

Item 1 – Cover Page

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August 2, 2011

This Brochure provides information about the qualifications and business practices of Smart Portfolios, LLC (“Smart”). If you have any questions about the contents of this Brochure, please contact us at 206-686-3636. The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about Smart Portfolios, LLC is also available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

Smart Portfolios, LLC is an SEC registered investment adviser. Registration of an investment adviser does not imply a certain level of skill or training.

## **Item 2 – Material Changes**

On July 28, 2010, the United State Securities and Exchange Commission (“SEC”) made changes to the requirements of the disclosure document that Smart is required to provide to its Clients. This Brochure, dated March 31, 2011, is prepared according to those new requirements and is materially different in structure from older versions of the document. It also includes new information that was not previously required.

Smart updates this document annually, or more frequently in the event of material changes. In future versions, this section will outline and summarize the specific changes made since the Brochure’s previous update.

Smart’s Clients may request a full copy of the latest version of this Brochure, free of charge, by contacting Bryce James, Chief Compliance Officer, at (206) 686-3636 or [info@smartportfolios.com](mailto:info@smartportfolios.com). A complete copy is also available online at web site [www.smartportfolios.com](http://www.smartportfolios.com).

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#### **Item 4 – Advisory Business**

**Smart Portfolios, LLC** is an SEC-registered investment advisor, which was founded in April 2005. Its sole shareholder is Shield Holdings, LLC, whose principal owner is Bryce James. As of January 1, 2011, Smart Portfolio managed \$220,146,832 in assets, all on a discretionary basis.

Smart's core focus is providing sub-advisory services to Registered Investment Advisors (RIAs). It also provides custom trading algorithms ("signal") to RIAs, has retail clients and acts as sub-advisor to a fund in a mutual fund family. Smart specializes in development of asset allocation models, which are selected by RIAs for their clients, or by Smart for retail clients and its mutual fund client, and in some cases delivered as signal.

Each of Smart's seven asset allocation models is developed to invest in one or more predetermined universes of securities (including, depending on the model, exchange-traded funds, mutual funds and collective investment trusts of insurance companies or TIAA/CREF), each with a pre-established risk objective. Client accounts are invested only in accordance with the particular model(s) selected for the Client.

Smart's models are based on application of Extreme Value Theory (EVT), which uses advanced mathematics to calculate the risk, return, and correlation of securities (the relationships between the price movements of securities) in a portfolio, to create a more real-time efficient frontier through its Dynamic Portfolio Optimization (DPO)<sup>™</sup> asset allocation system. The DPO system is used in each of the models. In addition to the models, Smart uses technical analysis, in which it charts price movements of securities and adjusts allocation appropriately.

Each of Smart's advisory services is described briefly below. The models used in performing these services are described in more detail in Item 8.

## **Types of Services**

### *Sub-Advisory Services*

Smart's principal focus is to act as sub-advisor for registered investment advisors. Pursuant to a separate agreement with each RIA, the RIA selects a model offered by Smart for the RIA's Client in accordance with its Client's financial position, objectives and risk tolerance, and may change the selection at any time. Smart trades the account in accordance with the model selected.

### *Signal Services*

Smart provides signals to RIAs pursuant to signal agreements. The RIA selects the signal to be provided (based on one of the Smart models), and makes all decisions whether and when to use the signal for its Clients. The RIA executes all trades.

### *Retail Services*

Smart provides separately managed account services, whereby Smart selects one of its models for a Smart Client based on the Client's financial position, objectives and risk tolerance, and then implements the selection pursuant to discretionary authority.

### *Mutual Fund Sub-advisory*

Smart acts as sub-advisor to a mutual fund as part of a fund family. Smart executes all trades within the fund in accordance with Smart model.

## **Account Restrictions and Tailoring**

Smart does not implement client restrictions governing investments, such as the type of securities or particular issuers to be bought or sold. Each RIA who selects Smart as sub-manager is responsible for ensuring that Client restrictions on accounts are consistent with selected Smart models. Likewise, with respect to Smart's Clients, Smart will not select models for a Client that are inconsistent with any restrictions imposed by the Client, and will not accept the Client if an available model would be inconsistent with any restrictions.

We do not specifically tailor models for Clients. Models are selected for Clients based on a Client's financial position, objectives and risk tolerance.

### **Item 5 – Fees and Compensation**

As a fee-only advisory firm, Smart is compensated solely through fees paid by its Clients. In most cases, fees are paid quarterly in advance by applying one quarter of the annual rate shown below to the account balance at the end of the previous quarter. The fee for accounts initiated or terminated during a calendar quarter is pro-rated. Clients who terminate receive a refund of the portion of the fee, calculated based on the number of days remaining in the quarter at the time of termination. Smart may, in its sole discretion, waive or negotiate fees.

Account fees may be deducted from Clients' assets or billed directly, depending on the custodian of the assets or type of account. Clients may not select the method of payment. For sub-advisory Clients, depending on the arrangement, the RIA may collect the entire quarterly fee directly and pay Smart its portion, Smart may collect the entire quarterly fee and pay the RIA the balance that exceeds Smart's fee, or Smart may debit or bill only its portion of the fee.

#### *Sub-Advisory Fees:*

The annual rate for Clients of an RIA are based on total assets under management at Smart, and the Client's total assets managed at Smart, as follows:

<u>Total AUM</u>	<u>Management Fee</u>
< \$10mm	0.70%
\$10mm - \$50mm	0.60%
\$50mm - \$100mm	0.45%
\$100mm >	0.35%

For Signal Services:

The annual rate for Clients of an RIA (for which the signal is used) are based on total assets under management at Smart, and the Client's total assets managed at Smart, as follows:

<u>Client AUM</u> <u>At Smart</u>	<u>RIA's AUM at Smart</u>			
	<u>\$0-\$50MM</u>	<u>\$50MM</u>	<u>\$150MM</u>	<u>\$250MM+</u>
First \$500,000	0.60%	0.58%	0.56%	0.54%
Next \$500,000	0.55%	0.53%	0.51%	0.49%
Next \$1MM	0.50%	0.48%	0.46%	0.44%
Over \$2MM	Negotiated			

\* Note: As of August 1, 2011 Smart Portfolio is no longer accepting new clients for signal business.

For Retail Services:

Annual rate:

First	\$1,000,000	1.50%
Next	\$1,000,000	1.20%
Next	\$2,000,000	1.00%
Next	\$2,000,000	.90%
Next	\$1,000,000	.80%
Next	\$1,000,000	.70%
Over	\$10,000,000	Negotiated

For Mutual Fund Sub-advisory Services:

Smart receives 50% of the net paid out to the fund. The expense ratio is currently 1.30%.

For Consulting Services:

Smart offers consulting services at a rate of \$250 per hour.

### Other Fees and Expenses:

In addition to Smart's fees, Clients pay custodial and other fees, costs, and expenses to their custodian. In addition to the advisory fee paid to Smart, clients may pay either a commission or an "asset based pricing fee" (fee in lieu of commission) to their custodian, which includes execution, custodial fees and other costs and expenses pursuant to separate agreement with the custodian. Clients may incur certain other charges imposed by custodians, brokers, third party investment and other third parties such as fees charged by managers, custodial fees, deferred sales charges, odd-lot differentials, transfer taxes, wire transfer and electronic fund fees, and other fees and taxes on brokerage accounts and securities transactions. Mutual funds and exchange traded funds (ETFs) also charge internal management fees, which are disclosed in a fund's prospectus. Such charges, fees and commissions are in addition to Smart's fee, and Smart does not receive any portion of these commissions, fees and costs. See Item 12 for further discussion regarding brokerage.

### **Item 6 – Performance-Based Fees and Side-By-Side Management**

Smart does not charge performance based fees.

### **Item 7 – Types of Clients**

Smart provides the majority of its services to RIAs as a sub-manager. In addition, Smart has Clients who are individuals, high net worth individuals, charitable institutions, sovereign nations and a registered mutual fund.

Smart requires a minimum initial investment of \$100,000 per Client. The minimum is not applicable to accounts held with insurance companies and TIAA/CREF. Smart may, at its discretion, reduce the minimum investment requirements.



## **Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss**

Investing in securities involves risks, including the possibility of a complete loss of the amount invested, which Clients should be prepared to bear.

Smart uses statistical modeling to create its asset allocation models. Nearly, all of Smart's models are based on Smart's proprietary asset allocation engine, Dynamic Portfolio Optimization (DPO). Smart's DPO engine modifies the portfolio asset mix to reflect the current risk and potential return of the investable markets. Using DPO, models are established with different pre-established risk objectives, but using the same philosophy. When markets are at greater risk the model strives to reduce risk tolerance level to preserve capital and when risk-adjusted returns are attractive the model's objective is to seize the opportunity for greater returns. In other words, the market, which is constantly changing, dictates the risk/reward profile. Our models are designed to track the changes in risk and return and to invest accordingly as we endeavor to optimize performance.

We invest primarily through ETFs because we believe ETFs efficiently diversify away company-specific risks that the market does not compensate investors to take. ETFs provide access to a wide diversity of asset classes, and their sector specificity allows us to take advantage of forecasted opportunities.

### ***Smart Philosophy:***

- Investors (collectively) make the market.
- Markets are driven by investor expectations.  
(fundamentals, economics, technicals, etc.)
- Changes in expectations affect security prices.  
(earnings estimates, interest rates, technical breakouts, etc.)
- Large errors in expectations cause rapid and pronounced price changes.  
(internet bubble, real estate boom, flash crash, Greek currency, Russian bond default, Mexican peso devaluation, etc.)

- We believe managing the changes in price, and velocity of change, optimizes portfolio performance.

Our research shows that extreme market events occur more often than is normally assumed, that volatility and the relationships between the price movements of securities (correlation) are not constant, and that future volatility, correlation, return opportunity and risk can be scientifically, albeit imperfectly, predicted over one-month horizons. Having developed tools to act on that philosophy, our strategy is to alter our market exposure, by degree and by sector, frequently to optimize risk-adjusted returns for our investors.

Multiple studies claim 91.5% of the quarterly variation in returns comes from asset allocation. Billions are spent annually in the remaining 8.5% but few resources are spent analyzing the largest driver, asset allocation. Nearly all asset allocation software solutions follow a three-step process to determine the optimal asset mix, a process termed portfolio optimization. These three steps require the modeler to calculate risk, return and correlation of a given set of securities. Most of these calculations come from concepts designed over 50 years ago. The Smart Portfolios method leverages current computing power and advanced mathematics to deliver what we believe is closer to a real-time asset allocation solution.

Each of the models, described briefly below, is designed for varying risk. Each is subject to the general risks described below. Additional risk for a particular strategy is inherent in the asset classes selected and the universe of available funds.

**ETF Moderate Allocation Strategy:** This strategy is designed to provide steady long-term growth by seeking lower volatility ETFs, such as those of fixed income or low correlated securities. Asset classes in the fund universe include: domestic and foreign fixed income, real-estate commodities and domestic and foreign equity securities.

**ETF Allocation Strategy:** This strategy is designed to be more aggressive than the Moderate Allocation Strategy and to provide long-term growth by investing in broader

market ETFs. Asset classes in the fund universe include: domestic and foreign fixed income, real-estate, commodities and domestic and foreign equity securities.

**ETF Aggressive Strategy:** This strategy is designed to provide long-term growth by investing in broader market ETFs and utilizing strategies such as investing in options and futures. Asset classes in the fund universe include: domestic and foreign fixed income, real-estate, commodities and domestic and foreign equity securities. In addition to the security selection above, the model may also use leveraged and inverse funds, as well as options.

**Pacific Life.** This strategy is designed for moderate risk investors seeking to outperform major market indices, such as the S&P 500. The strategy employs a diversified selection of investments including bonds, domestic and foreign equities, real estate and money market collective investment trusts. This universe is solely dependent upon the DPO model.

**Security Benefit Life.** Smart's Security Benefit Life strategy is to outperform an unmanaged mix of investments from the universe of investments offered by Security Benefit Life to their variable annuity customers. This model, due to the underlying investments, is designed for a more aggressive investor. The strategy makes an optimized selection of investments from the assortment offered by Security Benefit Life to their variable annuity customers. This universe of funds is managed solely through technical analysis and does not use the DPO model.

**TIAA-CREF 9 Allocation Strategy.** Smart's strategy using a TIAA CREF 9 Fund Universe is a portfolio focused on delivering investors sustainable long-term growth. This strategy is designed for investors with long-term time horizons. The strategy employs the preselected nine diversified investments including bonds, domestic and foreign equities, real estate, and money market funds. This universe of funds is managed solely through technical analysis and does not use the DPO model.

**TIAA-CREF 18 Allocation Strategy.** Smart's strategy using a TIAA CREF 18 Fund Universe is a portfolio focused on delivering investors sustainable long-term growth. The strategy employs the preselected eighteen diversified investments including bonds,

domestic and foreign equities, real estate, and money market funds. This universe of funds is managed solely through technical analysis and does not use the DPO model.

### ***Certain Material Risks:***

All Client portfolios are subject to material risks, including:

**General Economic Conditions and Market Disruptions.** Prices of securities may be volatile due to general economic conditions and market movements. Market movements are difficult to predict and are influenced by, among other things, government trade, fiscal, monetary and exchange control programs, changing supply and demand relationships; political and economic conditions and changes in interest rates. In addition, adverse global financial conditions may reduce prices and liquidity of equity, debt securities, commodities, real estate, and adversely affect their issuers.

**Liquidity in Financial Markets:** Adverse economic conditions may affect the financial markets in the United States and elsewhere and may reduce demand and liquidity in equity, credit and fixed-income, or alternative security markets. Because securities fluctuate in value based on supply and demand, this in turn could adversely affect the value of a portfolios' assets. For example, if many mutual fund investors sought to redeem their shares at the same time, mutual fund companies could be forced to sell their investments at lower prices in order to meet redemption requests.

**Investments in Equity Securities:** In general, the value of equity securities or stocks, including those in which Client accounts will be invested, is subject to market risk, including changes in economic conditions, growth rates, profits, interest rates and the market's perception of equity securities. While historically offering greater potential for long-term growth, equity securities are more volatile and more risky than some other investments.

**International Securities:** Smart's models may hold ETFs, which are purchased within the U.S., but whose underlying securities are of companies who are domiciled either in developed or emerging market countries. These investments may involve special risks due to economic, political and legal developments, including changes in currency exchange

rates; exchange control regulations; expropriation of assets or nationalization; imposition of withholding taxes on dividends or interest payments and less comprehensive accounting reporting and disclosure requirements.

**Trading:** Smart's investment models typically require more frequent trading than those of its peers. From a cost perspective, the Client doesn't see any additional cost if they are able to participate in an asset-based pricing account through their custodian. If the Client has to pay commission they may incur additional costs over and above what they would have paid had they had asset based pricing. A majority of capital gains will be from short-term gains, which is not advantageous in a non-qualified account

**ETNs:** Smart will occasionally invest in Exchange Traded Notes (ETNs). ETNs offer an alternative or solution to accessing difficult investments areas, such as India or commodities. ETNs cause counter party risk, where the ETN issuer assumes the risk that they can offset their liabilities under the ETNs by any means they choose, but insolvency by the issuer for any reason causes the ETN holders to become general creditors.

### **Item 9 – Disciplinary Information**

Like other investment advisers, Smart is required to disclose all material facts regarding any legal or disciplinary events that would materially impact a Client's evaluation of Smart or the integrity of Smart's management. No events have occurred at Smart that are applicable to this item.

### **Item 10 – Other Financial Industry Activities and Affiliations**

Smart is not actively engaged in a business other than giving investment advice. Neither Smart nor any of its management personnel is registered or has an application pending to register as a broker-dealer, futures commission merchant, commodity pool operator, commodity trading adviser or associated person of the foregoing, and Smart does not anticipate such affiliations in the future.

## **Item 11 – Code of Ethics**

Smart has adopted a Code of Ethics for all supervised persons of the firm describing its standard of business conduct, and fiduciary duty to its Clients. The Code of Ethics includes provisions relating to the confidentiality of Client information, a prohibition on insider trading, a prohibition on rumor mongering, restrictions on the acceptance of significant gifts and the reporting of certain gifts and business entertainment items, and personal securities trading procedures, among other things. All supervised persons at Smart must acknowledge the terms of the Code of Ethics annually in writing and agree to be bound by it.

Smart employees are not prohibited from investing in the ETFs, mutual funds or subaccounts that are in the predetermined universe for a particular model. Investors should note there is a possibility that employees might benefit from market activity of a Client in a security held by an employee. However, given the modest size of employee trades, if any, in relation to the size of the mutual funds and ETFs in Client portfolios, Smart believes that any employee trading would be unlikely to have any material impact on purchase or sales prices experienced by Clients.

Further, the Code of Ethics is designed to ensure that the personal securities transactions, activities and interests of the employees of Smart will not interfere with making or implementing decisions in the best interests of Clients. Employees are required to report their trading activity quarterly and their securities holdings annually. These reports are reviewed by Smart's Chief Compliance Officer.

The Code of Ethics designates certain classes of securities (including, without limitation, shares of open-end mutual funds) as exempt from reporting, based upon exemptions provided under applicable federal securities laws.

It is Smart's policy that the firm will not effect any principal transaction or cause Client accounts to enter into securities trades with each other. Principal transactions are

generally defined as transactions in which an adviser, acting as principal for its own account or the account of an affiliated broker-dealer, buys from or sells any security to any advisory client. An agency cross transaction is defined as a transaction in which a person acts as an investment adviser in relation to a transaction in which the investment adviser acts as a broker for both the advisory client and for another person on the other side of the transaction. Agency cross transactions may arise if an adviser is dually registered as a broker-dealer or has an affiliated broker-dealer. None of these circumstances applies to Smart. See Item 12 regarding brokerage practices.

Smart will provide a copy of the Firm's Code of Ethics to any Client upon request made to Bryce James at (206) 686-3636 or [info@smartportfolios.com](mailto:info@smartportfolios.com).

## **Item 12 – Brokerage Practices**

Smart does not have the authority to determine the custodian used for custody of Client securities. In order to use Smart's services Clients must have or establish an account at a custodian through which Smart can trade. However, Smart may recommend custodians based on pricing, perceived stability, security, efficiency, and the performance of trade execution and other routine services, as well as the reasonableness of fees charged. The value of special services, products and research made available to Smart will have no bearing upon recommendation of custodians.

Trades for securities held with most custodians, except a few brokerage firms, insurance companies and TIAA/CREF, are aggregated and executed through third party traders such as Knight Capital Group, Inc. Clients receive an average share price. Smart uses block trading to distribute pricing equally. For those unable to block trade a rotational trading priority is implemented to ensure that Clients are equitably treated. Third party traders are selected primarily on the basis of execution price and ability to act as agent and/or principal. In the case of Knight, Knight does not receive commissions, but rather is compensated through the arbitrage of the spread between the bid and ask. Knight's execution is evaluated on a quarterly basis. Securities held through subaccounts (at

insurance companies and in TIAA/CREF) are separately reallocated in accordance with models.

See Item 13 for a discussion of reallocation methodologies.

Smart, as a matter of policy and practice, does not have any formal or informal arrangements or commitments to utilize research, research-related products and other services obtained from broker-dealers, or third parties, on a soft dollar commission basis.

### **Item 13 – Review of Accounts**

All model positions (except collective investment trusts of insurance companies or TIAA/CREF) are reviewed internally daily. Most accounts are reallocated once per month, with certain large accounts reallocated twice per month. Bryce James, President, reviews all Dynamic Portfolio Optimization models at least weekly.

Smart will provide a written report to each Client on a quarterly basis regarding the performance and valuation of their account. In addition, Clients receive monthly or quarterly statements from their respective custodian.

### **Item 14 – Client Referrals and Other Compensation**

Smart compensates certain third party solicitors who refer Clients to Smart. The solicitor provides each prospective Client with a copy of this Brochure along with a written disclosure of the terms of the solicitation arrangement between Smart and the solicitor, including the compensation to be received by the solicitor from Smart. This fee does not increase or decrease the management fee any Client pays to Smart. Smart discloses the referral arrangement, if any, to the Client and asks the Client to acknowledge it in writing.

### **Item 15 – Custody**

Smart does not take possession of Client money or securities, although Smart often has the authority to deduct its advisory fees from Client accounts. See discussion regarding



custodians in Item 12. Clients receive monthly or quarterly statements from the custodian that holds and maintains the Client's account. Smart urges you to review those statements carefully and compare them to the performance reports we provide you. Our reports may vary from custodial statements based on accounting procedures, reporting dates, or valuation methodologies of certain securities. Clients should contact Smart immediately if any discrepancies or errors are discovered.

#### **Item 16 – Investment Discretion**

Smart receives discretionary trading authority from each Client at the outset of an advisory relationship when the Client signs a third-party authorization or grants discretionary authority in an advisory contract. Limitations on the authority are not permitted. However, when exercising discretion in a sub-advisory relationship, Smart limits use of the discretion to the models selected by the RIA for its Client. With respect to retail Clients, Smart exercises discretion in accordance with the Client's financial position, objectives and risk tolerance.

#### **Item 17 – Voting Client Securities**

With one exception, Smart does not vote proxies for securities owned by Clients. Clients will receive any proxies or other solicitations directly from their custodian. Smart is not in a position to discuss questions about a particular solicitation.

In the case of the mutual fund for which Smart acts as sub-advisor, Smart has contracted with Risk Metrics to vote those proxies in accordance with Risk Metrics' guidelines. That Client cannot direct the vote, but can obtain information from Smart about how the securities were voted.

A copy of Smart's proxy voting policy and procedures is available upon request from Smart's Chief Compliance Officer, Bryce James at (206) 686-3636 or [info@smartportfolios.com](mailto:info@smartportfolios.com).

**Item 18 – Financial Information**

Registered investment advisers are required in this Item to provide you with certain financial information or disclosures about Smart’s financial condition. Smart has no financial commitment that impairs its ability to meet contractual and fiduciary commitments to Clients, and has not been the subject of a bankruptcy proceeding.