

First Wilshire Securities Management, Inc

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This Brochure provides information about the qualifications and business practices of First Wilshire Securities Management Inc. ("FWSM", "We", "Us", or "Our"). If you have any questions about the contents of this Brochure, please contact us at 626-796-6622 or [info@firstwilshire.com](mailto:info@firstwilshire.com). 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.

We are a registered investment adviser. Registration of an Investment Adviser does not imply a certain level of skill or training. The oral and written communications of an Adviser should provide you with information to help you determine whether to hire or retain an Adviser.

Additional information about us is also available on the SEC's website at: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The SEC's web site also provides information about any persons affiliated with us who are registered, or are required to be registered, as investment adviser or representatives of FWSM.

## Item 2 – Material Changes

On September 27, 2012, First Wilshire Securities Management, Inc. re-organized by succeeding its broker-dealer business to a newly formed subsidiary, First Wilshire Securities Inc. (“FWS”) As of this date, all broker-dealer business, including legacy accounts described under the *Products No Longer Offered* section under Item 5 is conducted by FWS.

Currently, our Brochure may be requested by contacting our CCO, Matthew Dunn, at 626-796-6622 ext 119 or [mdunn@firstwilshire.com](mailto:mdunn@firstwilshire.com)

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## Item 4 – Advisory Business

First Wilshire Securities Management, Inc. ("FWSM," "We," or "Us") has been in business since 1977. We are 100% employee owned. Our Chairman, Frederick Astman, owns 60% and our CEO, Scott Hood, owns 40%.

We provide investment advisory and broker-dealer services to *clients* primarily by selecting securities to buy or sell on a discretionary basis. We also provide limited traditional brokerage services. We invest primarily using a value and contrarian investment philosophy, usually resulting in a portfolio of predominantly, though not exclusively, small and micro cap U.S. and foreign equity securities. Foreign securities may include but not be limited to ordinary shares, ADRs, ADSs, GDRs, or warrants. Securities may be traded via the New York Stock Exchange, NASDAQ, American Stock Exchange, OTCBB, Pink Sheets, and in other exchanges or venues.

This style, as described above is the primary form of investing and the only investment style we currently offer. Accounts managed by us in this style are referred to as Separately Managed Accounts ("SMA"). We do not specialize in any other strategies, styles, or securities. While we have several other strategies that are currently utilized, these accounts were accepted by exception and are not currently offered. The accounts managed by exception include Balanced and Multi-Cap investment styles.

We do not tailor our advisory services to the individual needs of *clients* who choose to open an SMA. *Clients* may not impose restrictions on investing in certain securities or types of securities that would hinder our management of the portfolio, such as limiting the percentage invested in a certain industry or requiring a minimum or maximum number of stocks.

We currently offer only fee based advisory products to new clients. (Please see Item 5 for a description of fees.) Not all programs are offered in all states, as some programs are offered through our affiliated broker-dealer, First Wilshire Securities, Inc. and others are offered through FWSM, a Registered Investment Advisor. These programs are further described under Item 5. All SMAs are managed in the same fashion, regardless of whether they are charged a commission or a flat fee or whether they are considered an advisory account or brokerage account.

We also manage accounts for two limited partnerships. (See section 6 for further description) These accounts are managed differently than the SMAs.

We had approximately \$593,000,000 of *client* assets under discretionary management as of September 30, 2012.

## Item 5 – Fees and Compensation

Although not anticipated, management fees charged by us may be negotiable.

The specific manner in which fees are charged by us is established in a *client's* written agreement with us. Fees are billed quarterly, in advance.

### **Products currently offered**

Under our fee schedule, new *clients* may choose to participate in one of the two following products using the strategy described in Item 4.

#### **1. FWSM Managed Account with Schwab or Wedbush as Broker Dealer and Custodian**

*Clients* may choose to establish brokerage accounts to maintain custody of *clients'* assets and to effect trades for their accounts with one of the following broker / custodians:

- A. Schwab Institutional division of Charles Schwab & Co., Inc. (Schwab), a registered broker-dealer, member SIPC; or,
- B. Wedbush Securities, Inc. ("Wedbush") a registered broker-dealer, member SIPC

Under this arrangement the *client* will enter into an investment advisory agreement with us whereby the *client* pays a commission and any other fees relating to the execution of transactions for the account by Schwab or Wedbush. We provide ongoing management of the *client's* account starting at a 1.8% annualized fee. *Clients* may also be eligible for breakpoints based on several factors, including amount of assets at account opening, investment climate, and other account specific circumstances. Under this arrangement *clients* may pay more or less to us than if they were to pay a combined fee, or ("wrap fee") for management and execution of transactions. (See Item 12 for a further description of accounts custodied at Schwab)

#### **2. FWSM Managed Account with Other Selected Firms as Broker Dealer and Custodian**

We also have arrangements to manage accounts with other non-affiliated broker dealers who also act as custodian for *client* accounts. We currently have such arrangements with Charles Schwab & Co., Inc., Morgan Keegan & Co., Inc., RBC Dain Rauscher, Morgan Stanley, Smith Barney, LLC, and UBS Financial Services, Inc. Under these arrangements, these firms' representatives may refer *clients* to us for investment management services or *clients* may select us as the investment manager. We charge *clients* with accounts at these firms an annual management fee of 1.5% and the *client* pays a commission or fee to the selected broker-dealer for execution and custodial services. We do not negotiate the amount of the fee or commission with these brokerage firms. *Clients* of non-affiliated broker dealers may negotiate other arrangements directly with the broker dealer. Such arrangements may result in higher or lower costs versus other investment products.

### **Products no longer offered**

The following products are not currently available for new clients:

1. FWSM Managed Account with FWS as Broker Dealer

Accounts managed under this structure pay a 1% annual management fee and separately, all transaction costs. These accounts are brokerage accounts and transactions are executed by First Wilshire's affiliated broker-dealer, First Wilshire Securities, Inc. ("FWS") and clear through its clearing broker, Wedbush Securities, Inc. ("Wedbush") (Please see Item 12 for additional information about our brokerage practices.)

These *client* accounts receive a 40 percent discount from the standard Wedbush commission schedule. Wedbush serves as our clearing broker and is not a discount broker. FWSs' commission rates are substantially higher than rates offered by discount brokers and may be substantially higher than rates available at other brokerage firms. Brokerage commission rates are not set by regulation or statute and we do not negotiate special rates for *client* accounts with FWS. For example, with the 40% discount, our brokerage division typically may charge \$.17-\$.21 per share for a 1,000 share transaction of a stock selling at \$10 -\$15 per share. Rates of other brokers for the same type of transaction vary depending on the firm and may range from \$.02-\$.06 per share to above \$.30 per share. Commissions charged by FWS for orders under 1,000 shares (100-500 share orders generally involving shares selling for \$20 or more) range from \$ 0.35 to \$ 0.60 per share; these rates include the 40% discount. Other brokerage firms may have more favorable rates for larger orders depending on the size of the order. We have a conflict of interest in determining how often securities will be purchased or sold for *clients'* accounts when *clients* pay FWS a commission on each transaction. In this circumstance, we have an economic incentive to engage in more security transactions for these *client* accounts than we would otherwise have based on the compensation FWS receives in the form of commissions on each transaction rather than on a *client's* needs. FWS does not reduce our advisory fees by the amount of brokerage commissions it receives. If *clients* select FWS as the brokerage firm and agrees to pay commissions to FWS, these conflicts are disclosed in the investment advisory agreement.

2. FWSM Wrap Fee Account with Schwab or Wedbush as Broker Dealer and Custodian

These accounts are established as brokerage accounts with Schwab or Wedbush to maintain custody of *clients'* assets and to effect trades for their accounts.

Under this arrangement the *client* will have entered into an investment advisory agreement with us whereby we pay all commissions and any other fees relating to the

execution of transactions for the account by Schwab or an affiliate or by the executing broker. We provide this service to the *client* for a 2% annualized fee. Under this arrangement *clients* may pay more or less to us than if they were to pay separately for management fees to us and execution of transactions under Schwab's or Wedbush's regular commission schedule. (See Item 12 for a further description of accounts custodied at Schwab)

*Clients* may be able to obtain the same services as we provide from other investment advisers for a lower fee.

The types of accounts listed above reflect the SMAs we have recently offered. We have in the past and by exception offered different arrangements using the same style described in Item 4. We currently manage many of these different accounts.

Clients who want to terminate their accounts with us must send us a written notice of termination. We will continue to collect a fee for 30 calendar days after receipt of the termination notice. We will refund any prepaid fees we have collected for the period 30 calendar days after we have received the termination notification with the following exception. If a client terminates us during the first quarter of management, we will keep the prepaid fees to cover account set-up costs.

As noted above, clients will incur brokerage (except the wrap fee accounts described above) and other transaction costs (please item 12 for additional information) including any charges imposed by custodians, brokers, third party investment advisors and other third parties such as transfer taxes, wire transfer and electronic fund fees, and other fees and taxes on brokerage accounts and securities transactions. In addition, clients whose uninvested assets are swept into money market mutual funds for short-term cash management purposes by the client's selected brokerage firm or custodian will also incur the additional fees and expenses assessed by such funds to the extent of their investment in the funds. *Clients* should carefully read the agreements they sign with an advisory and/or brokerage firm other than us to understand all the fees to which they may be subject. Such charges, fees and commissions (when the account is not a FWSM wrap fee account described above) are exclusive of and in addition to our fee, and we do not receive any portion of these commissions, fees, and / or costs.

Item 12 further describes the factors that we consider in selecting or recommending broker-dealers for client transactions and determining the reasonableness of their compensation (e.g., commissions).

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

We have entered into performance fee arrangements with qualified, accredited investors in our affiliated private funds described below.

We have been retained by Lake Street Management, LLC, ("Lake Street Management") the General Partner of The Lake Street Fund, LP and Mount Wilson Management, LLC, ("Mt. Wilson Management"), the General Partner of The Mt. Wilson Global Fund, LP to manage on a discretionary basis, investment portfolios of the Lake Street Fund and Mt. Wilson Global Fund.

There is and will be significant overlap in the securities held by the funds and the SMAs. The Funds are however, managed differently, and may purchase different types of securities, such as options and Private Placements that are not available for purchase for the SMAs.

Fredrick Astman and Scott Hood are executive officers and owners of Lake Street Management and Mt. Wilson Management, and are investors in Lake Street Fund and Mt. Wilson Global Fund and the owners of FWSM.

We or our affiliates receive compensation for the management of the Lake Street Fund and Mt. Wilson Global Fund (collectively "Funds") as follows:

- We receive from the Lake Street Fund a quarterly management fee of 0.375% of the Lake Street Fund's assets. Lake Street Management may receive an annual incentive fee of 20% above a 5% "hurdle" of each limited partner's share of any net profits if certain conditions are met.
- We receive from the Mt. Wilson Fund a monthly management fee of 0.125% of the Mt. Wilson Fund's assets. Mt. Wilson Management may receive an annual incentive fee of 20% above a 5% "hurdle" of each limited partner's share of any net profits if certain conditions are met.

Employee investors and one former employee investor do not pay a performance fee, or pay a reduced performance fee.

We have a conflict of interest in managing our SMA *clients* and the Funds because employees and principals are investors in the Funds and because we receive incentive payments.. We have an incentive to favor the Funds by allocating more profitable trading opportunities to the Funds; using the best trade ideas to trade their portfolios first; or potentially taking short positions in securities held in large amounts by the other funds or SMAs. However, we have established and implemented procedures designed to prevent any pricing or allocation preference to be given to the Funds and we prohibit the Funds from taking short positions in securities held by SMAs. The CCO, or designee reviews all trade allocations and prices to verify that allocations and prices are fair and equitable. See Item 12 for further description of allocation and pricing procedures.

## **Item 7 – Types of *Clients***



We provide portfolio management services to individuals, high net worth individuals, corporate pension and profit-sharing plans, charitable institutions, foundations, endowments, private investment funds, trusts and other U.S. and international businesses. Our current minimum new account investment is \$500,000.

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

### **Methods of Analysis**

We use primarily fundamental analysis to determine which companies to purchase and sell. We also utilize a variety of informational sources and strategies to make investment decisions. We may use any or all of the following:

- direct contact with company representatives;
- conference calls;
- quote and news service providers;
- various on-line informational websites;
- financial audits,\* and,
- regulatory filings.\*

\*We rely on the accuracy of information provided in a company's financial audits and regulatory filings.

We may increase or decrease cash positions and /or purchase or sell securities when conditions warrant as part of our overall investment strategy.

All investment advisory account decisions for SMAs and the Funds are made by our investment committee. Our CEO and President, Scott Hood, is the head of our investment committee. Our Chief Operating Officer, (“COO”) Thomas Hanson, also manages a small number of accounts in an investment style that we do not offer.

### **Risk of Loss**

*Investing in securities involves risk of loss that clients should be prepared to bear.*

- *Market Risk*— The market values of securities held in a *client's* account may decline, at times sharply and unpredictably.
- *Common Stock Risk*—Stocks may decline significantly in price over short or extended periods of time, particularly when overall economic activity decreases. Price changes may occur in the market as a whole, or they may occur in only a particular country, company, industry, or sector of the market.
- *Small and Microcap Company Risk*--Investment in small cap and microcap equity securities involves greater issuer risk than larger capitalization securities. The

markets for such securities may be more volatile and much less liquid. The securities of such companies may be subject to more volatile market movements than securities of larger more established companies. The equity securities of small cap and microcap companies typically are traded in lower volume and are typically more subject to changes in earnings and prospects. In addition, these companies typically have more limited product lines, markets, and financial resources and may be dependent on a smaller management group.

- *Foreign Investment Risk*-- Non-U.S. companies or U.S. companies with significant non-U.S. operations may be subject to risks in addition to those of companies that principally operate in the United States. These risks include adverse political, currency, economic, social or regulatory developments in a country including excessive taxation, lack of liquidity, and differing legal or accounting standards. Changes in currency exchange rates may affect the value of an equity security and the gains and losses realized on the sale of equity securities.
- *Emerging Markets Risk*—Investments in companies located in, or with significant operations in, emerging market countries are subject to special political, economic, and market risks that can make emerging market investments more volatile and less liquid than investments in developed markets. The markets of emerging markets countries generally do not have the level of market efficiency and strict standards in accounting and securities regulation to be on par with advanced economies, but emerging markets will typically have a physical financial infrastructure, including banks, a stock exchange and a unified currency. Emerging markets often experience faster economic growth as measured by GDP. All of the risks of investing in non-U.S. securities described above are heightened by investing in emerging markets countries.
- *Lack of 24-Hour Trading Desk*—Although we purchase foreign securities mainly in the form of ADRs and ADSs that are listed on a US exchange and trade during US trading hours, we may also purchase or sell foreign listed securities. We do not maintain a 24-hour trading operation so it is possible we will miss opportunities to purchase and / or sell foreign securities for *clients'* accounts. However, we typically do not engage in high frequency trading in *client* accounts.
- *Currency Risk*--Although all managed accounts will be denominated in US currency, the value of foreign securities may vary depending upon the value of the US dollar in relation to the currency of the company in which the managed account is invested. The exchange rates between the U.S. dollar and non-U.S. currencies depend upon such factors as supply and demand in the currency exchange markets, international balance of payments, governmental intervention, speculation and other economic and political conditions.

## Item 9 – Disciplinary Information

Registered investment advisers are required to disclose all material facts regarding any legal or disciplinary events that would be material to your evaluation of us or the integrity of our management.

We were fined \$10,000 by the state of New Hampshire in 2002. The fine was for conducting business as an investment advisor and broker-dealer without filing notice or registering in the state of New Hampshire. We also had to pay back registration fees of \$1,450, and remain withdrawn from the state for three years from May 29, 2001. See Part 1 of Form ADV for further information. We filed notice in the state of New Hampshire on July 27, 2001, and have since managed accounts domiciled in New Hampshire.

## Item 10 – Other Financial Industry Activities and Affiliations

### 1. Broker-Dealer.

FWSM's subsidiary, FWS, is a Financial Industry Regulatory Authority ("FINRA") registered broker dealer, CRD No. 6609. FWS has an introducing broker relationship with Wedbush. All brokerage transactions executed through Wedbush are on a fully disclosed basis, meaning that each account is set up individually with Wedbush. Please see Items 5 and 12 for additional information about the conflicts of interest when we act as a broker for *client* accounts. Please note that as of March 31, 2012, we no longer offer brokerage products to new clients.

Through Wedbush, FWS maintains traditional, transaction based, non-managed, brokerage accounts. Some of these accounts are held by our employees. These brokerage accounts may have different portfolio attributes than accounts managed by us. Therefore, the underlying portfolios in these accounts may hold different securities than the portfolios managed by us. Performance in these brokerage accounts may be better or worse than accounts managed by us.

We maintain our own proprietary investment account(s). During the normal course of business, we may purchase and sell the same securities for our account as we do for our *clients*. Our purchases are made for investment purposes only and never at prices more favorable than prices received by *clients* for trades occurring during the same day. Any such purchases are on a very limited basis. However, we may purchase or sell securities for our proprietary account one or more days in advance of *clients* and receive more favorable prices than *clients*.

### 2. General Partner and Sponsor of Private Funds that invest in securities.

See Item 6 for a description of our affiliated limited partnership offerings, including the conflicts of interest and potential conflicts of interest associated with them.

### **3. Other business activities of FWSM Employees.**

Several of our representatives engage in other business activities that do not fall under our supervision. For example, some of these business activities currently include tax preparation, insurance sales, or other services. Any income from these non-FWSM related activities is solely received by the representative and does not benefit us. These activities are known in the investment community as “outside business activities,” meaning they are business activities that are conducted outside our scope and management.

In addition, we have several employees with industry related outside business activities. While we do not supervise these activities, we review these activities to ensure that they are not subject to review under regulatory requirements. The firm’s president acts as a non-executive, non-operating director for an unaffiliated investment fund, and another employee maintains an outside registered investment advisory firm that receives a referral fee for accounts referred to us.

We also permit our employees and officers to engage in securities transactions executed away from us. We approve these transactions in advance, and supervise them as if they were transactions executed through us. See Item 11 for a description of our Code of Ethics that applies to investing by our employees and officers.

### **4. Employees who hold the CFA designation**

Several members of our research and investment committee hold the CFA designation. Below is a brief description of the designation.

The Chartered Financial Analyst (CFA) charter is a graduate-level investment credential established in 1962 and awarded by the CFA Institute — the largest global association of investment professionals.

To earn the CFA charter, candidates must: 1) pass three sequential, six-hour examinations; 2) have at least four years of qualified professional investment experience; 3) join CFA Institute as members; and 4) commit to abide by, and annually reaffirm, their adherence to the CFA Institute Code of Ethics and Standards of Professional Conduct.

## **Item 11 – Code of Ethics**

We have established and adopted the following Code of Ethics which set forth standards of conduct expected of personnel employed by the firm.

## **Investment Advisor Code of Ethics**

Rule 204A-1 under the Investment Advisers Act of 1940 ("Advisers Act") requires all investment advisors registered with the Securities and Exchange Commission ("SEC") to adopt codes of ethics that set forth standards of conduct and require compliance with federal securities laws. Our code of ethics (the "Code") is intended to reflect fiduciary principles that govern our conduct and our supervised persons in situations where we act as an investment advisor in providing investment advice to its *clients*. The Code contains policies regarding standards of conduct and compliance with laws, rules and regulation, protection of material non-public information and personal securities trading.

This Code applies to all our employees. All employees are required to read, be familiar with, and comply with the provisions of the Code.

## **Standard of Conduct and Compliance with Laws, Rules and Regulations**

The Code requires employees to comply with laws and regulations applicable to our business.

## **Protection of Material Non Public Information**

Our employees are prohibited from using nonpublic material information regardless of the source, including information regarding portfolio holdings or *client* transactions for their personal benefit. Specifically, employees are prohibited from using advance knowledge of non-public material information to trade ahead of or otherwise benefit from such knowledge.

## **Personal Securities Trading**

Employees are required to obtain prior approval from the CCO or his designee, prior to the purchase or sale of any securities. The approval is good for 3 business days and if the employee does not complete the pre-approved transaction within the 3-day period, the employee must request a new approval of the transaction. The Code requires all of our employees to report their securities transactions to the CCO.

Our surveillance program monitors employee securities accounts, personal securities holdings and trading. We require employees to submit duplicate account statements and trade confirms of all outside brokerage accounts to the CCO. Employees are not required to request duplicate confirms or statements for personal accounts traded through us, as we already have access to these records. Our surveillance program monitors holdings and trades to ensure compliance with the Code, our Written Supervisory Procedures, and other applicable firm policies. Additionally, our employees must disclose all securities accounts they own or control after their hire date and review and confirm the accuracy of those accounts on an annual basis during their employment.

## **Initial Public Offerings and Private Placements**

Our employees are prohibited from purchasing securities in an initial public offering. However, subject to the preclearance requirement described above, our employees may purchase securities in the after market. Our employees must receive written permission from the CCO to purchase any private placement. We grant permission when we believe the investment would not be suitable for our clients or if there are sufficient securities for both our clients and our employees to purchase the private placement.

### **Gifts and Entertainment**

No employee may receive any gift, service, or anything else of more than \$100 value from any person or entity that does business with or on behalf of the Firm. No employee may give or offer any gift of more than \$100 value to existing *clients*, prospective *clients*, or any entity that does business with or on our behalf without pre-approval by the CCO.

No employee may provide to or accept extravagant or excessive entertainment from a *client*, prospective *client*, or any person or entity that does or seeks to do business with or on behalf of the Firm. Our employees may provide or accept a business entertainment event, such as dinner or a sporting event, of reasonable value, if the person or entity providing the entertainment is present.

### **Consequences for Failure to Comply and Reporting Certain Conduct**

We may discipline our employees for violation of the Code or other applicable Firm policies. Sanctions include, among other things, suspension or termination of employment. Employees are required to report violations of the Code to the CCO. Our employees who in good faith raise an issue regarding a possible violation of law, regulation, the Code or other Firm policy or any suspected illegal or unethical behavior will be protected from retaliation.

We will provide a copy of our Code of Ethics to any client or prospective client upon request.

### **Employee and *Client* Transactions in the Same Securities**

As noted above in item #10, we may purchase or sell the same securities for our own proprietary accounts at the same time as we purchase or sell these securities for *clients*, but *clients* will receive the same or more favorable price than we receive on the same day at the same custodian. Similarly, our employees may purchase or sell the same securities at the same time as we purchase or sell for *client* accounts, but *clients* will receive the same or more favorable prices. If there are insufficient securities to fill orders for both *client* accounts and our employees, orders for *client* accounts will be filled first.

## **Item 12 – Brokerage Practices**

### **Directed Brokerage**

We do not maintain custody of your assets, although we may be deemed to have custody of your assets if you give us authority to withdraw management fees from your account (see Item 15 – Custody, below). Your assets must be maintained in an account at a “qualified custodian,” generally a broker-dealer or bank. We require clients to direct brokerage for their accounts to their chosen custodian. A list of the custodians with whom we have a relationship with is detailed under Item #5. Not all advisers require their clients to direct brokerage to a specific brokerage firm. As a result of this requirement, we cannot aggregate the transactions for all clients’ accounts to obtain large volume discounts. We can only aggregate the transactions for those accounts directed to the same brokerage firm. Further, orders for portfolio transactions are placed separately at each brokerage firm where client accounts are directed using a rotation system with the result that some clients’ orders will go ahead of other clients’ orders. Consequently, the price a client’s account receives for a security may be higher or lower than the price paid or received by our other clients who have directed brokerage to different brokers. Thus, by directing brokerage, we may not be able to achieve the most favorable execution of client transactions and this practice may cost clients money. Moreover, such direction prevents us from effectively negotiating brokerage commissions on a client’s behalf.

Depending on where clients decide to custody their accounts, we may be unable to participate in certain transactions for their account. For example, if we are able to obtain a block of securities from a dark pool, then we can only distribute those securities to accounts held at custodians who permit “trade aways.” Also, some brokers may participate in public offerings while others do not. We can only allocate these transactions to accounts held at custodians that participate in the offering.

### **Products and Services Available to Us from Schwab**

The following section applies to clients who choose to use Charles Schwab as their custodian and broker-dealer.

Schwab Advisor Services™ (formerly called Schwab Institutional®) is Schwab’s business serving independent investment advisory firms like us. They provide us and our clients with access to its institutional brokerage—trading, custody, reporting, and related services—many of which are not typically available to Schwab retail customers. Schwab also makes available various support services. Some of those services help us manage or administer our clients’ accounts; while others help us manage and grow our business. Schwab’s support services generally are available on an unsolicited basis (we don’t have to request them) and at no charge to us as long as our clients collectively maintain a total of at least \$10 million of their assets in accounts at Schwab. If our clients collectively have less than \$10 million in assets at Schwab, Schwab may charge us quarterly service fees of \$1,200. Following is a more detailed description of Schwab’s support services:

### **Services**

Schwab's institutional brokerage services include access to a broad range of investment products, execution of securities transactions, and custody of client assets. The investment products available through Schwab include some to which we might not otherwise have access or that would require a significantly higher minimum initial investment by our clients. Schwab's services described in this paragraph generally benefit you and your account.

### **Services That May Not Directly Benefit You**

Schwab also makes available to us other products and services that benefit us but may not directly benefit you or your account. These products and services assist us in managing and administering our clients' accounts. They include investment research, both Schwab's own and that of third parties. We may use this research to service all or a substantial number of our clients' accounts, including accounts not maintained at Schwab. In addition to investment research, Schwab also makes available software and other technology that:

- Provide access to client account data (such as duplicate trade confirmations and account statements)
- Facilitate trade execution and allocate aggregated trade orders for multiple client accounts
- Provide pricing and other market data
- Facilitate payment of our fees from our clients' accounts
- Assist with back-office functions, recordkeeping, and client reporting

### **Services That Generally Benefit Only Us**

Schwab also offers other services intended to help us manage and further develop our business enterprise. These services include:

- Educational conferences and events
- Consulting on technology, compliance, legal, and business needs
- Publications and conferences on practice management and business succession
- Access to employee benefits providers, human capital consultants, and insurance providers

Schwab may provide some of these services itself. In other cases, it will arrange for third-party vendors to provide the services to us. Schwab may also discount or waive its



fees for some of these services or pay all or a part of a third party's fees. Schwab may also provide us with other benefits, such as occasional business entertainment of our personnel. While we generally do not use any of the services described above, they are or may be made available to us.

### **Brokerage Commissions**

When a client selects FWS as the broker-dealer, the client's account is custodied at Wedbush and FWS sends the orders to Wedbush for execution. Wedbush is the clearing broker-dealer for FWS. Commission rates on these transactions typically are 40% off of Wedbush's standard commission schedule. (See Item #5 above for additional information.)

When a client directs brokerage to a firm other than Wedbush or Schwab, it is up to the client to negotiate the flat fee or commission rates for all transactions. Typically, the brokerage commission rate or flat fee for brokerage services is set by the directed brokerage firm and may be higher or lower than that which could be obtained from another brokerage firm and may be higher or lower than what our other clients pay.

We do not utilize client commissions to pay for third-party research, research products or research related services. We also do not accept payment for order flow.

### **Trade Aggregation, Trade Sequence and Allocation of Partially Filled Orders**

As noted above, we frequently purchase and sell the same securities on the same day for some or all of our managed accounts. In order to obtain a better execution of orders for client accounts, when feasible, we may combine orders of client accounts that are custodied at the same brokerage firm. However, often we are unable to purchase or sell a sufficient quantity of stock at a price that we want to pay or receive to fill all combined orders. When a partially filled, combined order is large enough to effectively allocate across multiple accounts, we will allocate the partially filled order pro rata to accounts participating in the order.

We use a proprietary computerized system to assist with the task of determining the sequence of placing orders with brokerage firms and allocating partially filled orders to client accounts when a pro rata allocation is not feasible. When adding to a position already held in client accounts, the program is designed to sort accounts first according to the percentage of the stock being purchased in the account and second according to the percentage of cash in the account. The accounts that have the lowest percentage of stock being purchased, and then the highest percentage of cash, will be at the beginning of the sorted list. Typically, we will place orders first with brokerage firms that hold accounts at the beginning of the list and next with brokerage firms that follow on the list and so on until all orders have been placed. Partially filled orders for purchases at each brokerage firm will typically be allocated in the same manner, that is, we will allocate the partially filled order to accounts according to the list so that the accounts with the lowest percentage of the stock being purchased and then the highest percentage of cash will be allocated first.

When purchasing a stock that is not held in client accounts, the program sorts accounts by the percentage of cash in descending order so that accounts with the highest percentage of cash will be at the beginning of the list.

When selling a stock, the program is designed to sort accounts according to the percentage of the stock held in client accounts in descending order so that orders for accounts that have the largest percentage of the stock will be at the beginning of the list. We will allocate the partially filled order to accounts according to the list so that the accounts with the highest percentage of the stock being sold will be filled first. Because transactions are executed at different brokerage firms, the prices client accounts receive will typically vary from firm to firm. However, *client* accounts that use the same brokerage firm will receive the same price on the same day for the same transaction. As a result, certain accounts, including those of the Funds in which our officers and employees have invested, may receive more favorable prices for the same security than other client accounts held at other custodians on the same day.

Although the above described method is designed to provide a basis for fair and consistent allocations, there are several additional factors that the portfolio manager considers during the process. Other considerations often dictate buys and sells that are not consistent with the selection by our proprietary program. Other factors include suitability of a transaction for an account, sector weight, tax consequences, portfolio restrictions, known future cash requirements, client directive, and age of the account. Accounts opened after initial purchase may purchase stock after orders for existing accounts have been filled and as a result, may receive different prices. Additional factors may be considered on a case by case basis.

## **Item 13 – Review of Accounts**

### **Portfolio Manager Review**

Typically, each day, the Portfolio Manager or his designee will review each managed account for account performance, sector weight, geographic exposure, holdings percentages, and recent transactions. In addition, the Portfolio Manager typically compares each account to the composite holdings of all managed accounts and reviews any outliers and / or exceptions.

### **Compliance Review**

The CCO, or designee reviews *client* accounts on a periodic basis. The review is typically based on account activity and / or value of assets held in the account, but may be based on other factors. Review frequency is based on activity in the account and any other information concerning the account that may suggest a review is necessary. Account review may be conducted on a daily, monthly, or quarterly schedule. Documents subject to review include account statements, confirmations, trade allocation spreadsheets, transaction memorabilia and electronic in-house systems, clearing firm systems, or other databases.

The custodian will provide trade confirmations to *clients* as trades occur. *Clients'* custodians will also send monthly and/or quarterly account statements after each period end. We do not send any periodic account-related reports to *clients*.

See Item 15 for further information about custody of *client* assets.

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

We currently have several arrangements with various third parties who are paid a referral fee for introducing *clients* to us. The referral fee is based on a percentage of assets of *client* accounts that are referred to us and the percentage is disclosed to *clients* at the time a third party makes a referral. *Clients* must also consent to such arrangements prior to, or at the time, we accept a referred *client's* account.

## **Item 15 – Custody**

We do not act as custodian of *clients'* accounts. *Clients* select the custodian which is also the brokerage firm selected by the *client* or the brokerage firm's clearing firm. (*Clients* participating in our wrap fee programs will have their accounts custodied at either Wedbush or Schwab) *Clients* should receive at least quarterly account statements from the broker dealer or other qualified custodian that holds and maintains the assets in a *client's* account we manage. We urge you to carefully review confirms, account statements, and any other documentation sent to you by your selected custodian or brokerage firm. Under government regulations, we are deemed to have custody of your assets if, for example, you authorize us to instruct your custodian to deduct our advisory fees directly from your account

## **Item 16 – Investment Discretion**

In the written investment advisory agreement we enter into with a new *client*, we receive discretionary authority from the *client* to select the identity and amount of securities to be bought or sold without a *client's* prior consent. When selecting securities and determining quantities to be transacted, we seek to comply with the *client's* investment policies as outlined in each *client's* investment management agreement. As noted above, *clients* may impose restrictions on our investment authority only to the extent that such restrictions would not hinder our management of the portfolio. (Please see item #4 above for additional information.) In addition, various securities and/or tax laws as well as our internal policies may impose additional restrictions on the investments that may be made for your account.

## Item 17 – Voting Client Securities

We will vote proxies only for the accounts held by the Funds. For all other *clients*, we will confine our activities on behalf of *clients* to the purchase and sale of securities. Upon request, we may provide information to the *client* designed to assist the *client* in making his/her voting choice. *Clients* will receive proxy solicitations from their custodian.

Specifically, we are not responsible to vote proxies for pension plans or other employee benefit plan accounts covered by ERISA. Pension plan fiduciaries / trustees expressly retain proxy voting authority over their pension plan or employee benefit plan accounts and agree to do so by and when opening an account with us.

We will maintain the following records relating to proxy voting of securities held by the Funds.

- Proxy voting policies and procedures;
- Proxy statements received for Fund securities, or we may rely on proxy statements which have been filed instead of maintaining hardcopies.
- Records of votes cast on behalf of the Funds; and,
- Any documents prepared by us that were material to making a proxy voting decision or that memorialized the basis for the decision.

Proxies for the Funds are to be voted in the best economic interest of the Funds' investors; Fund investors may request information related to any voting decision by contacting us. The portfolio manager and / or analysts employed by us may assist in determining how to vote when necessary.

Should any material conflicts of interest arise, we will "mirror vote" for the Funds, meaning we will vote in line with the majority of other shareholders.

*Clients* may obtain a copy of our proxy voting policy by contacting us at (626) 796-6622.

## Item 18 – Financial Information

Registered investment advisers are required in this Item to provide you with certain financial information or disclosures about our financial condition. We have no financial commitment that may impair our ability to meet contractual and fiduciary commitments to *clients*, and have not been the subject of a bankruptcy proceeding.