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HFRI-I Liquid Alternative UCITS Index

**APPRAOCH**

**Eligibility Criteria**

The process begins with screening the HFR Database of active liquid alternative UCITS funds. Funds eligible to be index constituents must meet the following criteria:

- Confirmed to be UCITS compliant
- Performance reported net of all fees in USD or in other currencies converted or hedged to USD
- Reports NAV on a daily basis
- Manages at least $30mm in AUM in the fund
- Provides daily redemption liquidity and T-3 redemption / subscription notice and T+3 redemption / subscription settlement or better
- Minimum 6 months of track record for the strategy
- Open to new investment

The performance of the Index is denominated in USD and is published daily on a T+1 basis.

In the case where a constituent fund of the Index becomes ineligible, the fund will be removed and/or replaced, either at rebalance or mid-quarter within a timeframe consistent with notice and subscription periods, trade dates and settlement. The allocation percentage from the removal will be allocated in whole or in part to a new eligible fund or allocated to one or more existing eligible funds, in the sole discretion of the Index Administrator. The allocation percentage may remain unallocated for a period of time until a new eligible fund or funds is / are identified. In the event a daily NAV cannot be ascertained from normal pricing sources and/or daily liquidity is no longer available, due to suspension, liquidation, or other reason, the Index Administrator, in its reasonable judgement and sole discretion, may apply a reduced NAV, including a valuation of zero, based on available information and taking the most conservative view as to what the value could be within the funds normal liquidity period. At the sole discretion of the Index administrator the ineligible fund may be carried in the index for a short period of time until it becomes eligible or liquidates for value or may be treated as having zero value and permanently removed from the index.

**Selection Process**

The following formula is used to define the representative UCITS Strategy Universe (“Strategy Universe”) derived from the UCITS Liquid Alternative Universe contained in the HFR Database. The UCITS Liquid Alternative Universe is expressed as:

\[ HFU = \bigcup HFS \]

where \( HFS \) is the set of UCITS compliant funds classified by strategy in the HFR Database.

The funds comprising the HFS are filtered using the following formula to create the Strategy Universe

\[ \delta(1 – UCITS) \cdot \delta(1 – freq) \cdot \delta(AUM \geq 30mm) \cdot \delta(1 – fees) \cdot \delta(M < 6) \cdot \delta(1 – liq) \cdot \delta(1 – open) \neq 0 \]

where \( \delta(x) \) is the delta function defined as
\[ \delta(x) = \begin{cases} 1 & x = 0 \\ 0 & x \neq 0 \end{cases} \]

and

- **UCITS** is confirmed UCITS fund (1=yes, 0=no)
- **freq** is the reporting frequency in business days (1=daily, 0=otherwise)
- **fees** is the returns net of all fees (1=yes, 0=no)
- **M**=total number of months reported (M<6: 1, otherwise: 0)
- **liq** is the redemption liquidity (1=daily, 0=otherwise)
- **open** indicates the fund is open to new investment (1=open, 0=otherwise)

In cases where a manager lists multiple funds with the same or similar investment profile, HFR chooses only the most representative fund for HFRI-I Liquid Alternative UCITS Index inclusion.

HFR also screens for funds that exhibit abnormal volatility compared to its peers and considers them for removal from the index. Funds with a 20-day Value-at-Risk at 99% Confidence Level (VaR99%) that exceed 20% over 5 times in a consecutive 20-business-days period are also subject for removal from the index. The 20-day VaR of a fund is given by

\[ VaR(k) = \sqrt{k} \cdot VaR \]

where \( k = 20 \) is the 20-day window over which VaR is being measured, and the 99% Confidence VaR is estimated as

\[ VaR = 2.58 \sigma_t \]

where \( \sigma_t^2 \) is the conditional variance of the returns of the fund at time “t” estimated by a EWMA model.

**Index NAV Calculation**

HFRI-I Liquid Alternative UCITS Indices (the “Index” and collectively, “Indices”) are total return indices and are published by HFR at [www.hedgefundresearch.com](http://www.hedgefundresearch.com) and on Bloomberg. Computation of the Index NAV uses actual performance of constituent funds as reported to Hedge Fund Research, Inc. Performance reflects constituent fund management fees, incentive fees, dividends and other distributions.

The Index NAV is 1000 at inception where “t=0”. The NAV changes are driven by the Index performance, which is defined as the percentage change in the value of the Index from a previous date “t-1” to current date “t”. The NAV at “t” is defined as

\[ NAV_t = NAV_{t-1} \times (1 + ROR_t) \]

Where \( ROR \) is the percentage change in the total value of the Index from “t-1” to “t”:

\[ ROR_t = \sum_{i=1}^{n} \left( w_i - \frac{w_c}{n} \right) \times ROR_t^i + w_c \times ROR_{MM} - BR - F \]

where \( ROR_t^i \) is the total return of constituent \( i \) at time “t”, \( n \) is the number of constituents in the Index and \( w_i \) is the weight of constituent \( i \) at time “t” computed as
\[ w^i_j = \frac{(1 + R^i_{t-1})}{\sum_{j=1}^{n}(1 + R^j_{t-1})} \]

where \( R^i_{t-1} \) is the cumulative total return of constituent \( i \) between the rebalance date “\( T \)” and time “\( t-1 \)”: \[
1 + R^i_{t-1} = \prod_{t_{r=T}}^{t-1}(1 + ROR^i_{t_r}).
\]

and \( ROR^i_t \) is the rate of return of fund “\( i \)” at time “\( t \)” defined as:

\[
ROR^i_t = \frac{NAV^i_t + Div^i_t + C^i_t}{NAV^i_{t-1}} - 1
\]

where \( Div^i_t \) is the dividend declared for the ex-dividend date, \( n \) is the number of funds in the index, \( C^i_t \) represents any corporate action that takes effect at time “\( t \)”, \( w_c \) is a weight corresponding to an allocation to a generic money market account, liquid fund or cash equivalent, with a \( ROR_{MM} \) return, \( BR \) is the Basis Risk\(^1\) between the theoretical index calculation and actual index calculation\(^2\), and \( F \) corresponds to a constituent share class adjustment of 50 bps/ann.

On the rebalance date “\( T \)” the weight of constituent \( i \) is set to:

\[
w^i_T = \left( \frac{1}{n} - w^i_{T-x} \right) \cdot \frac{NAV_{T-x}}{NAV_{T-1}} + w^i_{T-1}
\]

where “\( x \)” corresponds to the number of business days (5) prior to the rebalance date when the constituents of the index for the new quarter are determined.

**NUMBER OF FUNDS AND INDEX WEIGHTING**

The HFRI-I Liquid Alternative UCITS Index will have a minimum number of funds of 140.

The HFRI-I Liquid Alternative UCITS Index is equally weighted on the rebalance date across the selected funds. The HFRI-I Liquid Alternative UCITS Strategy Indices are also equally weighted on the rebalance date across the selected funds in each of the four main strategies: Equity Hedge, Event-Driven, Macro and Relative Value. The performance of the Indices is denominated in USD. The number of funds within each of the four main strategies will be selected in a manner seeking to achieve the strategy weightings of, or correlation to, those of the HFRI Asset Weighted Composite (Adjusted) Index.

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\(^1\) Current calculation assumes \( BR=0 \).

\(^2\) Calculation of a net performance return would reflect all administrative costs associated with running an investable index product, including but not limited to administrative fees, custody and trustee fees, management fees, rebalancing fees and trading costs.
Notes:

- The Indices are rebalanced on the last business day of the quarter.
- The HFRI-I Liquid Alternative UCITS Indices are updated daily on a T+1 basis. Index NAV is not published on any day where constituent funds are closed for trading, as per trading calendar.
- Any historic performance corrections will be incorporated into future Index NAVs.
- Duplicate share classes of funds are not considered as Index constituents.

Accompanying Notes

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# Addendum – Revisions to the Methodology

<table>
<thead>
<tr>
<th>Date</th>
<th>Revision</th>
<th>Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/29/2018</td>
<td>Changed index fee from 40 bps to 65 bps per annum to performance</td>
<td>Calculation adjustment of historical and live performance time series to reflect change in index fees</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Loading of daily data to SQL server table</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Loading of monthly data to Trakker record</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Publishing new index performance to website</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Update index methodology document to reflect change in fees</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Uploading of revised methodology document to website</td>
</tr>
<tr>
<td>10/29/2018</td>
<td>Name change: From HFRI-I USD Index to HFRI-I Liquid Alternative UCITS Index</td>
<td>Adjustment of index name on Trakker record</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Adjustment of index name on website</td>
</tr>
<tr>
<td>11/01/2018</td>
<td>Index ticker assigned as HFRIILAU</td>
<td>Recording of index ticker on Trakker record</td>
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<tr>
<td></td>
<td></td>
<td>Recording of index ticker on website record</td>
</tr>
<tr>
<td>1/16/2019</td>
<td>Removed Appendix</td>
<td>Removed Appendix from methodology document</td>
</tr>
<tr>
<td>1/17/2019</td>
<td>Added paragraph describing process to deal with a constituent becomes ineligible</td>
<td>Language added in the “Eligibility Criteria” section of this document</td>
</tr>
<tr>
<td>1/17/2019</td>
<td>Expanded return formula to provide more detail of NAV computation</td>
<td>Expanded return formula in current document to provide more detail of NAV computation</td>
</tr>
<tr>
<td>2/5/2019</td>
<td>Added formula clarifying weight of constituents at the beginning of each quarter</td>
<td>Added formula in current document clarifying weight of constituents at the beginning of each quarter</td>
</tr>
<tr>
<td>2/22/2019</td>
<td>The index fee was changed to 50 bps p.a. and a minimum AUM of $30mm requirement for constituents were included in the index methodology</td>
<td>The historical performance of the indices was revised to reflect the refinement in the methodology.</td>
</tr>
<tr>
<td>Date</td>
<td>Description</td>
<td>Notes</td>
</tr>
<tr>
<td>------------</td>
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</tr>
<tr>
<td>4/25/2019</td>
<td>Minimum number of Funds, Benchmark of HFRI AWC (Adjusted) Index and T-3/T+3 liquidity requirement was added to the Methodology. “Index Fee” was changed to “constituent share class adjustment”</td>
<td>No constituents or performance changes were made.</td>
</tr>
<tr>
<td>5/3/2019</td>
<td>“Open to new investment” was added as an eligibility condition</td>
<td>No constituents or performance changes were made.</td>
</tr>
<tr>
<td>5/31/2019</td>
<td>“Manages at least $30mm in AUM in the strategy” was changed to “Manages at least $30mm in AUM in the fund”</td>
<td>No constituents or performance changes were made.</td>
</tr>
<tr>
<td>5/31/2019</td>
<td>“Minimum 6 months of track record” was changed to “Minimum 6 months of track record for the strategy”</td>
<td>No constituents or performance changes were made.</td>
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<tr>
<td>6/3/2019</td>
<td>Updated the eligibility criteria narrative in page 3.</td>
<td>No constituents or performance changes were made.</td>
</tr>
<tr>
<td>6/14/2019</td>
<td>Clarified in the Notes section that the rebalance is done on the last business day of the quarter.</td>
<td>No constituents or performance changes were made.</td>
</tr>
<tr>
<td>6/14/2019</td>
<td>Clarified in the Notes section the definition of trading day.</td>
<td>No constituents or performance changes were made.</td>
</tr>
<tr>
<td>6/14/2019</td>
<td>Indicated in the Notes that Any historic performance corrections will be incorporated into future Index NAVs.</td>
<td>No constituent or performance changes were made.</td>
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</tbody>
</table>