

***“Technology is a gift of God. After the gift of life it is perhaps the greatest of God’s gifts. It is the mother of civilizations, of arts and of sciences.”***

***— Freeman Dyson***

Are the markets rigged? The topic of high frequency trading (HFT) appears heated and full of debate. At Lake Hill, we are often asked how HFT affects our industry. The short answer is: technology, automation and tighter spreads helps in the form of lower transaction costs. However, technology used to simply “front run” orders hurts.

While the issue can be complex, we believe that one must first define HFT. Using computers to quickly make trading decisions and transact - even in the microsecond timeframe - is no different from any other advancement in technology. If one player is faster than another is, while remaining compliant, how can we protest?

If HFT is simply defined as fast trading, we have no issue. If unethical players are using technology as a means of breaking laws or bending regulations designed to protect the integrity of markets, then we do have an issue.

Most would agree that using technology to automate the ability to front run - an age old problem - should clearly be regulated. The authorities have always squelched front running and why should this time be any different?

Not too long ago, prior to HFT, we called a floor broker to execute an order on the exchange. The floor broker legally traded for his own account ahead of his client order flow. Clearly, this was a form of front running and the regulators correctly put a stop to it.

After that, brokers created “arms-length” relationships with “floor traders,” or “locals,” who were legally able to “position” ahead of client order flow. This was just another form of front running. Once again, the regulators correctly put a stop to this.

Currently, high frequency traders are electronically able to identify an order being routed to an exchange and trade ahead of it. This is no different from before, when the broker had knowledge of an order and traded in front of it. As regulators take a closer look, the rules will undoubtedly change.

Technology is not the villain in the HFT debate. Today, locals, liquidity providers, market-makers, brokers and customers are able to interact on exchanges electronically from *anywhere*. This has made a profoundly positive impact on spreads and liquidity. Technological advancement, which includes speed, has certainly resulted in significantly reduced trading costs.

If high frequency trading is electronic trading that allows for greater and more efficient connectivity to exchanges, it is a good thing. If high frequency trading is really just an exercise in automated front-running, it is a bad thing.

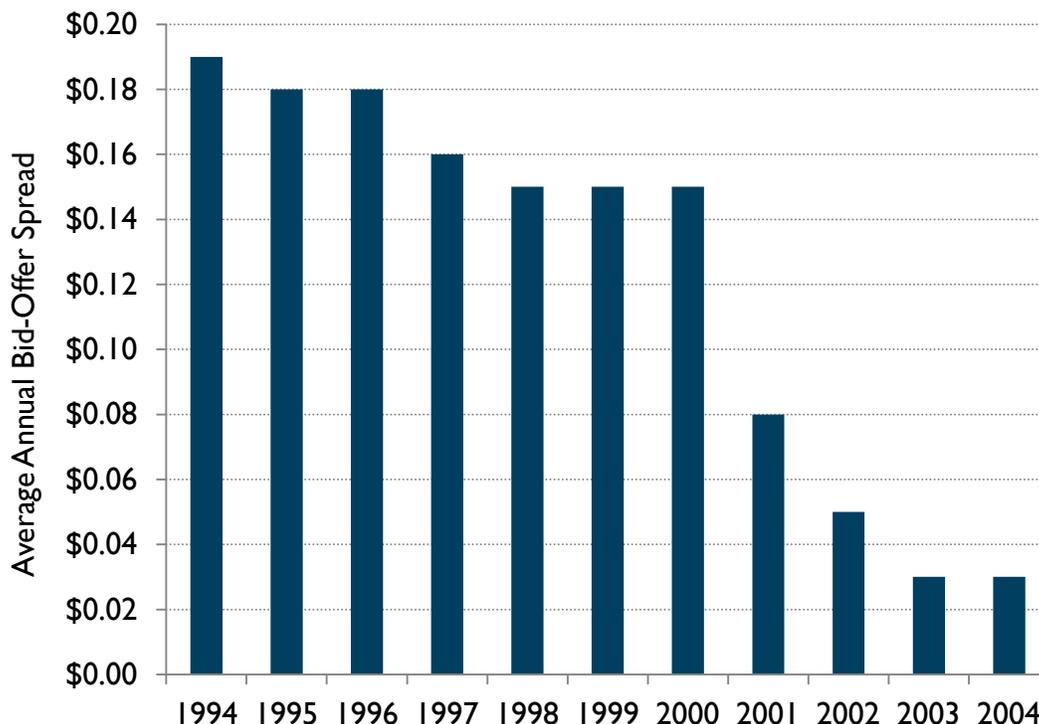


Figure 1: Average annual bid-offer spread for all stocks on the NYSE (<http://www.nyxdata.com/>)

The transaction cost per unit of stock is lower than it has ever been. Ultimately, the folks most shocked by “risk-free” profits of some HFT firms would be equally shocked by the hidden fees, commissions, and spreads paid when the industry was less technologically advanced. We are not defending malfeasance in the system, but we are defending the clear benefits that technology brings all market participants.

At Lake Hill we rely heavily on technology. It is a critical piece of our business that integrates risk management, portfolio construction, trading execution, transaction reconciliation, compliance and investor transparency.

In order to stay competitive, one must continuously adapt to evolving technology. Some players will be faster than others. Some rules will have to be updated. Irrespective of how one defines HFT, the combined overall impact of technology and innovation appears positive.

Electronification has had a big positive impact on investing. Everyone must adapt to this new world or become marginalized. Businesses across many industries need to be on the forefront of technology – including the finance industry– to remain competitive.

### **Important information regarding the information provided herein.**

**Not an offer and confidential.** This communication is provided for your internal use only. The information contained herein is proprietary and confidential to Lake Hill Capital Management LLC (“Lake Hill”) and may not be disclosed to third parties or duplicated or used for any purpose other than the purpose for which it has been provided. Although any of the information provided has been obtained from sources which Lake Hill believes to be reliable, we do not guarantee its accuracy, and such information may be incomplete or condensed. The information is subject to change without notice. This communication is for information purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security or of any fund or account Lake Hill manages or offers. Since we furnish all information as part of a general information service and without regard to your particular circumstances, Lake Hill shall not be liable for any damages arising out of any inaccuracy in the information.

**This document should not be the basis of an investment decision.** An Investment decision should be based on your customary and thorough due diligence procedures, which should include, but not be limited to, a thorough review of all relevant term sheets, offering documents, strategy descriptions as well as consultation with legal, tax and regulatory experts. Any person subscribing or considering an investment must be able to bear the risks involved and must meet the suitability requirements of the particular fund (each a “Fund” and, collectively, “Funds”) or account. Some or all alternative investment programs may not be suitable for certain investors. No assurance can be given that any Fund or Strategy will meet its investment objectives or avoid losses, including a complete loss. A discussion of some, but not all, of the risks associated with investing in the Funds or Strategies can be found in the private placement memoranda, subscription agreement, limited partnership agreement, articles of association or other documents as applicable to the given Fund or Strategy (collectively the “Offering Documents”), among those risks, which we wish to call to your attention, are the following:

- **Future looking statements, Performance Data and Strategy level performance reporting:** The information in this communication is NOT intended to contain or express exposure recommendations, guidelines or limits applicable to a Fund or Strategy. Investors should understand and consider risks when making an investment decision. This communication is not intended to aid an investor in evaluating such risks. The terms set forth in the Offering Documents are controlling in all respects should they conflict with any other term set forth in other marketing materials, and therefore, the Offering Documents must be reviewed carefully before making an investment and periodically while an investment is maintained. Statements made in this communication include forward-looking statements. These statements, including those relating to future financial expectations, involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Unless otherwise indicated, Performance Data is presented “net” of Management Fees and other Fund Expenses (i.e. legal, accounting and other expenses as disclosed in the relevant Fund’s Private Offering Memorandum) and “net” of Performance Fees. Performance Data is unaudited and subject to revision. Performance Data may be hypothetical, based on simulated or backtested data. Performance information should not be relied upon as a precise reporting of gross or net performance, but rather merely a general indication of past performance. Accordingly, the performance is not necessarily indicative of results that the Funds or Strategies may achieve in the future. If index information is included, it is merely to show the general trend in the markets in the periods indicated and is not intended to imply that the portfolio was similar to the indices in either composition or element of risk. This communication may indicate that it contains hypothetical or actual performance of specific strategies employed by Lake Hill, such strategies may comprise only a portion of any specific Fund’s portfolio, and therefore, the reported strategy level performance may not correspond to the performance of any Fund for the reported time period.
- **Investment Risks:** The Funds and Strategies are speculative and involve varying degrees of risk, including substantial degrees of risk in some cases. The Funds or Strategies may be leveraged and may engage in other speculative investment practices that may increase the risk of investment loss. Past results of the Funds, Strategies and investment manager are not necessarily indicative of future performance and performance may be volatile. The use of a single advisor could mean lack of diversification and, consequently, higher risk. The Funds and Strategies may have varying liquidity provisions and limitations. There is no secondary market for investors’ interests in any of the Funds or Strategies and none is expected to develop.
- **Not Legal, Accounting or Regulatory Advice:** This material is not intended to represent the rendering of accounting, tax, legal or regulatory advice. A change in the facts or circumstances of any transaction could materially affect the accounting, tax, legal or regulatory treatment for that transaction. The ultimate responsibility for the decision on the appropriate application of accounting, tax, legal and regulatory treatment rests with the client and his or her accountants, tax and regulatory counsel. Potential Investors should consult, and must rely on their own professional tax, legal and investment advisors as to matters concerning the Fund or Strategies. Prospective Investors should inform themselves as to: (1) the legal requirements within their own jurisdictions for the purchase, holding or disposal of Shares; (2) applicable foreign exchange restrictions; and (3) any income and other taxes which may apply to their purchase, holding and disposal of Shares or payments in respect of the Shares of the Fund or Strategies.