Glossary

Alternative Investment Terms

ABSOLUTE RETURN An absolute return hedge fund has a primary objective to produce positive returns, rather than outperforming a particular benchmark.

ACCREDITED INVESTOR Regulation D of the Securities Act of 1933, permits the sales of unregistered securities to financially sophisticated individual investors meeting the following qualifications:

- Individuals with a net worth exceeding $1 million (excluding the value of the person's primary residence);
- Individuals who have earned at least $200,000 each year for the last two years ($300,000 with his or her spouse if married) and have the expectation to make the same amount this year. (This income test is generally only applicable for managed futures funds at Morgan Stanley Wealth Management. All other alternative investments require an individual investor to satisfy the Net Worth test for Accredited Investor status.);
- Entities with total assets in excess of $5 million.

Morgan Stanley Wealth Management may impose a standard for a particular private fund that may be higher than those required to meet the "Accredited Investor" standard.

ALPHA A mathematical value indicating an investment's excess return relative to a benchmark. Measures a manager's value added relative to a passive strategy, independent of the market movement.

BARCLAY CTA INDEX This benchmark is representative of performance from commodity trading advisors. There are 416 programs included in the calculation of the Barclay CTA Index for the year 2021, which is equally weighted and rebalanced at the beginning of each year.

BETA A quantitative measure of the volatility of a security or strategy relative to a market index. An investment with a beta less than 1.0 is less volatile than the market while an investment with a beta greater than 1.0 is more volatile than the market.

BLOOMBERG BARCLAYS U.S. AGGREGATE BOND INDEX Covers the dollar-denominated investment-grade fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS pass-through securities, asset-backed securities, and commercial mortgage-based securities.

CAPITAL CALL The act of a private equity fund "calling down" previously pledged capital from its limited partners in order to execute an investment.

CAPITAL DISTRIBUTIONS: DEEMED Reflects the amount of capital that was contributed to a fund via deemed distributions. Deemed distributions are distributions applied against capital calls in which the amount of the distribution is considered to have been distributed and simultaneously recontributed to the fund, satisfying all or a portion of a current capital call. Instead of moving small amounts of cash between investors and the fund, deemed distributions are often used. Effectively, a deemed distribution reduces an investors outstanding capital commitment to a given fund.

CATCH-UP PROVISION This is a common term of the private equity partnership agreement. Once the general partner provides its limited partners with their preferred return, if any, then it typically enters a catch-up period in which it receives the majority or all of the profits until the agreed upon profit-split, as determined by the partnership agreement, is reached.

CORRELATION A measure of the degree to which two variables move in the same direction with the same impact on performance, measured in a range of -1.0 to 1.0. A correlation of -1.0 implies that the variables move inversely with one another while a correlation of 1.0 implies that the variables move in exactly the same manner. A correlation of zero implies that there is no relationship between the movements of the variables (therefore implying perfect diversification).

CREDIT LONG / SHORT This strategy consists of a core holding of long credits hedged at all times with varying degrees of short sales of bonds and/or index options. Some managers maintain a substantial portion of assets within a hedge structure and commonly employ leverage.

CTA (Commodity Trading Advisor) A professional trading manager who manages customer money in the futures, forwards, and options markets.

DISTRIBUTIONS Distributions paid to an investor from a fund may include those paid in cash or securities. Distributions are shown as a negative number as they represent a reduction in the total capital balance.

DISTRIBUTIONS: DEEMED Deemed distributions are distributions applied against capital calls in which the amount is considered to have been distributed and simultaneously recontributed to a fund, satisfying all or a portion of a current capital call. This represents the total amount of distributions that were used to offset capital calls. Deemed distributions are shown as a negative number as they represent a reduction in the total capital balance.

DISTRIBUTIONS: ESTIMATED RECALLABLE This reflects distributions previously distributed that may be recalled to pay for, among other obligations, fees, expenses, and obligations from currency exchange fluctuations. The amounts are estimated and based on current cash flow expectations of a fund and are subject to change at any time and may in fact not be required. Any amounts distributed and then recalled will be treated as returns of distributions and reduce the total distributions, rather than be treated as capital contributions. Recallable distributions are shown as a negative number as they represent a reduction in the total capital balance.

EQUITY MARKET NEUTRAL Equity market neutral strategies employ sophisticated quantitative techniques of analyzing price data to ascertain information about future price movement and relationships between securities, select securities for purchase and sale. These can include both factor-based and statistical arbitrage/trading strategies. Factor-based investment strategies include strategies in which the investment thesis is predicated on the systematic analysis of common relationships between securities. In many but not all cases, portfolios are constructed to be neutral to one or multiple variables, such as broader equity markets in dollar or beta terms, and leverage is frequently employed to enhance the return profile of the positions identified. Statistical arbitrage/ trading strategies consist of strategies in which the investment thesis is predicated on exploiting pricing anomalies which may occur as a function of expected mean reversion inherent in security prices; high frequency techniques may be employed and trading strategies may also be employed on the basis of technical analysis or opportunistically to exploit new information the investment manager believes has not been fully, completely or accurately discounted into current security prices. Equity market neutral strategies typically maintain characteristic net equity market exposure no greater than 10% long or short.

EVENT DRIVEN Investment managers in this strategy maintain positions in companies currently or prospectively involved in a variety of corporate transactions, including, but not limited to, mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event-driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company-specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

EXCHANGE FUNDS Private vehicles which enable holders of concentrated stock positions to exchange those stocks for a diversified portfolio.

FUNDS OF FUNDS Actively and professionally managed portfolios consisting of multiple hedge funds offering diversification across managers, strategies, styles and/or sectors.

FUNDAMENTAL VS. TECHNICAL INPUTS (BASIS FOR INVESTMENT VIEWS) Fundamental inputs use valuation techniques and macroeconomic variables as inputs to investment decisions. Technical inputs employ market-based (e.g., price and volume) information as inputs to trading decisions.

GENERAL PARTNER (GP) The firm that organizes and manages a limited partnership, such as a hedge fund or a private equity fund. The general partner assumes unlimited legal responsibility for the liabilities and usually holds a small general percentage interest (1% or more) in the fund. The general partner generally participates in the economic performance of the Master Fund through the incentive fee/carried interest.

GLOBAL MACRO STRATEGY This is a hedge fund strategy that bases its holdings—such as long and short positions in various equity, fixed income, currency and futures markets—primarily on overall economic and political views of various countries (macroeconomic principles).

GROSS EXPOSURE Gross exposure is calculated by adding the percentage of the fund's equity invested in short sales to the percentage of its equity used for long positions. In both cases, the exposures often exceed 100% because they do not account for the use of leverage. See also Net Exposure.

HEDGE FUNDS Privately managed investment funds that utilize sophisticated strategies in both the international and domestic markets. They're designed to potentially offset losses during a market downturn and often seek to generate returns higher than traditional stock and bond investments.

HEDGE FUND RESEARCH, INC. (HFRI) A research firm specializing in the collection, aggregation and analysis of alternative investment information. HFRI produces the HFR Database which comprises nearly 6,000 hedge funds, funds of funds, managed futures and liquid alternative investment products. The HFRI Monthly Indices are a series of benchmarks designed to reflect hedge fund industry performance by constructing equally weighted composites of constituent funds, as reported by the hedge fund managers listed within the database. The indices are broken down into four main strategies, each with multiple sub-strategies.

HIGH-WATER MARK A specified net asset value level (highest peak in value that the fund has reached) that a fund must exceed before performance fees are paid to the hedge fund manager.

INCENTIVE FEE (PERFORMANCE FEE) A certain percentage of realized and unrealized net investment gains and net appreciation a particular hedge fund manager charges per year over and above the management fee. The charge is typically between 20% and 30% over the threshold performance (hurdle rate or preferred return) in a calendar year. While this may create an alignment of interest between the investors and the manager as the manager can only earn this fee if the fund performs well, this may on the other hand present a conflict of interest as it gives the manager an incentive to make investments that carry more risk or may be more speculative than might be the case if no performance compensation were paid. Incentive fee is also referred to as the carried return in private equity. ***See Figure A on Page 6 for an example.***

INFORMATION RATIO Measures the active return of an investment manager divided by the amount of risk the manager takes relative to a benchmark. It is used in the analysis of performance of mutual funds, hedge funds, etc. Specifically, the information ratio is defined as active return divided by tracking error. Active return is the amount of performance over or under a given benchmark index. Thus, active return can be positive or negative.

Tracking error is the standard deviation of the active return. An alternative calculation of Information Ratio is alpha divided by tracking error, although it is preferable to use pure active return in the calculation.

INTERNAL RATE OF RETURN (IRR) A metric used in capital budgeting measuring the profitability of potential investments. IRR is a discount rate that makes the net present value (NPV) of all cash flows from a particular project equal to zero. It tells investors how much an investment returned while taking into account how long it took to generate the return. ***See Figure B on page 6 for an example.***

J-CURVE Common trend in the private equity industry where fund performance and cash flows are negative in early stages due to capital expenditures and other expenses, but rise over time as results are produced. The phenomenon causes a "J-curve" when looking at a chart of the fund's performance, with a slight dip at the onset followed by potential growth.

LEVERAGE Trading of commodity interests is speculative, volatile, and involves a high degree of leverage. A small change in the market price of a contract can produce major losses for a fund. You could lose all of your investment. Leverage is inherent in futures trading. In order to enter into a futures contract, a trader needs to post with the exchange only a small security deposit, or “margin,” sufficient to cover any daily fluctuations in the value of the positions, which is adjusted daily to account for changes in value. The low initial outlay, typically ranging from about 5% to 20% of the value of the contract, allows the investor continued use of most of his capital for the duration of the contract, while at the same time controlling positions with much greater value than the initial amount invested. This inherent leverage amplifies the effect of price fluctuations, creating greater gains and losses, as a percent of the actual amount invested and resulting in increased volatility.

LIMITED PARTNER (LP) Partners with limited liability. Limited partnerships in hedge and private equity funds are typically restricted to investors who are expected to understand and to be able to assume the risks associated with the investments.

LOCK UP A period of time during which investors cannot redeem invested capital. For example, illiquid alternative investments such as venture capital, private equity and real estate funds typically have lockup periods before the full return of capital and profits to investors.

MANAGEMENT FEE A fee paid to the investment manager for its services, typically as a percentage of aggregate capital commitments. Management fees in a private equity fund typically range from 1.25% to 2.5% of commitments during the fund’s investment period, and then step down to the same or a lower percentage based on the fund’s “invested capital” remaining in investments.

MANAGED FUTURES Employs professional money managers called Commodity Trading Advisors to direct investments in global currencies, interest rates, equities, metals, energy and agricultural markets through the use of futures, forwards and options on the basis of technical and fundamental analysis.

MAX DRAWDOWN The worst fall in performance, peak to trough, regardless of whether or not the drawdown consisted of consecutive months of negative performance.

MULTI-STRATEGY FUNDS Funds that include either a selection of several hedge fund strategies or may also include other alternative strategies such as private equity or real estate within the fund.

MULTIPLE ON INVESTED CAPITAL (MOIC) Gives a potential investor insight into the fund’s performance by showing the fund’s total value as a multiple of its cost basis. Based on all realized distributions, plus any unrealized or residual value dividend by paid-in capital.

NET ASSET VALUE (NAV) The market value of a fund's total assets, minus its liabilities and intangible assets, divided by the number of its shares outstanding. The measure is used to determine prices available to investors for redemptions and subscriptions. Hedge funds typically report it to investors on a monthly basis. In private equity, the term is used to represent the market value of the position and is generally updated quarterly.

NET EXPOSURE Net exposure takes into account the benefits of offsetting long and short positions, and is calculated by subtracting the percentage of the fund’s equity capital invested in short sales from the percentage of its equity capital used for long positions. For example, if a fund is 125% long and 50% short, its net exposure would be 75%.

PREFERRED RETURN The preferred return is a term normally used by private equity funds. It refers to the threshold return that the limited partners of a private equity fund must receive, before the private equity firm is entitled to receive its incentive fee or carried interest.

PRIVATE EQUITY Typically invests globally in nonpublic entities with a value-added approach, seeking to acquire undervalued/ underperforming entities or ones with significant growth potential with the objective of reselling at a higher price in the future. Underlying asset classes include buyouts, venture capital and mezzanine debt.

QUALIFIED CLIENT Under Rule 205-3 as amended, a client (including an investor in a Section 3(c)(1) fund) is a qualified client if:

- The client has at least $1.1 million under management with the advisor immediately after entering into the advisory contract (the “assets under management test”);
- The advisor reasonably believes that the client has a net worth (together, in the case of a natural

person, with assets held jointly with a spouse) of more than $2.2 million, excluding primary residence, at the time the contract is entered into (the "net worth test").

Morgan Stanley Wealth Management may impose a standard for a particular private fund that may be higher than those required to meet the "Qualified Client" standard.

QUALIFIED PURCHASER Qualified purchasers must meet one of the following standards. For purposes of this standard, an "investment" is defined to include securities, financial contracts entered into for investment purposes, cash, cash equivalents held for investment purposes, real estate held for investment purposes, CDs, bankers acceptances and other similar bank instruments held for investment purposes. Investments do not include real estate held for personal purposes, jewelry, art, antiques and other collectibles. Debt used to acquire the investments is excluded from the value of the investments.

- Individuals who own $5 million in investments;
- Institutional investors who own $25 million in investments;
- A family-owned company that owns $5 million in investments;
- For trusts with less than $25 million, a trust where the trustee and each person who contributes assets to the trust is a Qualified Purchaser.

Morgan Stanley Wealth Management may impose a standard for a particular private fund that may be higher than those required to meet the "Qualified Purchaser" standard.

For the complete definition of a Qualified Purchaser see Section 2(a)(51) of the 1940 Act as supplemented by relevant SEC rules thereunder [2(a)(51-1), 2(a)(51-3)].

REAL ESTATE Negotiated private investments in real estate assets with the objective of generating current income and/or reselling at a higher value in the future.

RELATIVE VALUE HEDGE FUNDS Relative value arbitrage attempts to take advantage of relative pricing discrepancies between instruments including equities, debt, options and futures. Managers may use mathematical, fundamental or technical analysis to determine misvaluations.

RETURN OF CAPITAL A return of invested capital from the full or partial sale of an underlying holding as opposed to income or profit generated thereon.

RISK-FREE RATE OF RETURN Theoretical rate of return of an investment with zero risk. Generally, only short-term U.S. government securities (specifically T-bills) are considered "risk-free."

SHARPE RATIO A measure of risk-adjusted return calculated by dividing an investment's return over the risk-free rate (see definition for Risk-Free Rate of Return) by the investment's standard deviation.

SPECIAL SITUATIONS Investments in unconventional strategies such as energy, royalty and distressed funds.

STANDARD DEVIATION A measure of the variation of returns around the mean return. Standard deviation is the most widely used approximation of the risk of an individual investment or portfolio. A higher standard deviation indicates higher risk.

S&P 500 INDEX A capitalization-weighted index of 500 U.S. large-cap stocks.

SYSTEMATIC STYLE (APPLICATION OF VIEWS) VS. DISCRETIONARY Global macro hedge funds can be classified as either "systematic" global macro, which use quantitative methods such as computer models and simulations in their trading strategies (no human intervention in trade generation), or "discretionary" global macro, which rely on manager discretion in their trading strategies. Global macro managers use price and volume information in conjunction with valuation information as inputs to their trading decisions.

VINTAGE YEAR The year of fund formation and its first takedown of capital. By placing a fund into a particular vintage year, the Limited Partner can compare the performance of a given fund with all other similar types of funds formed in that particular year.

FIGURE A. INCENTIVE FEE (PERFORMANCE FEE)

A certain percentage of realized and unrealized net investment gains and net appreciation a particular hedge fund manager charges per year over and above the management fee. The charge is typically between 20% and 30% over the threshold performance (hurdle rate or preferred return) in a calendar year. While this may create an alignment of interest between the investors and the manager as the manager can only earn this fee if the fund performs well, this may on the other hand present a conflict of interest as it gives the manager an incentive to make investments that carry more risk or may be more speculative than might be the case if no performance compensation were paid.

Example Fee Calculation Scenario:

- $100 million investment by Limited Partners
- 2% management fee
- 8% preferred return
- 20% incentive fee rate with 100% general partner ("GP") Catch Up
- $200 million proceeds from realizations

Original Contributions:	Limited Partners	General Partner	Total
	($100)		($100)
Management Fee (2%)		**$2**	**$2**
Sale of Investment for $200m			
Return of Capital	**$100**		**$100**
Preferred return for limited partners	$8		$8
100% Catch Up for GP		**$2**	**$2**
80/20 split or residual amount	$70.40	$17.60	$88
Closing Balance	**$78.40**	**$21.60**	**$100**

$100 million gross income is evenly split between GP and LPs

Figures are for illustrative purposes only.

FIGURE B. INTERNAL RATE OF RETURN (IRR)

A metric used in capital budgeting measuring the profitability of potential investments. IRR is a discount rate that makes the net present value (NPV) of all cash flows from a particular project equal to zero. It tells investors how much an investment returned while taking into account how long it took to generate the return.

Example Scenario:

- Capital contributed
  - $50 million in year 0; $50 million in year 1
- Total distributions net of fees
  - $100 million in year 3; $100 million in year 7 (final distribution)
- Investment value: $120 million in year 6

Estimated IRR in year 6:

$$0 = \underbrace{-50}_{\textbf{Today}} - \underbrace{\frac{50}{1 + IRR}}_{\textbf{Year 1}} + \underbrace{\frac{100}{(1 + IRR)^3}}_{\textbf{Year 3}} + \underbrace{\frac{120}{(1 + IRR)^6}}_{\textbf{Year 6}} \longrightarrow IRR = 22\%$$

Estimated IRR in year 7:

$$0 = \underbrace{-50}_{\textbf{Today}} - \underbrace{\frac{50}{1 + IRR}}_{\textbf{Year 1}} + \underbrace{\frac{100}{(1 + IRR)^3}}_{\textbf{Year 3}} + \underbrace{\frac{100}{(1 + IRR)^7}}_{\textbf{Year 7}} \longrightarrow IRR = 18\%$$

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Past performance is no guarantee of future results. Actual results may vary. Diversification does not assure a profit or protect against loss in a declining market.

Alternative investments involve complex tax structures, tax inefficient investing, and delays in distributing important tax information. Individual funds have specific risks related to their investment programs that will vary from fund to fund. Clients should consult their own tax and legal advisors as Morgan Stanley Wealth Management does not provide tax or legal advice. Interests in alternative investment products are offered pursuant to the terms of the applicable offering memorandum, are distributed by Morgan Stanley Wealth Management and certain of its affiliates, and (1) are not FDIC-insured, (2) are not deposits or other obligations of Morgan Stanley Wealth Management or any of its affiliates, (3) are not guaranteed by Morgan Stanley Wealth Management and its affiliates, and (4) involve investment risks, including possible loss of principal. Morgan Stanley Wealth Management is a registered broker-dealer, not a bank.

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