

# Cornerstone Capital Management LLC

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**This Brochure provides information about the qualifications and business practices of Cornerstone Capital Management LLC (“Cornerstone”). If you have any questions about the contents of this Brochure, please contact Loren Kix, Senior Vice President, Director of Finance & Operations and Chief Compliance Officer at 952-229-8120 or [lrk@cornerstonecapital.com](mailto:lrk@cornerstonecapital.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.**

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

## Item 2 – Material Changes

The following is a summary of material changes made to our brochure since the last annual update dated March 21, 2012.

### Item 4- Advisory Business

In November 2012, Cornerstone Capital Management LLC succeeded to the business of Cornerstone Capital Management, Inc. The information set forth herein relates to the investment advisory business formerly operated by Cornerstone Capital Management, Inc. and currently operated by Cornerstone Capital Management LLC. As a practical matter, Cornerstone's management team and its process to invest client assets are essentially the same as Cornerstone Capital Management, Inc.'s management team and process.

To request a copy of our Brochure, please contact Emily A. Einwalter, Director of Business Operations at [EAE@cornerstonecapital.com](mailto:EAE@cornerstonecapital.com) or 952-229-8121.

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## Item 4 – Advisory Business

### Who We Are

In November 2012, Cornerstone Capital Management LLC (“Cornerstone”) succeeded to the business of Cornerstone Capital Management, Inc. (“Cornerstone Inc.”), which was founded in 1993 in Minneapolis, Minnesota by Mr. Andrew S. Wyatt. In 2006, Mr. Wyatt as Chief Executive Officer, was joined by Mr. Thomas G. Kamp who became the firm’s Chief Investment Officer and President. The Keystone Mutual Funds were launched the same year, advised by Cornerstone Inc. Mr. Wyatt, Mr. Kamp and Cornerstone Inc. own Cornerstone. Cornerstone Inc. is owned by two trusts associated with Mr. David R. Frauenshuh.

### Cornerstone’s Advisory Services

#### ***Institutional Investment Management***

Cornerstone provides investment management services to pension and profit sharing plans, trusts, estates and charitable organizations including foundations and non-profits, corporations and other business and government entities. Cornerstone also provides sub-advisory services to both open and closed end mutual funds and trust companies. Cornerstone will accept separate account mandates for U.S. Large Cap Growth Equities (both traditional and focused) and U.S. Long Short Equities. Cornerstone tailors its advice within the strategies mentioned above to the extent it agrees to investment restrictions set forth in a client’s investment guidelines or policies.

#### ***Private Client Group***

Cornerstone seeks to provide customized investment management solutions through diversified equity, balanced and fixed income portfolios. Cornerstone provides frequent direct access to the principals and investment decision makers in the firm and personalizes its contact and communications to the particular needs and demands of each client.

#### ***Investment Company***

Cornerstone also serves as sponsor of and investment adviser to the Keystone Mutual Funds, currently offering its shares in one series, the Keystone Large Cap Growth Fund. More information concerning the fund, including advisory fees and investment minimums, is available in the fund’s prospectus.

#### ***Private Investment Fund***

Cornerstone also serves as managing member of and investment adviser to the Cornerstone Long Short Fund, LLC. More information concerning this fund is available in the fund’s confidential offering memorandum.

### ***Wrap Programs/Model Portfolio***

Cornerstone provides advisory services using the Large Cap Growth Equities strategy through programs ("programs") sponsored by broker-dealers or other financial intermediaries ("sponsors"). Many programs offer comprehensive brokerage, custody, consulting and investment advisory services or some combination thereof for a fully bundled fee ("wrap fee programs" or "wrap"). In certain programs, Cornerstone's services are provided on a non-discretionary basis by providing a model to a program sponsor or overlay manager. In all such programs, clients typically pay the program sponsor a program fee and the program sponsor in turn pays Cornerstone a portion of the program fee as its advisory fee.

For wrap and similar programs, Cornerstone is appointed to act as an investment adviser through a process administered by the program sponsor. Clients participating in a program, generally with assistance from the sponsor, may select Cornerstone to provide investment advisory services for their account (or a portion thereof) for a particular strategy. For discretionary programs, Cornerstone provides investment advisory services based upon the particularized needs of the program client as reflected in information provided to Cornerstone by the sponsor, and will generally make itself available as reasonably requested by clients and/or sponsors. For wrap and certain other programs, Cornerstone will not be able to accommodate investment restrictions that are unduly burdensome or materially incompatible with Cornerstone's investment approach. Clients are encouraged to consult their own financial advisors and legal and tax professionals on an initial and continuous basis in connection with selecting and engaging the services of an investment manager in a particular strategy and participating in a wrap or other program. In the course of providing services to program clients who have financial advisors, Cornerstone may rely on information or directions communicated by the financial advisor acting with apparent authority on behalf of its client.

Under wrap and similar programs, clients are not charged separate commissions or other transaction costs on each trade so long as the program sponsor (or its broker-dealer affiliate) executes the trade. A portion of the wrap fee generally is considered as in lieu of commissions or other transaction costs. Where permitted by program terms, Cornerstone may execute a transaction through a broker-dealer other than the program sponsor where Cornerstone believes that such trade would result in the best price and execution under the circumstances. In such cases, transaction and other fees may be included in the net price of the security. However, it is expected that in most or all situations trades will be executed with the program sponsor (or its broker-dealer affiliate) so as to avoid incurring brokerage costs or other transaction costs by using other broker-dealers, in addition to the wrap or bundled fee, or to avoid other costs associated with trading away. Trades for wrap and similar account programs generally will not be aggregated with and will be executed after trades for Cornerstone's other accounts where it has full trading discretion. Wrap and similar account programs may impose certain investment or transaction limitations or

restrictions on Cornerstone such that such accounts will be managed similarly, but not identically, to Cornerstone's non-wrap accounts.

Cornerstone also offers model-based managed account programs in which Cornerstone provides the program sponsor or its overlay manager non-discretionary investment advice through model portfolios. The model-based program sponsor or overlay manager is responsible for investment decisions and performing many other services and functions typically handled by Cornerstone in a traditional discretionary managed account program. Depending on the particular facts and circumstances, Cornerstone may or may not have an advisory relationship with model-based program clients. To the extent that this Form ADV Part 2A is delivered to program clients with whom Cornerstone has no advisory relationship or under circumstances where it is not legally required to be delivered, it is provided for informational purposes only. Furthermore, because a model-based program sponsor or overlay manager generally exercises investment discretion and, in many cases, brokerage discretion, performance and other information relating to Cornerstone's services for which it exercises investment and/or brokerage discretion is generally provided for informational purposes only and will not be representative of model-based program client results or experience.

More information concerning Cornerstone's trading practices with respect to wrap fee and model portfolio programs is contained in Item 12, Brokerage Practices.

Clients should review all materials relating to their program (including Form ADV Part 2A Appendix 1 or the applicable wrap fee program brochure, as applicable) regarding a program's terms, conditions and fees, and consider the advantages and disadvantages and overall appropriateness of the program in light of the client's particular circumstances. Depending upon the level of the wrap fee charged by a program sponsor, the amount of portfolio activity in a client's account, the value of the custodial and other services that are provided under a program arrangement and other factors, a program client should consider whether the wrap fee would exceed the aggregate cost of such services if they were to be provided separately. Similarly, a non-wrap fee program client paying separate fees should consider whether the fees charged by different parties for custody, advisory services, portfolio management services and securities execution and other services would exceed the aggregate cost of such services if they were provided in a wrap fee arrangement. Some broker-dealers serving as custodian charge fees for settling transactions executed through other broker-dealers.

### ***Services Involving Legal Proceedings***

As a general matter, Cornerstone will not monitor, advise or act for a client in legal proceedings, including, without limitation, class actions and bankruptcies, involving securities purchased or held in client accounts. Clients should instruct their custodians where to promptly forward any communications relating to legal proceedings involving such assets.

### **Reporting Assets under Management**

As of September 30, 2012, Cornerstone had the following client assets under management (rounded to nearest \$100,000):

Discretionary Assets	\$2, 702,000,000
Non-Discretionary Assets	\$ 0
Total Assets under Management	\$2, 702,000,000

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

The specific manner in which fees are charged by Cornerstone is established in a client's written agreement with Cornerstone. Clients may elect to be billed directly for fees or to authorize Cornerstone to directly debit fees from client accounts. Also, depending on the specifics of a client's investment management agreement, fees may be payable quarterly in advance (except that the first invoice on a new account may cover a partial first quarter and the entire following quarter) or quarterly in arrears. Management fees will be prorated for each capital contribution and withdrawal made during the applicable calendar quarter (with the exception of de minimis contributions and withdrawals). Investment management services may be terminated immediately upon written notice. Upon termination of Cornerstone's services, unearned fees paid in advance will be ratably refunded.

Cornerstone's fees are exclusive of brokerage commissions, transaction fees, and other related costs and expenses which shall be incurred by the client. Item 12 below discusses Cornerstone's brokerage practices. Clients may incur certain additional charges imposed by custodians, brokers, 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. To the extent client assets are invested in mutual funds and exchange traded funds, such funds charge advisory, administrative and other fees, which are disclosed in a fund's prospectus. As a result, clients will pay two levels of advisory fees with respect to such assets, one to Cornerstone and one to the fund's investment adviser. Fund charges, fees and commissions are exclusive of and in addition to Cornerstone's fee, and Cornerstone does not receive any portion of these commissions, fees, or costs.

From time to time, Cornerstone may recommend shares of the Keystone Large Cap Growth Fund or an investment in the Cornerstone Long Short Fund to clients for whom such an investment is suitable. Because the Keystone Large Cap Growth Fund pays an advisory fee to Cornerstone and the Cornerstone Long Short Fund pays fees to Cornerstone,

Cornerstone waives its separate advisory fee on those advisory client assets invested in either of these investments.

### **Portfolio Valuation**

Where we are responsible to price a client's portfolio for fee billing or investment performance calculation purposes, we generally use pricing information provided by an independent pricing service (the "Primary Pricing Source").

Based on our investment style and the types of securities in which we generally invest on behalf of our clients (see Item 8 for additional information), the Primary Pricing Source is typically able to provide pricing information for securities included within our clients' portfolios. In the event the Primary Pricing Source is unable to obtain a price, Cornerstone will determine a fair value for that security.

When determining a fair value, our objective is to identify a price we believe we could reasonably receive in a sale between market participants at the specific measurement date without forced liquidation. While, in practice, we rarely need to fair value securities, any security which is priced via fair valuation is routinely reviewed by the Investment Policy Committee.

We would encounter a clear conflict when fair valuing securities, as we have an incentive to value these securities higher in an effort to generate greater fees and higher investment returns. We have controls in place to mitigate this conflict, including: 1) responsibilities in establishing a fair valuation described above; 2) policies and procedures designed to provide reasonable assurance securities are valued properly; and 3) oversight by the Investment Policy Committee.

### **Fees for Services**

#### ***Fees for Institutional Investment Management***

Cornerstone's advisory fees for the U.S. Large Cap Growth Equities mandate (both traditional and focused strategies) are based on a percentage of assets under management in accordance with the following fee schedule:



<b>CCM Annual Fee Rate</b>	<b>Incremental Assets under Management</b>	<b>Incremental Fee</b>
0.85%	\$ 20,000,000	\$ 170,000.00
0.60%	\$ 20,000,000	\$ 120,000.00
0.45%	\$ 20,000,000	\$ 90,000.00
0.37%	\$ 40,000,000	\$ 148,000.00
0.30%	\$100,000,000	\$300,000.00
0.25%	on the balance	

Clients of Cornerstone prior to February 1, 2006 are subject to a different fee schedule than that noted above. Certain exceptions to the fee schedule may apply depending on the particular circumstances involved. Cornerstone does not have an individual account fee schedule for U.S. Long Short Equities, as its only client is the Cornerstone Long Short Fund, LLC. Fees are calculated on the market value of the managed assets, as determined by Cornerstone, and are billed quarterly in arrears. Fees for Institutional Investment Management are negotiable.

***Fees for Private Client Group Services***

Cornerstone's fees for providing Private Client Group services are based on a percentage of assets under management in accordance with the following fee schedule:

<b>Assets under Management</b>	<b>Annual Fee</b>
First \$2,500,000	1.00%
Next \$2,500,000	.75%
Next \$5,000,000	.50%

Cornerstone's annual fee for providing short term Fixed Income investment advisory services is .25% of assets under management.

The minimum fee for private client group services is \$5,000. Certain exceptions to the fee schedule may apply depending on the particular circumstances involved. Fees are calculated on the market value of the managed assets, as determined by Cornerstone and are billed quarterly in advance. All fees for Private Client Group Services are negotiable.

In rare circumstances, subject to Cornerstone's sole discretion, Cornerstone may provide investment management services on a fixed fee or hourly basis. When Cornerstone provides services on an hourly basis, the fee is \$350 per hour.

### ***Wrap Programs/Model Portfolio***

For wrap or model portfolio programs, Cornerstone's fee is determined by agreement between the sponsor and Cornerstone. Cornerstone has no set fee schedule for such programs and will negotiate them on a case-by-case basis. Program sponsors typically collect the total program fee and remit Cornerstone's fee to Cornerstone. The documents relating to each wrap or model portfolio program provide additional information regarding the timing and collection of fees, their negotiability, as well as the fees payable to Cornerstone in connection with the program.

### ***Investment Company***

Cornerstone's fee for advisory services to the Keystone Mutual Funds is available in the fund's prospectus.

### ***Private Investment Fund***

Cornerstone's fees for advisory services to the Cornerstone Long Short Fund, LLC are set forth in the fund's confidential offering memorandum.

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

The Cornerstone Long Short Fund, LLC, pays Cornerstone a performance-based fee. Performance-based fee arrangements may create an incentive for Cornerstone to recommend investments which may be riskier or more speculative than those which would be recommended under a different fee arrangement. Such fee arrangements also create an incentive to favor higher fee paying accounts over other accounts that use the same investment strategy but only a charge an asset-based fee (known as "side-by-side management"). This incentive could cause an investment adviser to allocate the "best" investment opportunities only to the higher-fee account and the better-executed trades to the higher fee account. Cornerstone has procedures addressing the allocation of investment opportunities and the execution of client trades that are designed and implemented to ensure that all clients are treated fairly and equally over time and that no client is systematically disadvantaged. Such procedures are generally described in Item 12 below. Cornerstone also reviews the investment performance of the performance-based fee account against the performance of similar accounts to identify any differences that might be caused by such favoritism.

## **Item 7 – Types of Clients**

Cornerstone provides investment management services and advice to high net worth individuals, pension and profit sharing plans, trusts, estates and charitable organizations including foundations and non-profits, corporations and other business and government entities, investment companies and a private investment fund.

Our employees may invest in Cornerstone's affiliated Keystone Funds, which could create an incentive for us to favor our mutual fund client over other clients. We also manage separate accounts for certain family members and friends. While presenting an inherent conflict, these clients receive standard reporting, are not involved in our day-to-day operations and have no knowledge of our trading or investment activities. We maintain investment, trade allocation and account valuation policies and procedures designed to address such conflicts of interest. Further, our Code of Ethics and Personal Trading Policy require employees to report investments in the mutual funds we manage.

### **Minimum Account Size**

#### ***Institutional Investment Management***

Cornerstone's investment minimum for institutional investment management services is \$25,000,000. Cornerstone reserves the right to waive this minimum at its sole discretion.

#### ***Private Client Group Services***

Cornerstone's investment minimum for private client group services is \$500,000. Cornerstone reserves the right to waive this minimum at its sole discretion.

#### ***Wrap Programs/Model Portfolio***

Please see each program sponsor's brochure for information concerning the minimum account size needed to participate in each specific program.

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

### **Institutional Investment Strategies**

Cornerstone offers institutional investment management services in the following mandates: U.S. Large Cap Growth Equities and U.S. Long Short Equities. Both services utilize a common investment philosophy and approach.

#### **Investment Philosophy and Approach**

Cornerstone understands that markets as well as investment styles are cyclical, but believes that over the long-term an investor prospers by maintaining a disciplined and focused approach.

This strategy's primary investment approach is to identify and trade on perception gaps. Perception gaps exist when the consensus expectations fail to recognize the true earnings power of a given company. These perception gaps are underappreciated opportunities. The greater the gap between the consensus expectations and the true earnings power of a given company, the greater the opportunity for profit as consensus realizes reality and the gap is closed. Furthermore, Cornerstone employs an active trading methodology which

trades around a core position as the gap widens and narrows with new information assimilated by the market.

Cornerstone gathers information data points from many sources. Such sources may include management teams, industry experts, sell side analysts, industry conferences, quantitative screens, and the macro environment (i.e. geopolitical, government policies, regulation and legislation, economic cycles, interest rates, inflation, commodities and currencies). The data points from these sources form a mosaic from which Cornerstone develops a clearer picture of reality. From that framework, Cornerstone develops recommended long and short ideas. Financial modeling by Cornerstone is often an iterative process as new information is uncovered to quantify the perception gaps.

### **U.S. Large Cap Growth Equities**

In the U.S. Large Cap Growth Equities service (a long-only service), clients may retain the firm to manage mandates in three strategies: traditional, focused, and dynamic. In all of the strategies, Cornerstone seeks long term growth of capital for its clients through the opportunistic selection of stocks expected to appreciate at a faster rate than the respective benchmark (e.g. the Russell 1000 Growth Index or Russell Dynamic Index). These stocks are evaluated based on a variety of key factors where our research identifies a “perception gap” (an underappreciated opportunity for growth in one or more of those key factors). Perception gaps cause an asymmetrical reward/risk opportunity that when applied over an entire portfolio and over a full market cycle should generate strong risk-adjusted returns.

Stock selection is further based on the fundamentals of revenue, earnings, cash flow, and management depth and credibility. Sector allocation is a by-product of individual stock selection. Stocks will generally be selected from those which are primarily traded on US exchanges or markets.

The objective of this service is to outperform the benchmark over the long term by purchasing high growth companies where our research has identified one or more perception gaps.

Cornerstone manages this strategy by investing predominantly in the equity securities of a limited number of large, carefully selected U.S. companies where Cornerstone believes it has identified one or more perception gaps. For these purposes, “large capitalization growth equities” are those stocks that, at the time of investment, have market capitalizations within the range of market capitalizations of companies appearing in the Russell 1000 Growth Index.

The traditional form of the strategy will normally invest in 35-55 companies, with the 25 most highly regarded of these companies usually constituting approximately 70% or more

of the net assets. The focused form of the strategy will normally invest in 15-20 companies. Holdings in the focused strategy will tend to be somewhat more evenly weighted across the portfolio. Cornerstone's investment strategy emphasizes stock selection and investment in the securities of a limited number of issuers. An emphasis is placed on identifying companies whose prospective earnings growth appears to not be fully appreciated by the market or reflected in current market valuations. In addition, Cornerstone seeks companies that have strong management, superior industry positions, excellent balance sheets and superior earnings growth prospects.

Cornerstone seeks to utilize market volatility judiciously (assuming no change in company fundamentals), striving to capitalize on apparently unwarranted price fluctuations, both to purchase or increase positions on weakness and to sell or reduce overpriced holdings. The strategy normally remains nearly fully invested and normally does not take significant cash positions for market timing purposes. During market declines, while adding to positions in favored stocks, Cornerstone may become somewhat more aggressive, gradually reducing the number of companies represented in its portfolio. Conversely, in rising markets, while reducing or eliminating fully valued positions, investing becomes somewhat more conservative, gradually increasing the number of companies represented in the portfolio. Through this process, Cornerstone tends to add to positions on price weakness and sell into price strength, all else being equal and assuming the price movement is greater than the change in the long-term company fundamentals. Cornerstone uses this active management and trading strategy to attempt to add incremental performance while seeking to mitigate risk by utilizing a buy low, sell high discipline. This active trading can affect investment performance by increasing brokerage and other transaction expenses for investors. Active trading also may result in the realization of substantial net short-term capital gains, which, when distributed, are taxable. However, Cornerstone believes that it adds significant value from its active trading.

### **U.S. Long Short Equities**

Cornerstone's U.S. Long Short Equities service utilizes the same bottom up fundamental research process used in our long-only product. However, rather than setting aside stocks with negative prospects, Cornerstone's US Long Short Equities service can act on them.

Cornerstone seeks long term growth of capital for its clients through the opportunistic selection of non-consensus long and short ideas within the equity market. Each stock is evaluated in an effort to identify one or more "perception gaps" in the key factors that drive the financial and operational performance of a given company. (The perception gaps are underappreciated opportunities for upside or downside in one or more of the key factors.) Perception gaps cause an asymmetrical reward/risk opportunity that when applied over an entire portfolio and over a full market cycle should generate strong risk-adjusted returns.

Stock selection is further based on the fundamentals of revenue, earnings, cash flow, and management depth and credibility. Sector allocation is a by-product of individual stock selection. Stocks will generally be selected from those which are primarily traded on US exchanges or markets.

The objective of this service is strong absolute risk-adjusted returns over a full market cycle.

Under normal circumstances, at least 80% of the value of the strategy's assets, which are expected to include both long and short positions, will consist of different equity securities, selected from a universe of publicly traded securities with characteristics similar to those comprising the Russell 1000 Index. Equity securities in which the strategy invests significantly include common stocks of U.S. and foreign companies, including depositary receipts. Long positions (equal to as much as 125% of the strategy's net assets) will be in securities that Cornerstone believes are likely to appreciate in value. Under normal circumstances, the strategy's net long position will generally be in the range of -10% to +25%. Short positions (equal to as much as 125% of the strategy's net assets) will be in securities Cornerstone believes are likely to depreciate in value.

The strategy takes long and short positions mainly in equity securities and derivatives on those securities of companies that each has a market capitalization of at least \$0.3 billion at the time of purchase. Equity securities in which the strategy invests significantly include common stocks of U.S. and foreign companies, including depositary receipts. Under normal circumstances, the long portion of the strategy is comprised of stocks or other securities of approximately 45 to 90 companies which Cornerstone believes have positive perception gaps. The strategy has no policy to concentrate in the securities of issuers in a particular industry or group of industries. Because Cornerstone's approach focuses on individual security selection, any resulting industry, or sector concentration is a byproduct of the investment selection process. As an operating policy, however, Cornerstone does not intend for net exposure to any one economic sector to exceed 50% of an account's net assets. In addition, the net exposure to securities from non-US issuers will be limited to 35% of the portfolio.

The strategy will buy and sell, as well as short and cover shorts in, equity securities (and derivatives on those securities) according to Cornerstone's research and beliefs about business prospects and valuation. In general, Cornerstone buys and covers shorts in securities that are identified as undervalued and considers selling or shorting them when they appear overvalued. Along with attractive valuation, Cornerstone often considers a number of other criteria such as 1) catalysts that could trigger a price move in a stock, 2) high potential reward compared to potential risk, and 3) temporary mispricing caused by market overreactions.

Selling stock short allows the strategy to more fully exploit insights in stocks that Cornerstone expects to underperform, as well as enabling the strategy to establish additional long positions. Short sales involve the sale of a security which the strategy does not own in hopes of purchasing the same security at a later date at a lower price. To make delivery to the buyer, the strategy must borrow the security, and the strategy is obligated to return the security to the lender, which is accomplished by a later purchase of the security by the strategy. Derivatives, which are instruments that have a value derived from or based on another instrument, exchange rate or index, may be used as substitutes for securities in which the strategy can invest. The strategy may use derivatives, including futures contracts, options, swaps, exchange traded funds, and contracts for differences (CFDs), to more effectively gain targeted equity exposure from its cash positions, to hedge various investments, for risk management, including to obtain significant amounts of long or short exposure, and to increase the potential for gain. Such derivatives may be used to effectively position the portfolio for expected catalysts at specific dates in time.

During market declines, while adding to long positions in favored securities, Cornerstone expects that it will become somewhat more aggressive, concentrating the portfolio by reducing the number of long positions. Conversely, in rising markets, while reducing or eliminating fully valued positions, Cornerstone expects that it will become somewhat more conservative, expanding the portfolio by increasing the number of long positions represented in the Long-Short Account's portfolio. Through this process, Cornerstone expects that it will tend to add to positions on price weakness and sell into price strength, all else being equal and assuming that long-term fundamentals remain intact or have changed less than the prices. Therefore, volatility may tend to increase during periods of weakness and decrease during periods of strength. Cornerstone expects that it will use this active management strategy to attempt to add incremental performance while seeking to mitigate risk by enforcing a buy low, sell high discipline. This active trading can affect investment performance by increasing brokerage and other transaction expenses for investors. Active trading also may result in the realization of substantial net short-term capital gains, which, when distributed, are taxable. However, Cornerstone believes that it adds significant value from its active trading.

### **Private Client Group Investment Strategies**

Cornerstone seeks to provide customized investment management solutions through diversified equity, balanced and fixed income portfolios. During initial meetings, Cornerstone gathers detailed information in order to perform a thorough analysis of the client's current financial situation and form a baseline for future recommendations. Then Cornerstone applies fundamental asset allocation to meet the investment objectives that are unique to each client, in an effort to balance the inherent investment risks within the identified time horizon. Cornerstone builds a diversified portfolio of mutual funds whose investment advisers Cornerstone believes are fundamental stock pickers and/or fixed

income market leaders. Depending on the size of the portfolio and the client's needs, Cornerstone may also recommend individual bonds, such as government bonds, corporate bonds and municipal bonds. Cornerstones works to determine the proper balance of risk and reward in an effort to build a portfolio which seeks to maximize return but limit risk to levels appropriate to each client's resources. Evaluation and monitoring are continuous, but aimed at low turnover.

### **Material Risks**

Investing in securities involves risk of loss that clients should be prepared to bear. There is no assurance that an investment will provide positive performance over any period of time. Past performance is no guarantee of future results and different periods and market conditions may result in significantly different outcomes. The material risks presented by each strategy and its investments are set forth below, but this section does not attempt to identify every risk, or to describe completely those risks it does identify.

#### **Market Risk**

The market values of the securities owned in the strategy may decline, at times sharply and unpredictably. Market values of equity securities are affected by a number of different factors, including the historical and prospective earnings of the issuer, the value of its assets, management decisions, decreased demand for an issuer's products or services, increased production costs, general economic conditions, interest rates, currency exchange rates, investor perceptions and market liquidity.

Cornerstone does not offer any products or services that guarantee rates of return on investments for any time period to any client. All clients assume the risk that investment returns may be negative or below the rates of return of other investment advisers, market indices or investment products.

#### **Concentrated Portfolio Risk**

To the extent a strategy invests in a limited number of stocks, it may have more risk because changes in the value of a single security may have a more significant effect, either negative or positive, on the strategy's performance. This risk is enhanced for the U.S. Large Cap Growth Equities focused strategy due to the small number of holdings.

#### **Risks of Investing in Large Cap Growth Companies**

Stocks of large-cap companies tend to be less volatile than stocks of smaller companies. However, since many investors buy large-cap growth stocks for their anticipated earnings growth, earnings disappointments often result in sharp price declines. While large-cap companies often have greater resources to weather economic shifts than smaller companies, they may be slower to innovate and adapt to changing conditions than smaller companies. Stocks with growth characteristics can have sharp price declines as a result of



earnings disappointments, even small ones. Since these companies usually invest a high portion of earnings in their businesses, they may lack the dividends of value stocks that can help to cushion stock prices in a falling market.

### **Foreign Investment Risk**

Investments in the securities of foreign issuers may experience more rapid and extreme changes in value than funds with investments solely in securities of U.S. companies. This is because the securities markets of many foreign countries are relatively small, with a limited number of companies representing a small number of industries. Additionally, foreign securities issuers may not be subject to the same degree of regulation as U.S. issuers. Reporting, accounting, and auditing standards of foreign countries differ, in some cases significantly, from U.S. standards. Also, nationalization, expropriation or confiscatory taxation, currency blockage, or political changes or diplomatic developments could adversely affect investments in a foreign country. In the event of nationalization, expropriation, or other confiscation, an investor could lose their entire investment. ADRs are U.S. dollar-denominated equity and debt securities of foreign issuers that are offered on U.S. exchanges. Interest or dividend payments on such securities may be subject to foreign withholding taxes.

### **Economic Risk**

Changes in economic conditions, including, for example, interest rates, inflation rates, political and diplomatic events and trends, tax laws and innumerable other factors, can substantially and adversely affect investments.

### **Management Risk**

This is the risk that Cornerstone will not successfully execute a strategy even after applying its investment process. There can be no guarantee that Cornerstone's decisions will produce the intended result, and there can be no assurance that an investment strategy will succeed.

### **Risks of Investing in Smaller Companies (U.S. Long Short Equities Only)**

Cornerstone may invest the account's assets in securities issued by smaller companies, including companies with capitalizations as small as \$300,000,000. Smaller companies may offer greater opportunities for capital appreciation than larger companies, but investments in smaller companies may involve certain special risks. Smaller companies may have limited product lines, markets or financial resources and may be dependent on a limited management group. While the markets in securities of smaller companies have grown rapidly in recent years, such securities may trade less frequently and in smaller volume than more widely-held securities. The values of these securities may fluctuate more sharply than those of other securities, and Cornerstone may experience some difficulty in establishing or closing out positions in these securities at prevailing market prices. There may be less publicly-available information about the issuers of these

securities or less market interest in these securities than in the case of larger companies, and it may take a longer period of time for the prices of such securities to reflect the full value of their issuers' underlying earnings potential or assets.

### **Derivatives Risk (U.S. Long Short Equities Only)**

The strategy may use derivatives, such as options, futures and swaps. The derivatives market is, in general, a relatively new market and there are uncertainties as to how it will perform during periods of unusual price volatility or instability, market illiquidity or credit distress. Substantial risks are also involved in borrowing and lending against derivatives. Derivatives prices can be volatile, market movements are difficult to predict and financing sources and related interest rates are subject to rapid change. One or more markets may move against the derivatives positions held by an account, thereby causing substantial losses. Most of these instruments are not traded on exchanges but rather through an informal network of banks and dealers who have no obligation to make markets in them and can apply essentially discretionary margin and credit requirements (and thus in effect force Cornerstone to close out positions). In addition, some derivatives carry the additional risk of failure to perform by the counterparty to the transaction. Many unforeseeable events, such as government policies, can have profound effects on interest and exchange rates, which in turn can have large and sudden effects on prices of derivative instruments.

### **Risks of Short Sales (U.S. Long Short Equities Only)**

The strategy may seek to realize additional gains or hedge investments through short sales. Short sales are transactions in which an account sells a security it does not own, in anticipation of a decline in the market value of that security. To complete such a transaction, the account must borrow the security to make delivery to the buyer. The account then is obligated to replace the security borrowed by purchasing it at the market price at or prior to the time of replacement. The price at such time may be more or less than the price at which the security was sold by the account. Until the security is replaced, the account is required to repay the lender any dividends or interest that accrues during the period of the loan. To borrow the security, the account also may be required to pay a premium, which would increase the cost of the security sold. The net proceeds of the short sale will be retained by the broker (or by the account's custodian in a special custody account), to the extent necessary to meet margin requirements, until the short position is closed out. The account also will incur transaction costs in effecting short sales.

An account will incur a loss as a result of the short sale if the price of the security increases between the date of the short sale and the date on which the account replaces the borrowed security. The account will realize a gain if the security declines in price between those dates. The amount of any gain will be decreased, and the amount of any loss increased, by the amount of the premium, dividends, interest or expenses the account may be required to pay in connection with a short sale. An increase in the value of a security

sold short by the account over the price at which it was sold short will result in a loss to the account, and there can be no assurance that the account will be able to close out the position at any particular time or at an acceptable price. Except in the case of short sales “against the box” (as to which the account owns or has a contractual right to acquire at a fixed price the securities sold short), the account’s market risk is unlimited in that the increase in the market price of the security sold short is unlimited.

#### **Asset Allocation Risk (Private Client Strategies Only)**

Asset Allocation may have a more significant effect on account value when one of the more heavily weighted asset classes is performing more poorly than the others. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.

#### **Fixed Income Risks (Private Client Strategies Only)**

Including: *interest rate risk*, which is the chance that bond prices overall will decline because of rising interest rates; *income risk*, which is the chance that a strategy’s income will decline because of falling interest rates; *credit risk*, which is the chance that a bond issuer will fail to pay interest and principal in a timely manner, or that negative perceptions of the issuer’s ability to make such payments will cause the price of that bond to decline; and *call risk*, which is the chance that during periods of falling interest rates, issuers of callable bonds may call (repay) securities with higher coupons or interest rates before their maturity dates. The strategy would then lose any price appreciation above the bond’s call price and would be forced to reinvest the unanticipated proceeds at lower interest rates, resulting in a decline in the strategy’s income.

#### **Municipal Securities Risks (Private Client Strategies Only)**

To the extent the strategy invests in bonds issued by local governments, such bonds are subject to the fixed income risks described above as well as the following risks: legislative risk- the risk that a change in the tax code could affect the value of tax-exempt interest income; and liquidity risk- the risk that investors may have difficulty finding a buyer when they want to sell and may be forced to sell at a significant discount to market value. Liquidity risk is greater for thinly traded securities such as lower-rated bonds, bonds that were part of a small issue, bonds that have recently had their credit rating downgraded or bonds sold by an infrequent issuer.

### **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 the client’s evaluation of their firm or the integrity of their management. Cornerstone has no information applicable to this Item.

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

Cornerstone serves as sponsor of and investment adviser to the Keystone Mutual Funds, an open-end registered investment company that currently offers its shares in one series, the Keystone Large Cap Growth Fund.

Cornerstone also serves as managing member of and investment adviser to the Cornerstone Long Short Fund, LLC, a private investment fund.

From time to time, Cornerstone may recommend shares of the Keystone Large Cap Growth Fund or an investment in the Cornerstone Long Short Fund to clients for whom such an investment is suitable. Because the Keystone Large Cap Growth Fund pays an advisory fee to Cornerstone and the Cornerstone Long Short Fund pays fees to Cornerstone, Cornerstone waives its separate advisory fee on those advisory client assets invested in either of these investments.

As discussed in Item 6, Cornerstone has certain conflicts related to its management of the Cornerstone Long Short Fund. Please also refer to the discussion of policies and procedures specific to side-by-side management in Item 12 “Brokerage Practices”.

## **Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

Cornerstone has adopted a Code of Ethics for all supervised persons of the firm describing its high 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 of rumor mongering, and restrictions on and the reporting of personal securities trading procedures, among other things. All supervised persons at Cornerstone must acknowledge the terms of the Code of Ethics in writing annually, or as amended.

Cornerstone employees may trade for their own accounts in securities which are recommended to and/or purchased for Cornerstone’s clients. Because Cornerstone permits such personal trading, this creates the conflict that employees could use their knowledge of pending client transactions in an attempt to benefit their own personal transactions. For example, if an employee owns a security the employee knows Cornerstone will be selling out of client accounts, the employee could sell the personal holding ahead of time in an effort to obtain a higher price than might exist when the client account holdings are sold. To address conflicts related to personal trading, the Code of Ethics requires pre-approval of many types of securities transactions and imposes restrictions on the timing of personal securities transactions when client accounts are trading in the same securities. The Code contains certain exceptions for transactions

deemed low risk by Cornerstone. The Code also requires employee reporting of personal securities transactions and Cornerstone to review such reports. Cornerstone's clients or prospective clients may request a copy of the firm's Code of Ethics by contacting Loren Kix at 952-229-8120 or [Lrk@cornerstonecapital.com](mailto:Lrk@cornerstonecapital.com).

From time to time, Cornerstone may recommend shares of the Keystone Large Cap Growth Fund or an investment in the Cornerstone Long Short Fund to clients for whom such an investment is suitable. Because the Keystone Large Cap Growth Fund pays an advisory fee to Cornerstone and the Cornerstone Long Short Fund pays fees to Cornerstone, Cornerstone has a financial conflict of interest such recommendations. To address this conflict, Cornerstone waives its separate advisory fee on those advisory client assets invested in either of these investments.

A Cornerstone employee has a material investment in the Cornerstone Long Short Fund and other employees may have such investments in the future. Certain of the conflicts related to this are addressed by Cornerstone's policies and procedures related to side-by-side management described in Item 6 and Item 12. Another conflict relates to the advice that might be given to clients to invest in the fund, e.g., that client investments are recommended only to add to the fund's assets and support employee personal investments. Cornerstone requires employees to put client interests first, however, and ensures that any recommendation to invest in the fund is made only to clients for whom such an investment is suitable. Cornerstone's Code of Ethics also requires employees to obtain pre-approval of any personal transactions in the fund to address any potential conflicts related to their knowledge of the fund's activities.

Cornerstone holds warrants in a private company that is also held in certain accounts in our Private Client Group. A Cornerstone employee has also invested in the private company. Cornerstone and the employee have a potential conflict of interest to the extent any advice they provide to clients regarding the private company might be affected by their financial interest in seeing the private company succeed. To address this conflict, the situation is disclosed to the affected clients, neither Cornerstone nor the employee will provide any investment advice or recommendations concerning the private company and no advisory fees will be charged on client assets invested in the private company. Cornerstone's Code of Ethics also requires the employee to obtain pre-approval of any transactions in the private company.

## **Item 12 – Brokerage Practices**

### ***Selection of Brokers***

It is Cornerstone's policy to seek the best execution of client security orders at the best security price available with respect to each transaction, in light of the overall quality of

brokerage and research services provided to it or its clients. The best price means the best net price without regard to the mix between purchase or sales price and commissions.

With respect to a specific order for institutional clients, Cornerstone seeks to choose the broker most capable of providing the brokerage services necessary in seeking to obtain the best available price and most favorable execution. Cornerstone notes the particular characteristics of a security to be traded including relevant market factors. Cornerstone will also consider other factors such as: ability to minimize trading costs; level of trading expertise; infrastructure; ability to provide information or services; financial condition; confidentiality provided by broker-dealer; competitiveness of commission rates; evaluations of execution quality; promptness of execution; past history; ability to prospect for and find liquidity; difficulty of trade and security's trading characteristics; size of order; liquidity of market; block trading capabilities; quality of settlements; specialized expertise; overall responsiveness; and willingness to commit capital. All of these considerations (and others as relevant) guide Cornerstone in selecting the appropriate venue (e.g., an Electronic Communications Network ("ECN") or Alternative Trading System ("ATS"), a traditional broker, a crossing network, etc.) in which to place an order and the proper tactics with which to trade.

In selecting a broker, Cornerstone may also consider research or brokerage services provided by the broker-dealer, consistent with the requirements of Section 28(e) of the Securities Exchange Act and related interpretative guidance. More information on Cornerstone's client commission policies and procedures is contained in the section "Use of Client Commissions" below.

Another factor Cornerstone may consider in selecting broker-dealers is when a client directs Cornerstone in writing to execute a portion of the client's trades through a particular broker-dealer. Typically, the client has an arrangement with such broker-dealer which results in the client receiving some benefit from the broker-dealer in exchange for the directed brokerage. Although Cornerstone generally discourages such direction, Cornerstone does permit client direction in certain circumstances, ensuring that clients are apprised of the potential risks associated with directed brokerage. These include:

- the direction may result in higher commissions, greater spreads or less favorable net prices than would be the case if Cornerstone selected the brokers;
- the direction may result in trades for the client's account not being aggregated with similar trades for other client accounts and thus not eligible for the benefits that accrue to such aggregation of orders;
- that as a result of not being aggregated, client transactions will generally be executed after client accounts whose trades are aggregated and may receive less favorable prices; and

- that because of the direction the client's account may not generate returns equal to those of other client accounts which do not direct brokerage.

Similarly, in the case of client accounts that are maintained at broker-dealers, Cornerstone may have discretion to select brokers or dealers other than the custodians when necessary to fulfill its duty to seek best execution of transactions for clients' accounts. However, brokerage commissions and other charges for transactions not effected through the custodian, may be charged to the client. We will treat the custody of client assets by a broker-dealer as a direction by the client to execute all transactions through that broker dealer.

Cornerstone is generally not in a position to negotiate commission rates with the custodians in these arrangements. A client who participates in these arrangements should consider that, depending on the level of the fee charged by the broker-dealer custodian, the amount of portfolio activity in the client's account, the value of the custodial and other services that are provided under the arrangement, and other factors, the fees may exceed the aggregate cost of such services if they were to be provided separately.

Under no circumstances does Cornerstone consider the marketing efforts of broker-dealers on its behalf or on behalf of the Keystone Large Cap Growth Fund, or investment opportunities offered by broker-dealers in selecting broker-dealers to execute client trades. Cornerstone also has policies and procedures in place to limit and monitor gifts and entertainment received from third parties, including broker-dealers that do business with Cornerstone or wish to do business with Cornerstone.

Cornerstone's Trade Oversight Committee routinely reviews its broker-dealers and its efforts to seek best execution in light of current market circumstances and published statistical studies and other available information.

### ***Use of Client Commissions***

Subject to the criteria of Section 28(e) of the Securities Exchange Act of 1934, as amended, and regulatory guidance from the SEC, Cornerstone may pay a broker a brokerage commission higher than that which another broker might have charged for effecting the same transaction in recognition of the value of the brokerage and research services provided by the broker. In other words, Cornerstone may "pay up" using client commissions or "soft dollars" to obtain research or brokerage services that benefit Cornerstone and its accounts. As a general matter, many of the research services Cornerstone receives from broker-dealers are used to service all of Cornerstone's accounts. However any particular research service may not be used to service each and every client account, and may not benefit the particular accounts that generated the brokerage commissions. Cornerstone does not try to allocate soft dollar benefits to client accounts

proportionately to the soft dollar commissions the accounts generate. When Cornerstone uses client brokerage commissions to obtain research or research services, Cornerstone receives a benefit because it does not have to produce or pay for the research or research services. As a result, Cornerstone may have an incentive to select a broker-dealer based its interest in receiving the research or other products or services, rather than on clients' interest in receiving most favorable execution. Because the use of client commissions to pay for research or brokerage services for which Cornerstone would otherwise have to pay presents a conflict of interest, Cornerstone has adopted policies and procedures concerning soft dollars, which address all aspects of its use of client commissions and requires that such use be consistent with Section 28(e), provide lawful and appropriate assistance to Cornerstone in the investment decision-making process, and that Cornerstone determine that the value of the research or brokerage service obtained be reasonable in relation to the commissions paid.

To the extent that a certain group of Cornerstone's clients are not available to pay for soft dollar benefits (e.g., clients that direct brokerage commissions and wrap account program clients), clients who give Cornerstone brokerage discretion will support a disproportionate share of Cornerstone's soft dollar benefits.

During its last fiscal year Cornerstone received the following types of research and research services: both as prepared by broker-dealers that execute client transactions ("proprietary research") and as prepared by third parties but for which the executing broker-dealers are obligated to pay ("third-party research"): information on the economy, industries, groups of securities, individual companies, technical market information, stock quotes, analytic tools, risk measurement analyses, performance analyses and analyses of corporate responsibility issues, index holdings and data, earnings and revenue estimates. Such research services were received in the form of written reports, telephone contacts and personal meetings with securities analysts. In addition, such research services were provided in the form of access to various types of computer-generated data and meetings arranged with corporate and industry spokespersons.

To facilitate best execution of trades, Cornerstone uses order and report processing services offered by brokers who otherwise meet Cornerstone's selection criteria. Various order and report processing services are available at no cost to Cornerstone and are used as reference materials only when assimilating Cornerstone's own internal trade management analysis.

Cornerstone's Trade Oversight Committee is responsible for its procedures concerning the use of client commissions. It is responsible for approving any new soft dollar brokerage relationship and for reviewing all research and brokerage services annually to make a determination as to the reasonableness of the brokerage allocation as well as the price for such services versus the value received. Where necessary, the Trade Oversight Committee



makes the good faith allocation between hard and soft dollars with respect to mixed-use services, as described below.

Where Cornerstone receives both administrative or marketing benefits and research and brokerage services from the services provided by brokers, a good faith allocation between the marketing and administrative benefits and the research and brokerage services will be made, and Cornerstone will pay for any marketing or administrative benefits with cash. In making good faith allocations between marketing or administrative benefits and research and brokerage services, a conflict of interest may exist by reason of the allocation by Cornerstone of the costs of such benefits and services between those that primarily benefit Cornerstone and those that primarily benefit clients.

With respect to directing client transactions to particular broker-dealers in exchange for soft dollar benefits, Cornerstone first ensures such direction is consistent with its obligation to seek best execution. In connection with third-party benefits, Cornerstone participates in commission sharing arrangements to receive research services. In commission sharing arrangements, an adviser effects transactions, subject to best execution, through a broker and request that the broker allocate a portion of the commission or commission credits to a segregated "research pool" maintained by the broker. An adviser may then direct such broker to pay for eligible products and services from the "research pool". Cornerstone has such arrangements with Goldman Sachs & Co. and Barclays Capital, Inc. Participating in commission sharing arrangements enables Cornerstone to (1) strengthen its key brokerage relationships; (2) consolidate payments for eligible research and research services; and (3) continue to receive a variety of high quality eligible research services while facilitating best execution in the trading process.

The Trade Oversight Committee also oversees the annual process used to set informal, non-binding soft dollar targets for the following year, which involves a review of the previous year's budget vs. actual; a review and evaluation of all current and contemplated services for their soft dollar eligibility; negotiations where possible of the cost of service; and consideration of investment and trading professional feedback concerning the execution service and proprietary research provided by brokers.

In no case will Cornerstone make binding commitments as to the level of the brokerage commissions it will allocate to a broker. Nor does Cornerstone "backstop" or otherwise guarantee any broker's financial obligation to a third party for such research or services.

### ***Directed Brokerage***

In limited instances, Cornerstone will accept direction from clients as to which broker-dealers are to be used. Any such direction must be in writing and accepted by Cornerstone before it will be effective. Typically, the client has an arrangement with such broker-dealer which results in the client receiving some benefit from the broker-dealer in exchange for

the directed brokerage. Although Cornerstone generally discourages such direction, Cornerstone does permit client direction in certain circumstances, ensuring that clients are apprised of the potential risks associated with directed brokerage, including that it may cost the client more money for the following reasons:

- the direction may result in higher commissions, greater spreads or less favorable net prices than would be the case if Cornerstone selected the brokers;
- the direction may result in trades for the client's account not being aggregated with similar trades for other client accounts and thus not eligible for the benefits that accrue to such aggregation of orders;
- that as a result of not being aggregated, client transactions will generally be executed after client accounts whose trades are aggregated and may receive less favorable prices; and
- that because of the direction the client's account may not generate returns equal to those of other client accounts which do not direct brokerage.

Similarly, in the case of client accounts that are maintained at broker-dealers, Cornerstone may have discretion to select brokers or dealers other than the custodians when necessary to fulfill its duty to seek best execution of transactions for clients' accounts. However, brokerage commissions and other charges for transactions not effected through the custodian, typically are charged to the client. We will treat the custody of client assets by a broker-dealer as a direction by the client to execute all transactions through that broker dealer. This results in such accounts essentially being treated as directed brokerage accounts. Also see the disclosure below regarding Private Client Group Brokerage.

### ***Special Disclosures Regarding Private Client Group Brokerage***

Cornerstone does not maintain custody of client assets that we manage, although we may be deemed to have custody of client assets if clients give us authority to withdraw fees from their accounts (see Item 15 – Custody, below). Client assets must be maintained in an account at a "qualified custodian," generally a broker-dealer or bank. If asked, we recommend that our clients use Charles Schwab & Co., Inc. (Schwab), a registered broker-dealer, member SIPC, as the qualified custodian. Cornerstone is independently owned and operated and is not affiliated with Schwab. Schwab will hold client assets in a brokerage account and buy and sell securities when we instruct them to. While we recommend that client use Schwab as custodian/broker, each client will decide whether to do so and will open an account with Schwab by entering into an account agreement directly with Schwab. We do not open the account for client, although we may assist clients in doing so. Even though an account is maintained at Schwab, we can still use other brokers to execute trades for an account as described below (see "Client Brokerage and Custody Costs").

*How Cornerstone Selects Brokers/Custodians.* We seek to recommend a custodian/broker who will hold client assets and execute transactions on terms that are, overall, most

advantageous when compared to other available providers and their services. We consider a wide range of factors, including, among others:

- Combination of transaction execution services and asset custody services (generally without a separate fee for custody)
- Capability to execute, clear, and settle trades (buy and sell securities for client account)
- Capability to facilitate transfers and payments to and from accounts (wire transfers, check requests, bill payment, etc.)
- Breadth of available investment products (stocks, bonds, mutual funds, exchange-traded funds, etc.)
- Availability of investment research and tools that assist us in making investment decisions
- Quality of services
- Competitiveness of the price of those services (commission rates, margin interest rates, other fees, etc.) and willingness to negotiate the prices
- Reputation, financial strength, and stability
- Prior service to us and our other clients
- Availability of other products and services that benefit us, as discussed below (see “Products and Services Available to Us From Schwab”)

*Client Brokerage and Custody Costs.* For our clients’ accounts that Schwab maintains, Schwab generally does not charge clients separately for custody services but is compensated by charging clients commissions or other fees on trades that it executes or that settle into the Schwab account. Schwab’s commission rates applicable to our client accounts were negotiated based on the condition that Cornerstone’s clients collectively maintain a total of at least \$50 million in aggregate assets at Schwab. This commitment benefits clients because the overall commission rates clients pay are lower than they would be otherwise. In addition to commissions, Schwab charges clients a flat dollar amount as a “prime broker” or “trade away” fee for each trade that we have executed by a different broker-dealer but where the securities bought or the funds from the securities sold are deposited (settled) into a Schwab account. These fees are in addition to the commissions or other compensation clients pay the executing broker-dealer. Because of this, in order to minimize client trading costs, we generally have Schwab execute most trades for client account. We have determined that having Schwab execute most trades is consistent with our duty to seek “best execution” of client trades. Best execution means the most favorable terms for a transaction based on all relevant factors, including those listed above (see “How We Select Brokers/Custodians”).

*Products and Services Available to Us From Schwab.* Schwab provides 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 That Benefit Clients.* 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 clients.

*Services That May Not Directly Benefit Clients.* Schwab also makes available to us other products and services that benefit us but may not directly benefit clients. These products and services assist us in managing and administering our clients' accounts. For example, Schwab 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 May 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.

*Our Interest in Schwab's Services.* The availability of these services from Schwab benefits us because we do not have to produce or purchase them. We don't have to pay for Schwab's services so long as our clients collectively keep a total of at least \$10 million of their assets in accounts at Schwab. Beyond that, these services are not contingent upon us committing any specific amount of business to Schwab in trading commissions or assets in custody. The \$10 million minimum may give us an incentive to recommend that clients maintain an account with Schwab, based on our interest in receiving Schwab's services that benefit our business rather than based on an interest in receiving the best value in custody services and the most favorable execution of client transactions. This is a potential conflict of interest. We believe, however, that our recommendation of Schwab as custodian and broker is in the best interests of our clients. Our selection is primarily supported by the scope, quality, and price of Schwab's services (see "How We Select Brokers/Custodians") and not Schwab's services that benefit only us.

*Fixed Income Trading.* Cornerstone buys and sells individual bonds for client accounts when suitable. Cornerstone seeks best execution of such transactions and will generally execute trades through Schwab or two other broker-dealers depending on a variety of factors including bid prices and inventory.

### ***Allocation of Investment Opportunities among Clients***

Cornerstone provides investment management services to a wide variety of accounts, including institutional clients, a Cornerstone-sponsored mutual fund, other mutual funds, and a private investment fund. It is Cornerstone's policy to allocate suitable investment opportunities fairly and equitably to clients with the same or similar investment objectives over time. In particular, Cornerstone primarily manages long-only, large-cap growth accounts that feature an asset-based advisory fee ("Long-Only Accounts"). Cornerstone, however, also manages a long-short strategy that does invest in large-cap stocks and which features an advisory fee along with a performance fee ("Long-Short Accounts"). This side-by-side management presents certain actual and potential conflicts of interest including a direct economic incentive to favor Long-Short Accounts over Long-Only Accounts; a marketing incentive to favor new investment strategies like the Long-Short Accounts over existing investment strategies like the Long-Only Accounts; and a trading incentive to manage one type of an account in a manner that harms or has the potential to harm the interests of other accounts being managed (for example, the Long-Short Accounts selling an issuer before the Long-Only Accounts and not suffering the price differential that might arise were all accounts sold together, and the Long-Short Accounts holding a short interest in an issuer held long by the Long-Only Accounts).

It is Cornerstone's policy to allocate suitable investment opportunities fairly and equitably to clients with the same or similar investment objectives over time. A security will be suitable for an account if it is consistent with the investment objectives, strategies and risk tolerance of the account and permitted by the investment restrictions and limitations

applicable to the account. For example, Cornerstone anticipates that as a general matter all investment opportunities that are suitable for the Long-Only Accounts will also be suitable for the Long-Short Accounts, but that not all investment opportunities for the Long-Short Accounts will be suitable for the Long-Only Accounts due to the Long-Short Accounts' broader investment strategy.

Where an investment opportunity is suitable for both Long-Only Accounts and Long-Short Accounts, it is Cornerstone's policy that all such accounts shall participate in the transaction, subject to Cornerstone's determination that participating in the transaction is not in the account's best interest for reasons such as:

- Lack of available cash
- Net exposure to holding, industry or sector is higher than desired
- Specific client restrictions, e.g., industry or sector limits

Cornerstone may invest in securities being offered in an initial public offering ("IPO" or "new issue"), if it determines that such an investment is desirable for one or more clients. In making this judgment, Cornerstone shall consider, among other things, a client's investment objectives, restrictions and tax circumstances; a client's tolerance for risk and high portfolio turnover; the nature, size and investment merits of the IPO; the size of a client's account and the client's cash availability and other holdings; and other current or expected competing investment opportunities that may be available for the account.

Sometimes the demand for new issues exceeds the supply, and the amount of certain new issues made available to Cornerstone may be limited. If Cornerstone is not able to obtain the total amount of securities needed to fill all orders, Cornerstone allocates the shares actually obtained on a pro rata basis. Based on the circumstances of the transaction, Cornerstone may establish a minimum lot size and then allocate pro rata accordingly. All such allocations are monitored to ensure that clients are treated fairly and equitably over time and that no clients are systematically disadvantaged.

### ***Aggregated Trades***

Generally, trading orders are processed and executed in the order received by the trading desk. However, when Cornerstone purchases or sells the same securities for two or more accounts, Cornerstone may bunch orders where it deems this to be appropriate, in the best interests of clients and consistent with Cornerstone's fiduciary duties. The decision to aggregate is only made after Cornerstone determines that: it does not intentionally favor any account over another; it does not systematically advantage or disadvantage any account; Cornerstone does not receive any additional compensation or remuneration solely as the result of the aggregation; and each participating account will receive the average share price and will share pro rata in the transaction costs. Cornerstone systematically rotates the execution of such aggregated trades between two specific trade groups: 1)

Long-Short Accounts and 2) Long-Only Accounts. Trades of Directed Brokerage Accounts (where Cornerstone is directed to trade with specific brokers) and Wrap Accounts are generally not aggregated for trade execution purposes – see related disclosure under “Non-Aggregated Trades” below for more information.

When a bunched order is filled in its entirety, each participating client account will participate at the average share price for the bunched order on the same business day. Transaction costs generally will be shared pro rata based on each client's participation in the bunched order. However, there may be occasions when clients may pay disparate transaction costs due to minimum charges per account imposed by either the broker effecting the transaction or the client's custodian.

When a bunched order is only partially filled, the securities purchased will be allocated on a pro rata basis to each account participating in the bunched order based upon the initial amount requested for the account, subject to the exception set forth below, and each participating account will participate at the average share price for the bunched order on the same business day.

If Cornerstone is able to purchase only a de minimis percentage of the securities sought, in some cases the value of the few shares a client would receive would be less than the amount of the client's custody fees. In such cases, Cornerstone will allocate the shares using a method it deems fair and equitable, generally allocating the de minimis fill to its largest accounts. If Cornerstone is able to purchase only a de minimis percentage of the securities sought on the following day as well, the next largest accounts will be allocated shares. Cornerstone's objective is to allocate these de minimis fills to those accounts where the position will have a minimal impact on the portfolio. Cornerstone may use other methods it deems fair and equitable, such as a pro rata allocation with a minimum lot size, a rotational system, or some other methodology. Cornerstone monitors this practice to ensure that no accounts are systematically disadvantaged over time.

### ***Non-Aggregated Trades***

Cornerstone may determine that an order will not be aggregated for a number of reasons. These reasons include:

- the account's governing documents do not permit aggregation or impose significant restrictions on Cornerstone's core investment process, including limiting Cornerstone's ability to purchase certain types of securities (Restricted Accounts);
- the client has directed that trades be executed through a specific broker-dealer;
- aggregation is impractical because of directions received from the portfolio manager, e.g., a limit order or orders with different strategies; and

- a determination by the head trader that aggregation is not consistent with seeking best execution.

Cornerstone assigns client accounts to distinct account trade groups based on investment mandates, styles, account restrictions or custodial platforms. For non-aggregated trades, Cornerstone applies a consistent sequencing process in trading these account trade groups, as follows:

1. Fully discretionary account trade groups (defined as those accounts where Cornerstone has full brokerage and investment discretion; namely, Long-Only, Long-Short and Focused) are traded first. Restricted Accounts are often traded with this account trade group; if not, trades in Restricted Accounts are executed next.
2. Trades in Directed Brokerage Accounts, where Cornerstone is directed to trade with specific brokers are executed next. Cornerstone may merge Directed Brokerage Account trades with our discretionary account trades (where Cornerstone has full brokerage and investment discretion) when trading through the same broker.
3. Wrap platform trades are generally executed last.

When implementing a particular trade, Cornerstone in its professional judgment may determine that best execution should be sought by separating the overall trade into segments. Depending on various trading considerations, all segment trades for the fully discretionary accounts may or may not be completed before the segment trades for the Directed Brokerage Accounts begin. These segmented trades are all completed before the wrap platform trades are executed, however. Cornerstone maintains records of this trading activity and reviews them in connection with the Trade Oversight Committee's assessment of best execution, as described below.

Where account trade groups contain more than one account and trades are not aggregated within these account trade groups, Cornerstone randomly determines the order in which specific accounts within each account trade group trades in an effort to ensure equitable treatment over time.

With respect to wrap account trades, Cornerstone will typically execute trades through the program sponsor so as not to incur extra trading expenses for the client's account. Currently, where Cornerstone is transacting in the same securities for wrap and non-wrap account clients, Cornerstone shall execute wrap account trades after Cornerstone's non-wrap client account trades. Cornerstone shall ensure that such delay is no longer than the next business day. With respect to the model portfolio recommendations, pursuant to instructions from the program sponsor, Cornerstone communicates trades to the sponsor's



overlay manager the business day following the day in which Cornerstone executes similar trades for its other accounts. Cornerstone has no influence over when or even whether model changes are implemented.

### ***Further Restrictions Related to Side-by-Side Management***

The policies and procedures set forth above are reasonably designed to mitigate or eliminate the actual or potential conflicts of interest related to side-by-side management discussed earlier. Cornerstone has adopted additional policies and procedures reasonable designed to address further any actual or potential conflicts of interest involving Long-Only Accounts and Long-Short Accounts.

- Cornerstone may not short a security (directly or in any other transaction that is the economic equivalent of a short) that is held in the Long-Only Accounts.
- No Cornerstone employee compensation shall be tied to the performance of Long-Short Accounts.
- Cross trades between Long-Only Accounts and Long-Short Accounts are prohibited (see general prohibition described in following section).

### ***Internal Cross Transactions and Principal Transactions***

Internal cross transactions are trades between advisory client accounts. Principal transactions are trades between a client account and an account of Cornerstone or its employees. It is Cornerstone's policy to prohibit both cross transactions and principal transactions.

### ***Trade Errors***

On occasion, a mistake may occur in the execution of a trade. As a fiduciary, Cornerstone owes clients duties of loyalty and trust, and as such must treat trade errors in a fair and equitable manner. Errors may occur for a number of reasons, including human input error, systems error, communications error or incorrect application or understanding of a guideline or restriction. Examples of errors include, but are not limited to the following: buying securities not authorized for a client's account; buying or selling incorrect securities; buying or selling incorrect amounts of securities; and buying or selling in violation of one of our policies. In correcting trade errors, Cornerstone does not make the client account absorb any financial loss due to the trade error; use soft dollars or directed trades to fix the error; or attempt to fix the error using another client account. To the extent correction of the error results in a loss to the client's account, Cornerstone reimburses the account. To the extent correction of the error results in a gain to the client's account, Cornerstone allows the client to keep the benefit.

### ***Oversight of Trading Practices***

Cornerstone's Trade Oversight Committee is responsible for the overall supervision of its trading practices, including trade errors, aggregation, allocation and side-by-side matters.

The Committee meets on at least a routine basis and minutes of such meetings are made and retained.

### **Item 13 – Review of Accounts**

Cornerstone's Investment Policy Committee includes the Chief Executive Officer, the Chief Investment Officer and three Senior Vice Presidents. At least quarterly, one or more members of the Investment Policy Committee reviews all accounts for which Cornerstone provides investment management services. This exercise includes a review of current holdings, transactions during the period, performance and achievement of investment objectives. More frequent reviews may be triggered by changes in asset allocation or sector issue weighting, new buys/sells or capital market/macro-economic movements.

Written investment management reports are provided to clients quarterly and include a summary of assets, portfolio returns and transactions for the quarter and an asset allocation summary. Cornerstone will conduct annual review meetings with clients, or more often as may be requested by the client.

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

Cornerstone does not have solicitation or referral arrangements in place with third parties at this time. Please refer to the discussion related to use of client commissions in Item 12 "Brokerage Practices" for information about other compensation.

With respect to Private Client Group accounts, Cornerstone receives an economic benefit from Schwab in the form of the support products and services it makes available to us and other independent investment advisors whose clients maintain their accounts at Schwab. These products and services, how they benefit Cornerstone, and the related conflicts of interest are described above (see Item 12 – Brokerage Practices). The availability to Cornerstone of Schwab's products and services is not based on Cornerstone giving particular investment advice, such as buying particular securities for our clients.

### **Item 15 – Custody**

Cornerstone does not maintain custody of client assets, although Cornerstone is deemed by the applicable regulations to have custody of assets if clients give it authority to withdraw quarterly fees directly from their custodial accounts. Client assets must be maintained in an account at a qualified custodian; generally a broker dealer or bank. A custodian is appointed by each client to have possession of the assets of the account, settle transactions for the account and accept instructions from Cornerstone regarding the assets in the account, subject to certain procedural restrictions.

Clients should receive at least quarterly statements from the broker dealer, bank or other qualified custodian that holds and maintains their investment assets. Cornerstone urges clients to carefully review such statements and compare such official custodial records to the account statements that Cornerstone may provide. Cornerstone statements may vary from custodial statements based on accounting procedures, reporting dates, or valuation methodologies of certain securities. Clients should contact Cornerstone using the information on page 1 if they have any questions about their statements or if their qualified custodians stop sending them at least quarterly statements. Cornerstone is not affiliated with any qualified custodian.

In its role as managing member of the Cornerstone Long Short Fund, LLC, Cornerstone has legal access to the Cornerstone Long Short Fund's securities or funds in a manner which deems Cornerstone to have custody over such assets. To mitigate this risk, the Cornerstone Long Short Fund is audited by an independent accountant annually, and investors annually receive audited financial statements.

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

Cornerstone receives discretionary authority in the investment management agreement executed with the client at the outset of an advisory relationship. The accounts over which Cornerstone exercises investment discretion are generally subject to investment restrictions and guidelines developed in consultation with clients. These restrictions and guidelines customarily impose limitations on the types of securities that may be purchased and also generally limit the percentage of account assets that may be invested in certain types of securities. Additional policies may be set by a client's board or investment committee. Cornerstone is generally authorized to make the following determinations, consistent with the each client's investment goals and policies, without client consultation or consent before a transaction is effected:

- Which securities or other investments to buy or sell;
- The total amount of securities or other investments to buy or sell;
- The broker or dealer through whom securities are bought or sold;
- The commission rates at which securities or other investment transactions for client accounts are effected; and
- The price at which securities or other investments are to be bought or sold, which may include dealer spreads or mark-ups and transactions costs.

However, from time to time, Cornerstone may accept accounts for which it has discretionary authority to purchase securities for the account, but not to select broker-dealers for transactions. Cornerstone may also accept non-discretionary arrangements,

where clients retain investment discretion with respect to transactions in the account. In these situations, the client's retention of discretion may cause the client to lose possible advantages that discretionary clients may derive from factors that result from our ability to act on its recommendations for those discretionary clients in a more timely fashion, such as the aggregation of orders for several clients as a single transaction.

Cornerstone may act as investment manager to other clients (including funds) now or in the future and each account's investment restrictions and guidelines may differ. All investment decisions for an account are made in accordance with the investment restrictions and guidelines of that account. Investment decisions for each account are made with a view to achieving the account's investment objectives and after consideration of such factors as the account's current holdings, the current investment views of the portfolio manager, availability of cash for investment, and the size of the account's positions generally.

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

Cornerstone does not generally vote proxies for its separate account clients, unless provided otherwise in the client's advisory agreement. When Cornerstone is obligated to vote proxies, it uses a third-party proxy voting administrator to monitor proxies, recommend voting decisions and ensure that proxies are submitted in a timely manner. Cornerstone's Investment Policy Committee will make the final decision on how to vote proxies, though it will generally follow the recommendations of the administrator. Whenever the administrator identifies proposals which are controversial or non-routine in nature, such proposals will be reviewed on a case-by-case basis by the Investment Policy Committee.

If a material conflict of interest is identified regarding proxy voting, it will generally be addressed in one of the following ways by the Investment Policy Committee:

1. The proxy will be voted according to the proxy voting guidelines, provided that the proposal at issue is not one which the Guidelines require to be considered on a case-by-case basis.
2. In conflict situations which cannot be addressed using the guidelines, Cornerstone's Investment Policy Committee will follow the recommendation of the administrator or another third party proxy voting service.
3. If neither of the previous two procedures provides an appropriate voting recommendation, Cornerstone's Investment Policy Committee may retain an independent fiduciary to advise Cornerstone on how to vote the proposal or Cornerstone may abstain from voting.

Clients for whom Cornerstone does not have proxy voting authority should ensure that they receive proxies and other solicitations from their custodian or transfer agent. Clients may contact Cornerstone with questions regarding a proxy solicitation.

Clients who wish to direct Cornerstone how to vote regarding a particular proxy or want a copy of Cornerstone's Proxy Policy, as well as information about how their securities were voted, should contact Loren Kix at 952-229-8120 or [lrk@cornerstonecapital.com](mailto:lrk@cornerstonecapital.com).

## **Item 18 – Financial Information**

Registered investment advisers are required to provide certain financial information or disclosures about their financial condition. Cornerstone has no financial condition that impairs its ability to meet contractual commitments to clients, and has never been the subject of a bankruptcy proceeding.

## **Other Information**

### **Dual Roles**

Cornerstone's Chief Compliance Officer also serves as Cornerstone's Director of Finance & Operations, as well as serving as Chief Compliance Officer for Cornerstone's affiliated mutual fund, Keystone Mutual Funds. In these roles, he may face an inherent conflict with his Cornerstone compliance responsibilities. Cornerstone management is cognizant of these potential conflicts, and strives to ensure his other responsibilities do not impair his responsibilities as Cornerstone's Chief Compliance Officer.