credit Default Swaps

The Multi-Strat Funds purchase and sell credit derivatives contracts (primarily credit default swaps). Credit default swaps can be used to implement Hudson Bay Capital's view that a particular credit, or group of credits, will experience credit improvement or deterioration. In the case of expected credit improvement, the Multi-Strat Funds may sell credit default protection in which they receive a premium to take on the risk. In such an instance, the obligation of the Multi-Strat Funds to make payments upon the occurrence of a credit event creates leveraged exposure to the credit risk of the referenced entity.