



## **DUE DILIGENCE QUESTIONNAIRE** **FCI-Credit Premium Program (FCI-CPP)**

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For a copy of the offering memorandum, please contact Financial Investments Inc. at 462 Herndon Parkway, Suite 205 Herndon, Virginia 20170 or call (703) 435-2777.

### **GENERAL QUESTIONS**

#### 1. Manager(s) Background

##### Craig B Kendall:

Craig B. Kendall, is the owner and manager of Kendall & Company, CPA's, Financial Investment, Inc. and Financial Investment, LP. Mr. Kendall, is a CPA licensed in the state of Virginia. Mr. Kendall operates, Kendall & Company, a local CPA firm, tailoring its services to entrepreneurial business needing comprehensive CPA and Chief Financial Officer, "CFO Services for Hire".

In 1997, Mr. Kendall, founded Financial Investments, Inc. an investment firm participating in the acquisition of equities, private placement memorandums (PMM), and has participated in other investments securities.

Mr. Kendall holds FINRA Series 3 and Series 66 licenses, and serves as the firm's

investment advisor.

His business experience includes over twenty years in the finance, accounting and investment banking industry.

Gaurav Gupta:

Gaurav P. Gupta holds a Bachelor of Commerce and a Masters of Commerce degree with a major in accounting from Mumbai University in India. He holds FINRA Series 3 license. He also earned a Masters of Science in Finance from The George Washington University (GWU). While in GWU, he was The Vice President of Trading of Finance and Investment Club. From June 2005 to May 2006, he worked with The American Council of Life Insurers. He is currently pursuing his Chartered Market Technician (CMT) designation.

2. Who owns the company?

Craig B. Kendall is the sole owner of the company

3. What is your capacity to manage in US\$ terms?

Our capacity to manage would be about \$300 million for this particular strategy

4. Do you accept managed accounts? If yes, what is the minimum amount?

Yes, we do accept managed accounts. The minimum investment is \$50,000

5. Was there any disciplinary action against the firm in the last 5 years?

None

6. Is there any pending litigation against the firm in the last 5 years?

None

**STRATEGY / APPROACH**

7. Define your Fund/program

Similar to FCI's Option Selling Strategy program, the primary trading strategy of FCI - CPP will be to sell, on behalf of a client, options on futures contracts. However, FCI - CPP is different from the Option Selling Strategy program because FCI - CPP may sell options that are likely to be closer to the expiration date, ranging from four (4) days to ninety (90) days from expiration, [versus thirty (30) to forty-five (45) days from expiration for the Option Selling Strategy program], and (b) closer to being "in the money". The program also utilizes

more of a vertical credit and calendar spread strategy, thus reducing per trade capital requirements. When premium collection transactions become unprofitable contracts, offsetting futures contracts or options are purchased as a hedge to limit further future contract losses. The net effect is that FCI - CPP targets higher returns with additional contracts being executed. There is an increased likelihood of the strike price being met on options written versus the portfolio of options written in the Option Selling Strategy program. Furthermore, FCI - CPP is more progressive with its rolling forward, exiting out of option contracts, and with the rolling further out as a hedge to limit contract losses. FCI - CPP will also utilize directional future trades from time to time. This will occur when underlying futures appear to be over extended in either an over or under valued status in relation to historical values of an underlying commodity. Finally, FCI - CPP program will utilize larger margin account balances with capital requirements targeted at a range of 40% to 60% of the total account balance.

8. What is your edge (competitive advantage/inefficiency)?

Most investors buy options in anticipation of a market direction with expectations of big things happening. The Chicago Mercantile Exchange estimates that approximately 80-90% of the options held through expiration will expire worthless. Our strategy is unique because contrary to what most people would consider prudent, we don't buy options - instead we sell options. Moreover, with today's volatile markets, this strategy works to our advantage.

9. Why do you make money (economic rationale)?

Options are a wasting asset, their value declines over time. As an option approaches its expiration date without being in the money, its time value declines since the probability of that option being profitable (in the money) is reduced. Also, the time decay of an option begins to accelerate in the last 30 days before expiration, provided the option is not in the money. This is exactly how we profit. Most of options we sell expire worthless providing full profit on the option premium sold. Sometimes, the value of the option declines even if the futures price moves against us and that's because the time decay of the option is at play. Positions that are opened as a calendar or horizontal option spread have predetermined profits and losses calculated. The net profit is the difference between the premium received on the sale of the higher priced option, less the premium paid on the lower priced option, before transaction fees and costs.

10. What are the strengths/ weaknesses of your investment strategy?

The main strength of our investment strategy is the ability to predetermine profits and losses with the use of spreads and hedged positions. The main weakness is not getting orders filled when opening positions at the predetermined hedged price.

The benefits and drawbacks of option selling strategy are summarized briefly below:

Benefits	Drawbacks
Percentages in your favor	Unlimited risk if not covered
Profit taking is easy (it expires)	Limited profit potential
Time is on your side	Slow moving
No need to guess market direction	
Perfect timing not necessary	

11. What makes your strategy different from those of other managers?

Our strategy not only works in trending markets but also in volatile, neutral, inconsistent markets that have no market direction and this makes our strategy different from those of other managers. Moreover, we take an integrated portfolio approach which utilizes option positions on eight to ten most liquid commodities and derivative contracts and thereby achieving sufficient degree of diversification. This diversification not only reduces portfolio volatility but also provides incremental profit opportunities.

12. What are the general characteristics of your trading method?

- Systematic mechanical
- Discretionary
- Chart patterns
- Fundamental
- Multiple systems
- Neural Networks
- Computerised
- Manual

- Contrarian
- Counter trend
- Trend following
- Seasonal cycles

- Short term (less than one week)
- Medium term (1 to 3 weeks)
- Long term (3 weeks+)

- Outright trading
- Spreads
- Arbitrage

- Options
- Interbank

Others - please specify:

13. The following list comprises the types of data generally used in most trading models. Indicate by checking the appropriate boxes which types best represent those utilized in your trading system (please mark):

- Daily Prices (Open, High, Low, or Close)
- Volume
- Intra-Day price data (price movements within the day)
- Open Interest
- Psychology - Market sentiment - Bullish Consensus
- Fundamental Data - Supply and Demand decisions, Micro/Macro Economic statistics

Others - please specify:

14. Listed below are a number of techniques used in Systems Development. Of those listed, check the characteristics which best describe the techniques used in your program

- Moving averages of prices, or multiple averages (including exponential, weighted average - single or multiple)
- Chart patterns (head and shoulders, triangles, flags etc.) on bar charts
- Momentum
- Oscillators
- Point and figure charts
- Probability models
- Penetration identification
- Overbought / oversold
- Cyclic analysis
- Seasonal analysis
- Fundamental or economic analysis
- Arbitrage
- Spreads
- Trend following
- Counter-trend
- Reversal
- Artificial intelligence
- Others - please specify:

15. Does the system(s) rely on proprietary indicators or do you use non-proprietary indicators like Gann, Stochastics, Moving Averages, RSI, Elliott Wave?

We rely not only on proprietary indicators but also non-proprietary indicators like Gann, Stochastics, Moving Averages, RSI, Elliott Wave etc.

16. Does your success depend on a few key people or could the company proceed if certain people would not be with your organisation anymore?

Although we employ key personnel, our value proposition lies with our unique investment strategy, disciplined investment approach and consistent monitoring of markets allowing us to capitalize on key markets.

17. Within the general framework of your system, is there room for judgmental decision making? If so, comment briefly?

Yes. There is room for judgmental decision making. Once, we get a pointer to trade a particular market, it is judgmental to decide which expiration month and what strike prices do we select.

18. Why are you able to make money also in the future?

There has been a trend of increasing volatility in the financial markets. This works in our favor. Moreover, we see the trend continuing and it will assist us to make money in the future

19. Since when do you run your strategy? Any interruptions? If yes why?

Since May 2006. No interruptions yet

20. Where did you learn what you do today? Did you have any mentors?

We have studied and reviewed extensive material from numerous S&P Option Seller investors. Max Ansbacher of AIM is our mentor.

21. Which sectors do you trade?

- Fixed Income
- Equity
- Currency
- Commodity

22. Which markets do you trade? Which one do you avoid intentionally and why?

We trade the most liquid markets with above normal volatility i.e.: crude oil, silver, corn, soybeans, wheat, gold, gasoline, financial currencies, bond, equity indices, etc.

23. What instruments do you use?

Underlying

- Options
- Futures
- Swaps
- OTC
- Funds

24. Are all instruments you trade for your portfolio publicly listed and quoted? If not, name them:

Yes

25. What are the inputs for your decision making?

- Market Price
- News
- Information
- Research
- Fundamental and Technical Analysis

26. What role do computers play in your approach?

- Choosing markets
  - Entry points
  - Exit points
  - Timing
- Asset Allocation
- Risk Management
- Market information
- Data Analysis

27. Do you use always the same parameter(s) to analyze a trade / market?

No. We analyze each trade on a case to case basis.

28. Which market environment factors are favorable/unfavorable for you strategy?

High volatility environment is favorable for our strategy

29. Do you trade equity or fixed portfolio size?

No

30. How do you enter a new account into the market (please mark)?

- Wait for equity dip
- New Signals only
- Enter all current positions

Others: \_\_\_\_\_

31. How many systems or strategies do you use in your program?

We use just one strategy – Credit Premium Program

32. Do you ever add on to an existing position?

Yes.

33. Do you exit on the same system you used to generate your initial entry? If not, how does your exiting strategy differ?

Yes

34. What types of orders do you use?

- Open
- Limits
- Stops
- Market
- Stop Close Only

35. How many years have you back tested each system?

15 years

36. When was the last time the system(s) and program(s) were reviewed or materially changed? What caused this to happen and what have been the results since the changes were fully implemented?

We monitor our system and program on a continuous basis. It has been modified and refined so as to improve our historical win rate. Moreover, we have incorporated tighter contingent stop loss parameter into a program and have enhanced internal reporting and monitoring system.

37. Do you use the same parameters for every commodity? If not, why and how are you doing it?

No. We choose the commodities based on its underlying volatility, liquidity and price movement.

38. Do large accounts outperform small accounts or vice versa? If yes why?

No, we treat all the accounts equally.

39. Which markets do you believe your methods of trading perform best in?

- Bull Trends
- Bear Trends
- Congestion zones
- The same in all 3 markets
- Bull and Bear, but not congestion zones

40. What do you estimate your average holding period is (specify days, weeks, months)?

5-45 days

41. What is the trading frequency (stated as the number of round turns per million per year) and commissions as the percent of equity (state commission rate the percentages based upon)?

Average of 5,000 round turns per million. Commission as a percent of equity is a maximum of 5%

42. How does your trading system adapt to changes in volatility?

Performs best when volatility is at a premium. Returns can be enhanced when underlying trades within a price range over an extended period of time moves in our favor.

43. Do you intend to implement any major changes during the next six (6) months? Your answer to this question should include changes in systems, trading programs, markets traded, instruments traded and amount of assets under management?

No

44. What other factors influence your ability to make money?

We see opportunities to make money even during extremely low volatility of liquid commodities

## **RELATIONSHIPS**

45. Where do you get the information you need for your approach/strategy?

OptionVue, Option Volatility Software, Real time underlying commodity pricing, Commitment of Trader's Reports, and external forecast demand and research reports

46. What is the role of brokers or similar institutions in your approach? List the sources:

We work closely with floor brokers to secure and execute favorable pricing and volume execution.

47. Who is your prime broker(s)? Could an investor clear through another of his choice?

Our prime broker is MF Global. Yes, the investor can clear through another broker of his choice.

48. How does your approach differ from the other managers in the same area?

Our approach differs from the other managers because we are not a trend following system.

49. Who are the six main competitors in your sector/area?

There are a number of CTAs who execute a similar options selling strategy on S&P 500. The six main competitors would be:  
Ace Investment Strategists  
Ascendant Asset Advisors  
Cervino  
Clarke Capital  
Crescent Bay  
LJM Partners

50. Do you have any soft dollar agreements? If yes what services does it include?

No, we do not have any soft dollar agreements.

51. What are the information systems you are using?

Dell Desktop and Laptops, Windows XP.

52. What percentage of importance would you allocate to the following factors within trading methodology (out of a hundred percent)?

<input checked="" type="checkbox"/> Technical tools	20 %
<input checked="" type="checkbox"/> Fundamental tools	30 %
<input checked="" type="checkbox"/> Discretion based on experience	50 %

53. Do any of the firm's principals have other business involvements, and if so, how much of the professional time is devoted to them?

Yes, Craig Kendall has other business involvements. He is the owner and manager of Financial Investments Inc and Kendall & Company, CPA's. He

devotes a total of about less than 10% of his time to the entities mentioned above.

54. Do you have any affiliations with Brokers or FCMs? If yes, please explain.

FII has a pending Introducing Broker (IB) application on file with the NFA.

55. At what brokerage firms are you currently approved?

MF Global, Peregrine Financial Group (PFG), Goldman Sachs, Alaron and Vision.

56. Do you utilize exchange for physicals (EFP) within your trading? If yes for which exchanges?

FCI may trade in physical or cash commodities for immediate or deferred delivery, including specifically gold bullion, as well as futures, options, swaps, and forward contracts when it believes that cash markets offer comparable or superior market liquidity or ability to execute transactions at a single price.

## **RISK MANAGEMENT**

57. Who manages the risk for your firm?

Financial Commodity Investment's 'Trading and Investments' Division is responsible for accessing and managing the risk for the firm.

58. What determines risk in your strategy?

In a spread or hedged position the amount of risk is determined by the amount of protection that is obtained when opening and maintaining the position. Hedged positions allow greater use of available margin for additional positions.

59. How do you measure and manage risk?

Due to the volatile nature of trading futures and options on futures markets, FCI adheres to strict money management principals to increase the opportunity of success of the trading program. Position exposure and the potential percentage loss that the portfolio may incur in unfavorable market moves are continuously monitored. Volatility models are used to determine position size adjustments to maintain the programs maximum exposure limits. Position exposure limits are the total equity risked in any one market, and is generally between 0.5% and 5.0% of the total equity. An increase of the volatility model may cause a position size reduction in any particular market.

60. Is the risk calculated for each investment?

Yes

61. Describe the firm's overall risk management principles and approach?

There are number of ways one could control risk but our risk management principle requires us to have a contingency plan of action for whatever the market does. When we get into a trade, we know where and why we will be getting out of the market, if we are wrong. It is difficult to control where the market goes but it is easier to control what we can do about it.

62. How is the portfolio hedged?

Initial option positions within the portfolio will be hedged using either vertical or horizontal spreads, with the width determined by risk/reward assessments performed prior to entry. Additional hedging may be accomplished with the use of the underlying futures contract. Our discretionary method does allow the sale of an option that is believed to expire without the use of a hedge to allow collection of the most premium.

63. Under what principle is overall portfolio risk controlled?

One of the money management principles we strictly follow is to avoid overtrading. Moreover, we quickly cut things off once the losses start to reach about 5-10% of the total portfolio value. Moreover, risk is also mitigated through the use of diversification of the portfolio and weekly internal reports to monitor our positions and to exit losing contracts. Parameters are based on a function of premium and time decay existing on a contract.

64. What determines the leverage used?

The fund is subject to risk based margin requirements typical of an options seller. Since, we are volatility sellers, volatility of the underlying contract determines the leverage used. Hedging enhances available leverage by providing a degree of protection against adverse movements, thereby limiting the loss to a predetermined level. This layer of protection reduces margin requirements and margin calls to maintain the position.

65. Does the firm impose limits on the amount of margin committed to different markets, sectors, or portfolios?

Yes. We impose limits on the amount of margins committed to any given commodity at a maximum of 15% of total equity. We also try to maintain a margin/equity ratio of about 40% with a maximum of 60%

66. How does the firm react if the volume and/or open interest of a market in which a position is held are suddenly reduced significantly?

FII keeps a close eye on the volume and the open interest of all the market it trades in. The decision taken by the firm with regards to the position held when

the above two variables are suddenly reduced significantly depends on how close is the market price to the strike price and how many days is it prior to expiration. If it is too close to the strike price or there are too many days left for expiration, we would decide to exit the position. We prepare a Daily Status Report to monitor our positions and to support our decision making in exiting contracts.

67. Does adding or reducing a position in one market ever influence the size of positions held in other markets? If yes, please explain.

Yes, adding or reducing a position in one market might influence the size of the positions held in other correlated markets. A good example would be corn and soybeans since they tend to move in tandem

68. What are the external events that could cause a major loss for your program?

Events like 9/11 where the markets are closed for a number of days could cause a sizeable loss for the program.

69. Is there an event inherent to your approach that could cause a major loss?

No

70. What is the maximum single position in your portfolio?

Maximum single position in the portfolio would be 10-15% of total equity

71. How much do you risk per trade in % of equity?

About 1-2%

72. Do you place stops?

Yes, we do place stop loss orders on our positions. All the positions are monitored continuously and we get out of the position if the situation warrants so.

73. Do you stay out of the market completely? If yes, why and when?

We stay out of the markets in which we don't clearly understand the fundamentals and thus feel uncomfortable to predict the future price movement in that particular market with some level of accuracy.

74. What is the required margin to equity ratio?

We maintain the margin to equity ratio at about 20% with a maximum of 40%

75. Do you employ leverage? If yes, why, how much and how often over time?

Yes. It varies over different commodities

76. What determines the leverage used?

The fund is subject to risk based margin requirements typical of an options seller. Since, we are volatility sellers, volatility of the underlying contract determines the leverage used.

77. Are "higher leverage" and "lower leverage" versions of the same program offered? If yes, please explain how they are structured?

No. We offer just one program

78. What is the typical breakdown of your portfolio?

Energies – 30%  
Grains and Oilseeds – 10%  
Metals – 15%  
Softs – 10%  
Equity Indices – 10%  
Currencies – 25%

79. How do you calculate the correlation between each investment in the portfolio?

We calculate the correlation between investments by studying the historical price behavior between different commodities and using the R-Square test.

80. Are you analyzing historical or temporary correlation between investments and does such analysis influence your portfolio design? If yes, please explain. Do you determine position limits for such correlating groups?

We analyze correlations between different investments on a case to case basis. For example, the correlations between crude oil and natural gas or between soybeans and corn may be required, but not quite so between Soybeans and Coffee. Moreover, we make sure that we do not overweigh a particular sector.

81. What is your average cash position? Max/min?

Average Cash position – 60%  
Max – 90%  
Min – 35%

82. What is your diversification policy?

We try to diversify the portfolio among a minimum of four-six commodities at any point in time. We also impose limits on margins committed to any given commodity at a maximum of 15% of the total equity. This helps us in not overweighing any particular market.

83. Are there a minimum number of markets in which the firm always holds positions in order to achieve a minimal portfolio diversification effect?

No

84. Do you have a risk objective?

Risk tolerance is set so that there is no target drawdown greater than 10% in any one month

85. Largest decline in history, date and reasons for it?

December 2008. We entered a strategic seasonal trade with less reliance on volatility effect. Direction of the underlying price of the commodity did not go as anticipated and hence generated an 8.7% drawdown.

86. How have your losses occurred? (be precise as possible)

Underlying commodity trended towards our option strike prices. We exited contracts prior to expiration so as to preserve capital and minimize losses

87. What have you changed since those losses occurred?

We grew to be more prudent money managers. We document not only the winning trades but also the losing trades and the reasons for the losses. This acts as a learning mechanism for us within the firm. Moreover, we incorporated greater discipline in executing contingent stop loss parameters.

88. What do you estimate is your maximum potential decline?

Around 10% in a month

89. What are you doing in such a case?

We let our profits run and take steps to curtail our losses if the markets start moving against us by a sizeable amount.

90. At what percent drawdown would the firm either stop trading or recommend that an account be closed?

More than 50% drawdown

91. Would power, phone or computer breakdown affect your trading? What are your contingency plans for such an event?

No - power, phone or computer breakdown would not affect our trading.

92. On a scale of 1 to 5 (1 being the low risk peer investment and 5 being a risky manager/investment in your area) where do you place yourself?

We would place ourselves at number 3.

93. Do you trade counterparty currency or commodity forwards?

No

94. Do you trade on emerging markets? If yes, please describe the markets.

No

95. Does the firm trade on exchanges that are open outside local office hours?

No

## **LIQUIDITY**

96. Has there been a liquidity problem with the vehicles you use in the past? What could create one in the future?

No

97. How long would it take you to liquidate the entire portfolio?

It would take about 1 to 3 business days to liquidate the entire portfolio

98. Do you have a lock-up in your strategy/fund?

Yes, 90 days

99. How frequently can I invest in FCI?

On a daily basis

100. What is the redemption frequency?

On a daily basis

101. Is there any redemption notice period?

Yes. 45 business days

102. Does FCI distribute income in any form (eg. Dividends)?

No

## **PERFORMANCE**

103. What is your performance objective with what level of risk?

Our performance objective is a minimum of 15% to the clients after all the fees.

104. What percentage of your performance comes from an index (beta) and what from your own value added (alpha)?

Our performance is not correlated with the index. Hence, 100% of our performance is alpha, our own value added.

105. What excessive monthly return (positive or negative) would surprise you?

A monthly positive return of more than 15% and a drawdown of more than 10% would surprise us.

106. When was the last time you were audited by a Regulatory Body?

October 2008.

107. How many assets in US\$ do you have under management?

At the end of December 2008, we had 40 million dollars under management

108. What was the rate of return for the previous month?

Our rate of return for the month of January 2009 was 6.8% net of fees.

## **FEES & NAV**

109. What is your fee structure?

Our fee structure is the standard: "1 and 25", a 1% management fees as % of assets and 25% incentive fees as % of net new profits. High-water mark methods applied to incentive fee calculation.

110. What is the maximum Commission per round-turn that you will accept an account?

The maximum commission per round turn that we will accept for an account is \$25.

111. When are the fees debited to the fund?

FCI will charge a maximum of 1/12 of 1% of the beginning of the month's net assets of the client's account as management fees. Management fees, in months that additions are made to client's account shall be time-weighted based on the day of the month in which funds are traded. FCI will also debit a monthly incentive allocation of 25% of net trading profits at the end of the month.

112. Do you have a hurdle rate or benchmark? If yes what is it?

No, we do not have a hurdle rate. Our benchmark is our Proprietary Peer Group Index.

113. Do you have a high water mark?

Yes.

114. Do you have any administrative fees?

No.

115. Do you have any set-up fees?

No.

116. Do you have any redemption fees?

No.

117. Do you have any sales fees?

No.

118. Do you have any other fees?

No.

119. Who are the following parties for your products:

- Advisor: Financial Commodity Investments Inc (FCI)
- Prime Broker: MF Global
- Other Brokers: Peregrine Financial Group (PFG) and Goldman Sachs
- Legal Advisor on-shore: Ruddy Law Firm
- Legal Advisor off-shore: N/A

## **ORGANIZATION**

120. Describe your corporate culture?

The corporate culture at FII is very professional. We at FII ascribe and instill upon the employees professionalism, integrity, quality of work, fiduciary responsibly and relentless pursuit of excellence.

121. How are you structured (research, trading and back office)? Number of people?

Trading and Investing Division takes care of all the trading decisions. The administrative division is in charge of reporting and evaluation. There are four people

122. List all names of key employees and their responsibility:

Craig B. Kendall – Trading, Programming, Marketing and Business Development, Research and Development, Reporting

Gaurav Gupta – Trading, Programming, Research and Development, Administration, Reporting

Melanie Martin – Administration, Reporting

123. Does the firm (or principals thereof) hold the following regulatory registrations:

a) CTA  Yes  No Name: Financial Commodity Investments  
NFA Number: 0364738

b) CFTC  Yes  No Name: Number:

c) SFA  Yes  No Name: Number:

d) SEC  Yes  No Name: Financial Investments Inc  
IARD CRD Number 119611

e) NFA  Yes  No Name: Financial Investments Inc  
NFA Number 0325968

124. Please list your attorney of the company?

Attorney – Ruddy Law Firm

125. Who does the marketing for your activities (internal & external)?

Internal

126. Describe your current research projects?

Currently researching opportunities in FOREX (foreign currencies)

127. What is your annual research budget? How much has your firm invested in research since inception?

We do not have a defined annual research budget.

128. Have you published any research/academic papers? If yes, give details.

No

### **FINAL QUESTIONS**

129. Do you have any written comments, updates, reports?

All the reports are available on the website

130. Do you have your own money in your fund?

Yes

131. How much of your net wealth in percentage is invested in your strategy?

About 15% of net wealth of Craig B Kendall is invested in this strategy.

132. Do you have a side trading account? If yes why?

No

133. Do you invest the fund money with other 3rd party managers? If yes explain

No

134. If you had to allocate some of your personal funds, to whom would you entrust them?

We would invest some in foreign exchange

135. Do other multi-manager funds have money with you?

No

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