

Part 2A of Form ADV: *Firm Brochure*

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August 1, 2012

This brochure provides information about the qualifications and business practices of Hester Capital Management, L.L.C. If you have any questions about the contents of this brochure, please contact us at 512.474.6657 or JoyRoberts@hestercapital.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. Any references to Hester Capital Management, L.L.C. as a “registered investment adviser” or being “registered” with the SEC or any state does not imply a level of training or skill.

Additional information about Hester Capital Management, L.L.C. is available on the SEC’s website at www.adviserinfo.sec.gov. You can search this site by a unique identifying number, known as a CRD number. The CRD number for Hester Capital Management, L.L.C. is 109623.

Item 2. Summary of Material Changes

On July 28, 2010, the United State Securities and Exchange Commission (“SEC”) published “Amendments to Form ADV” which amends the disclosure document that we provide to clients as required by SEC Rules. This Firm Brochure is a new document prepared according to the SEC’s new requirements and rules. As such, this document is materially different in structure and requires certain new information that our previous brochure did not require.

In the future, this Item will discuss specific material changes that are made to the Firm Brochure and provide clients with a summary of such changes.

In the past, we have offered or delivered information about our qualifications and business practices to clients on at least an annual basis. Pursuant to new SEC Rules, we will ensure that you receive a summary of any materials changes to this and subsequent Brochures within 120 days of the close of our business’ fiscal year. We may further provide other ongoing disclosure information about material changes as necessary.

Currently and as of the date of this Firm Brochure, our firm has the following material change to disclose.

Change of Majority Ownership

Effective July 31, 2012, Luther King Capital Management Corporation, a registered investment management firm based in Fort Worth, TX, acquired the majority ownership interest of Hester Capital Management, L.L.C. previously owned by PlainsCapital Corporation, a Texas financial holding company. While deemed to be a change in control under regulatory interpretations, the corporate management, investment professionals and advisory services of Hester Capital continue unchanged with on-going services to support our advisory clients.

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Item 4. Advisory Business

INTRODUCTION

Hester Capital Management, L.L.C. (hereinafter “Hester Capital,” “HCM” or “we”), is an investment management firm founded in 1989 and located in Austin, Texas. HCM is registered with the U.S. Securities and Exchange Commission as a registered investment advisory firm.

HCM manages equity, fixed income, and balanced portfolios using clearly defined investment objectives and guidelines established in private consultation with each of our clients.

Currently, we manage approximately \$1 billion in client assets under management. Hester Capital is majority owned by Luther King Capital Management Corporation (“LKCM”), a registered investment management firm based in Fort Worth Texas and minority owned and managed by Craig Hester, James Huffines, and John Gunthorp.

INVESTMENT SUPERVISORY SERVICES

HCM offers and provides these investment supervisory services to individuals, including high net worth individuals, banking institutions, corporations, state and municipal entities, pension and profit sharing plans, trusts, estates, foundations, endowments and charitable organizations, among other institutions. Our firm also participates as sub-adviser in several wrap fee programs sponsored by independent broker-dealer firms and model account programs.

Institutional and Individual Clients

HCM's basic service is to manage client portfolios in accordance with their clearly defined investment objectives and guidelines established at the initiation of the relationship. Once established, these objectives and guidelines (which are based upon discussions with the client) are reviewed annually and/or at each client meeting to ensure they are appropriate and to make any necessary adjustments. Establishing investment objectives is a critical part of the investment process and represents the bridge between the client's unique circumstances and needs and the achievable rates of return and risk exposure offered by HCM's style of equity and fixed-income management. The basic strategy is to build and manage the portfolios in a prudent manner and to purchase on a timely basis those securities which will blend together to achieve the client's investment objectives.

Model Portfolio Programs

HCM also participates in two "Model Portfolio Programs." For these programs, HCM will recommend the securities to be held and the weighting of those securities based on an equity model portfolio. The sponsors of the programs have the sole responsibility of investment discretion over client assets, client suitability for the programs, and monitoring changes in the client's financial situation or individual needs. The financial institution may then implement HCM's model recommendations on that institution's own trading platform for the clients that have chosen to participate in the program. The financial institution may choose to implement some or all of HCM's recommendations in terms of both the securities and/or the weightings. As securities and weightings change in the model, those modifications are communicated promptly to the financial institutions that are using HCM's model. There is no requirement that the program be administered as it is provided, or at all, and HCM does not monitor or supervise the program administered by the outside institutions. HCM is not responsible for trading securities in these programs or for taking any action or rendering any advice with respect to the voting of proxies. This may not be deemed "investment supervisory services." HCM's percentage of total advisory billings from these programs is minimal and the value of assets is not counted in HCM assets under management. These programs include:

1. Capital Ideas, Inc. Model Portfolio Program for use by Capital Ideas in the investment of assets of its clients, and
2. Unified Overlay Management Program sponsored by FDX Advisors, Inc., a wholly owned subsidiary of Folio Dynamics, Inc.

As each program is different from the other, HCM fees have been negotiated individually.

The above programs could cause a potential conflict of interest regarding the trading of securities in HCM client accounts if trades are communicated to the programs on the same day that HCM is purchasing or selling securities. To minimize this potential conflict of interest, HCM does not submit portfolio change notifications to the model sponsors before client account trades have commenced. The timing of notifications and recommendations to sponsors may disadvantage participants in those programs to the limited extent that the entry of orders by the sponsors, if placed, would be after the transactions entered by HCM for its clients.

Wrap Fee Programs

In some instances HCM is retained by clients under "wrap fee" arrangements sponsored by a broker-dealer, wherein the broker-dealer may recommend retention of HCM as investment adviser, pay HCM's investment advisory fee on behalf of the client, monitor and evaluate HCM performance, execute the client's portfolio transactions without commission charge, and provide custodial services for the client's assets, or provide any combination of these or other services, all for a single, all-inclusive, fee paid by the client to the broker-dealer as sponsor of the Wrap Fee Program.

In evaluating such an arrangement, a client should recognize that brokerage commissions for the execution of transactions in the client's account are not negotiated by HCM. Transactions are effected "net," i.e., without commission, and a portion of the wrap fee is generally considered as being in lieu of commissions. Trades are generally expected to be executed only with the broker dealer with which the client has entered into the wrap fee arrangement, so that HCM may not be able to seek best price and execution by placing transactions with other broker-dealers. Additionally, wrap accounts may or may not be traded after discretionary accounts.

Accordingly, the client may wish to satisfy itself that the broker dealer offering the "wrap fee" arrangement can provide adequate price and execution for most or all transactions. The client should also consider that, depending upon the level of the wrap fee charged by the broker-dealer, the amount of portfolio activity in the client's account, the value of custodial and other services which are provided under the arrangement, and other factors, the wrap fee may or may not exceed the aggregate cost of such services if they were to be provided separately and if HCM were able to negotiate commissions and seek best price and execution of transactions for the client's account. In wrap fee accounts, HCM requires the client to execute an investment agreement with HCM.

The programs in which HCM participates are as follows:

- (1) RBC Dain Rauscher (sponsor) Investment Consulting Services - Managed Account Program.
- (2) UBS Financial Services, Inc. (sponsor) Managed Account Consulting Program.

Additional information about the above wrap fee programs, services, fees, and conflicts of interest is provided in the Wrap Fee Disclosure Brochure (Form ADV 2 Appendix 1) provided by each broker-dealer sponsor.

Item 5. Fees and Compensation

Investment Supervisory Services

Equity and Balanced Accounts

1.00% on the first \$1 million
0.75% on the next \$4 million
0.50% on the next \$20 million
0.40% on the next \$25 million
0.30% on the next \$50 million
Fees negotiable on amounts in excess of \$100 million

Fixed Income Accounts:

0.50% on the first \$5 million,
0.25% on the amount over \$5 million
Minimum Account Size: \$1 million

Model Account Programs

HCM's percentage of total advisory billings from these Model Account Programs is minimal and the value of assets is not counted in HCM assets under management. As each program is different from the other, HCM fees have been negotiated individually for each program.

Wrap Fee Programs

The programs in which HCM participates and applicable fees received by HCM are as follows:

(1) RBC Dain Rauscher (sponsor) Investment Consulting Services - Managed Account Program: HCM is compensated by sponsor for its advisory services by an annual fee generally equal to .50% - 1.00% of the market value of the assets in each account managed under this program.

(2) UBS Financial Services, Inc. (sponsor) Managed Account Consulting Program: HCM is compensated by sponsor for its advisory services by an annual fee generally equal to .50% - 1.00% of the market value of the assets in each account managed under this program.

Additional information about the above wrap fee programs, services, fees, and conflicts of interest is provided in the Wrap Fee Disclosure Brochure (Form ADV Part 2 Appendix 1) provided by each broker-dealer sponsor.

GENERAL INFORMATION ON FEES

Pricing Practices

HCM will use information provided by the FT Interactive Data as our main pricing source for purposes of valuing client portfolios on a monthly basis, both for fee billing and investment performance calculation purposes. In this regard, the prices reported by HCM may not always match custodial prices, based on the various pricing services. In the rare instance where FT Interactive Data does not price a security, the price is obtained from the client's custodial statement.

Negotiability of Fees

The fee charged is calculated as described above and is not charged on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of a client. The schedule represents the majority of the services offered to HCM clients. However, a fixed fee may be charged for a service provided based on a specific client mandate for which there is not a set fee schedule and is therefore not represented in this brochure. These instances generally are negotiated with the client on a case-by-case basis. Under some circumstances, which HCM considers appropriate, we may waive fees or make special fee arrangements which may vary from the fee schedules above.

In certain cases, based on investment objectives, location, and/or portfolio size, fees may vary among accounts. Most fees are payable quarterly in advance. The quarterly market value of the portfolio will serve as the basis for quarterly fee calculations. Certain accounts, per account contract and/or custodial considerations, are payable quarterly or monthly in arrears. In certain circumstances, fees and account minimums may be negotiable.

Termination

If an investment agreement is terminated prior to the end of a quarter for which a fee has already been paid, HCM will refund a pro-rated amount of such fee based upon the termination date. An investment agreement may generally be terminated at any time by the client or HCM on written notice to the other party. The investment agreement is not assignable by either party.

Custody and Brokerage Expenses

The fees charged by HCM do not include custodial fees or trading costs incurred in buying and selling securities. The client has the ultimate decision on the custodian to be used and the asset mix. HCM does not act as custodian of client assets (but does have authority to deduct advisory fees upon individual client instruction), and HCM fees do not include custodial charges. Also, in most instances, cash is invested in short-term interest bearing instruments and/or funds available through the custodian. A charge may be made by such custodian, which may not be disclosed on the custodian's statement if a commingled or money market mutual fund vehicle is utilized. For a determination of such charges, information or a prospectus may be obtained from the custodian. Any such charges by the custodian would be in addition to fees paid to HCM.

Separate Expenses and Fees

All fees paid to HCM for investment advisory services are separate and distinct from the fees and expenses charged by mutual funds and exchange traded funds (ETFs) to their shareholders. These fees and expenses are described in each fund's prospectus. These fees will generally include a management fee, other fund expenses, and a possible distribution fee for mutual funds. If the mutual fund also imposes sales charges, a client may pay an initial or deferred sales charge.

A client could invest in a mutual fund or ETF directly, without the services of HCM. In that case, the client would not receive the services provided by our firm which are designed, among other things, to assist the client in determining which mutual funds or ETFs are most appropriate to each client's financial condition and objectives.

Accordingly, the client should review both the fees charged by the funds or ETFs and the fees charged by our firm to fully understand the total amount of fees to be paid by the client and to evaluate the advisory services being provided.

Debiting of Advisory Fees

For certain clients that maintain custodian brokerage accounts, HCM, with the written consent of clients, provides such clients and custodian with an invoice for payment of such advisory fee. Each client invoice describes the amount of the advisory fee, the value of the client's assets on which the fee was based and the manner in which the fee was calculated. The custodian deducts, unless a client otherwise instructs the custodian, the advisory fee from the clients' account and remits such amount directly to HCM. At least on a quarterly basis, the custodian sends each client a statement summarizing all amounts disbursed from such client's account during such period, including the amount of such client's advisory fees, if any, paid directly to HCM by the custodian.

Under no circumstances will we earn fees in excess of \$1200 more than six months in advance of services rendered.

Item 6. Performance-Based Fees and Side-By-Side Management

HCM may, as a matter of policy and practice, offer and charge any performance-based fees for its investment management services when appropriate and agreed upon with a qualified client. Currently, HCM has no such fee arrangements.

Our advisory fees are calculated as described above and are not charged on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of an advisory client (Section 205(a)(1) of the Investment Advisers Act of 1940, as amended).

Side-by-side management refers to multiple client relationships where an adviser manages advisory client relationships and portfolios on a simultaneous basis for individuals, businesses, institutions and also mutual funds and/or hedge funds. In such circumstances, potential conflicts of interest may arise by and between the clients and the mutual and hedge funds, e.g., performance fee arrangements.

HCM does not currently manage any hedge funds or mutual funds or have any performance based fee arrangements. Accordingly, HCM does not have any side-by-side potential or actual conflicts of interests other than to the extent investment opportunities may be available and allocated among the various clients. HCM, as a fiduciary to our clients, has adopted allocation policies for the fair and equitable treatment of all clients as more fully described in Item 12 below.

Item 7. Types of Clients

HCM offers and provides these investment supervisory services to individuals, including high net worth individuals, banking institutions, corporations, state and municipal entities, pension and profit sharing plans, trusts, estates, foundations, endowments and charitable organizations, among other institutions. Our firm also participates as sub-adviser in several wrap fee programs sponsored by independent broker-dealer firms and model account programs as described in Item 1.

Item 8. Methods of Analysis, Investment Strategies & Risk of Loss

The first step is to determine the client's individual objectives and circumstances. We probe to understand our client's ability and desire to take investment risk in order to achieve long term returns. This analysis allows us to determine how to allocate the client's portfolio between equity and fixed-income investments. There is more to constructing investment portfolios than simply selecting stocks and bonds. We seek to combine securities that respond to different market forces in order to dampen the volatility of our results. For those clients who have chosen us to manage balanced portfolios, we constantly assess the weighting of equity and fixed income investments to ensure that the allocation mix appropriately and accurately reflects their needs.

Equity Strategy: Growth and Income

Our primary objective for our clients' equity investments is to realize an attractive total return from a well-diversified multi-cap portfolio of stocks managed using a growth and income strategy. Key elements of our stock selection strategy are: We are value driven, meaning we purchase shares in companies when they are trading at what we believe to be a significant discount to the company's underlying value. We seek to reduce risk by emphasizing fundamental analysis and by investing in companies with ample balance sheets and free cash flow. We look for positive future change in investment expectations by investing in shares when expectations are low.

Our Fixed Income Philosophy

We use fixed income securities to build portfolios that provide clients with more income and less volatility than those constructed solely of common stocks. For some of our clients, these objectives are paramount and we manage portfolios that consist entirely of fixed-income instruments. Our primary objectives for fixed-income portfolios are: To preserve capital, to maximize cash flow, and to earn a real (inflation-adjusted) rate of return over a full interest rate cycle.

Balanced Portfolios

While most of our clients seek to grow their capital for the future, they are also concerned about income and stability. As a result, for a majority of our clients we manage balanced portfolios that blend our disciplined equity selections with fixed income securities. We focus considerable attention on asset allocation in managing balanced portfolios. While we recognize that stocks generally outperform bonds over the long term, we utilize bonds and cash to reduce downside risk, as well as to meet client income requirements.

Fundamental Analysis

Our firm generally employs fundamental analysis methods to formulate client recommendations. Fundamental analysis of a business involves analyzing its income statement, financial statements and health, its management and competitive advantages, and its competitors and markets. Fundamental analysis school of thought maintains that markets may mis-price a security in the short run but that the "correct" price will eventually be reached. Profits can be made by trading the mis-priced security and then waiting for the market to recognize its "mistake" and re-price the security. However, unforeseen market conditions and/or company developments may result in significant price fluctuations that can lead to investor losses.

Occasionally, we use technical analysis which seeks to identify price patterns and trends in financial markets and attempt to exploit those patterns. We follow and examine such indicators as price, volume, moving averages of the price and market sentiment. Since technical analysis predictions are only extrapolations from historical price patterns, investors bear risk that these patterns will not reoccur as expected.

Quantitative analysis

We use mathematical models in an attempt to obtain more accurate measurements of a company's quantifiable data, such as the value of a share price or earnings per share, and predict changes to that data.

A risk in using quantitative analysis is that the models used may be based on assumptions that prove to be incorrect.

Qualitative analysis

We subjectively evaluate non-quantifiable factors such as quality of management, labor relations, and strength of research and development factors not readily subject to measurement, and predict changes to share price based on that data.

A risk in using qualitative analysis is that our subjective judgment may prove incorrect.

Asset Allocation

Rather than focusing primarily on securities selection, we attempt to identify an appropriate ratio of securities, fixed income, and cash suitable to the client's investment goals and risk tolerance.

A risk of asset allocation is that the client may not participate in sharp increases in a particular security, industry or market sector. Another risk is that the ratio of securities, fixed income, and cash will change over time due to stock and market movements and, if not corrected, will no longer be appropriate for the client's goals.

Mutual fund and/or ETF analysis

We look at the experience and track record of the manager of the mutual fund or ETF in an attempt to determine if that manager has demonstrated an ability to invest over a period of time and in different economic conditions. We also look at the underlying assets in a mutual fund or ETF in an attempt to determine if there is significant overlap in the underlying investments held in other funds in the client's portfolio. We also monitor the funds or ETFs in an attempt to determine if they are continuing to follow their stated investment strategy.

A risk of mutual fund and/or ETF analysis is that, as in all securities investments, past performance does not guarantee future results. A manager who has been successful may not be able to continue or replicate that success in the future. In addition, as we do not control the underlying investments in a fund or ETF, managers of different funds held by the client may purchase the same security, increasing the risk to the client if that security were to fall in value. There is also a risk that a manager may deviate from the stated investment mandate or strategy of the fund or ETF, which could make the fund or ETF less appropriate for the client's portfolio.

Risks for all forms of analysis

Our securities analysis methods rely on the assumption that the companies whose securities we recommend, purchase and sell, the rating agencies that review these securities, and other publicly available sources of information about these securities, are providing accurate and unbiased data. While we are aware that indications, reporting or data may be incorrect, there is always a risk that our analysis may be compromised by inaccurate or misleading information.

Item 9. Disciplinary Information

Our firm, its principals and associated persons have no disciplinary or regulatory events that are required to be disclosed.

Item 10. Other Financial Industry Activities and Affiliations

Luther King Capital Management Corporation

Luther King Capital Management Corporation (“LKCM”), a registered investment management firm based in Fort Worth Texas, is the majority shareholder of HCM. LKCM has other industry activities and affiliations as summarized below.

LKCM Affiliates

LKCM has various related persons under common control and ownership, including registered investment companies and entities, which serve as the sponsor, general partner, managing member (or equivalent) of various private investment funds for which LKCM serves as investment manager.

Specific additional information about LKCM’s related persons and private investment funds is disclosed in LKCM’s Form ADV available on the SEC’s website at www.adviserinfo.sec.gov.

Additional Compensation

The investment professionals of HCM have no other financial affiliations or activities and devote all their time and efforts to the investment activities of Hester Capital and the firm’s clients. These individuals receive no additional compensation from any outside entities or affiliations.

Item 11. Code of Ethics, Participation in Client Transactions and Personal Trading

Code of Ethics

HCM's employees may at times own securities that are also owned by HCM's clients. HCM's employees may also at times own securities that are similar to or different from those owned by or recommended to HCM's clients. However, the purchase and sale of securities by employees must comply with HCM's Policy on Personal Securities Transactions, which is subject to certain restrictions and which includes pre-approval authorization for certain securities transactions in addition to quarterly and annual reporting and monitoring of transactions.

A copy of HCM's Code of Ethics, is available upon request. The intents of our Code and Policy on Personal Securities Transactions are to prevent an "access person" (those authorized for access to client information) with the firm from knowingly benefiting in his or her personal investments from his or her position with the firm or to make personal investment decisions based on the investment decision of advisory clients. One of the founding principles of HCM is always putting our clients' interest first. This is particularly true in the area of personal investment transactions.

HCM has adopted a Code of Ethics reflecting the firm's commitment to ethical and honest conduct. At all times HCM and its associates will comply with the HCM Code of Ethics. The Code is designed to ensure that the high ethical standards long maintained by HCM continue to be applied. The purpose of the Code is to preclude activities which may lead to or give the appearance of conflicts of interest, insider trading, and other forms of prohibited or unethical business conduct. HCM requires that all individuals must act in accordance with all applicable Federal and State regulations governing registered investment advisory practices.

HCM's Code of Ethics further includes the firm's policy prohibiting the use of material non-public information. Any individual not in observance of the above may be subject to disciplinary action, including termination of employment with HCM.

A copy of HCM's Code of Ethics is available upon written request to HCM.

Additional Conflicts of Interest

HCM seeks to avoid conflicts of interest but makes best efforts to disclose instances in which potential conflicts of interest could arise:

- * While HCM and LKCM are both registered investment management firms, and LKCM has become the majority owner of HCM, currently there are no referral arrangements between the two firms for compensating either firm for introducing clients or prospective clients to the other firm.

Further, HCM currently does not recommend or solicit potential investors for any of the LKCM private funds.

- * HCM has been hired as Investment Adviser for some of its directors and for friends and relatives of some of its employees. This could present a potential conflict in favoring these accounts over others managed by HCM. Trade aggregation and allocation procedures have been put in place to address this potential conflict.
- * At HCM, one of our core values is to reinvest in our communities. In this regard, HCM makes contributions to non-profit entities, some of which are clients of HCM. This could present a potential conflict in contributing to clients

to retain their business. The firm will not make contributions that might influence the recipient in business transactions involving HCM.

As these situations present a conflict of interest, HCM has established various additional policies in order to ensure its fiduciary responsibilities.

It is the policy of our firm that no person may purchase or sell any security prior to a transaction(s) being implemented for an advisory account, thereby preventing any employees from benefiting from transactions placed on behalf of advisory accounts.

1. No principal or employee of our firm may buy or sell securities for their personal portfolio(s) where their decision is substantially derived, in whole or in part, by reason of his or her employment unless the information is also available to the investing public on reasonable inquiry. No principal or employee of our firm may prefer his or her own interest to that of the advisory client.
2. We maintain records of securities transactions and holdings for our firm and anyone associated with this advisory practice with access to advisory recommendations. These holdings are reviewed on a regular basis by the firm's Chief Compliance Officer.
3. We emphasize the unrestricted right of the client to decline to implement any advice rendered.
4. All of our principals and employees must act in accordance with all applicable Federal and State regulations governing registered investment advisory practices.
5. Any individual not in observance of the above may be subject to termination.

Item 12. Brokerage Practices

Selection of Broker-Dealers

Our firm endeavors to select those brokers or dealers which will provide the best services at the lowest commission rates possible. The reasonableness of commissions is based on the broker's stability, reputation, ability to provide professional services, competitive commission rates and prices, research, trading platform, and other services which will help our firm in providing investment management services to clients.

Generally, HCM determines the brokerage firm where security transactions are executed. HCM has a Brokerage Execution and Soft Dollar Committee that meets semi-annually to review performance of approved broker-dealers and analysis of best execution efforts. The determination of a broker-dealer is based on several factors:

- * where the best execution is likely to be obtained; this is a function of past experience with individual firms, particular brokers and traders, and the securities in question;

- * a brokerage firm's research and investment ideas that directly impact clients' portfolios;
- * price (the amount of commission paid): trades may be negotiated based on special services received over and above execution of the trade;
- * the responsiveness and operational aspects of brokerage firm's back office; and
- * in certain cases clients may direct brokerage to a dealer of their choice

Research, Brokerage Services and Soft Dollars

HCM as a matter of policy does obtain research and other brokerage services on a soft dollar commission basis subject to Section 28(e) of the Securities Exchange Act of 1934. In this regard, client commission dollars are used to purchase research products or services over and above the implied cost of execution. Research includes information, products, and services that assist the portfolio manager in the decision-making process as it relates to client portfolios and accounts. This may consist of, among other things, information concerning the market; economic and financial data; statistical information; analyses concerning specific securities, companies, industries, or sectors; and market, economic and financial studies and forecasts. Research may be obtained in written, oral or electronic form.

Because of the above considerations, HCM may use a client commission to pay a brokerage commission in excess of that which another broker might have charged for effecting the same transaction in recognition of the value of brokerage or research services provided by the broker. This higher commission in excess of the cost of execution is referred to as "soft dollars." Research services furnished by brokers that HCM effects securities transactions through may be used in servicing all of HCM's accounts (and not necessarily just the clients whose commissions are used for the research). Accordingly, not all clients may pay for research on each trade but all may benefit from it.

HCM may establish soft dollar arrangements with certain brokers. This may create an inherent conflict of interest in the use of client commissions over and above the cost of execution. To address this conflict of interest, HCM's Brokerage Execution and Soft Dollar Committee monitors best execution activity on a quarterly basis as outlined above and makes a good faith determination of the value of the research product or services in relation to the commissions paid.

All of these research services are used exclusively in providing investment advice to our clients. HCM utilizes such soft dollar research services in providing investment advisory advice to its clients without regard to the particular securities transactions providing such research services.

Brokerage firms that HCM selects to execute transactions occasionally may refer clients to our firm. In the event of any such referrals, we will not make commitments to any brokerage firm for brokerage transactions for client referrals; however, a conflict of interest arises between the client's interest in obtaining best price and execution and HCM's interest in receiving future referrals.

Wrap Fee Programs

For participants in wrap fee programs, clients should recognize that brokerage commissions for the execution of transactions in the client's account are not negotiated by HCM. Transactions are effected "net," i.e., without commission, and a portion of the wrap fee is generally considered as being in lieu of commissions. Trades are generally expected to be executed only with the broker dealer with which the client has entered into the wrap fee arrangement, so that HCM may not be able to seek best price and execution by placing transactions with other broker dealers. Additionally, wrap accounts may be traded after discretionary accounts.

Accordingly, the client may wish to satisfy itself that the broker dealer offering the "wrap fee" arrangement can provide adequate price and execution for most or all transactions. The client should also consider that, depending upon the level of the wrap fee charged by the broker dealer, the amount of portfolio activity in the client's account, the value of custodial and other services which are provided under the arrangement, and other factors, the wrap fee may or may not exceed the aggregate cost of such services if they were to be provided separately and if HCM were able to negotiate commissions and seek best price and execution of transactions for the client's account. In wrap fee accounts, HCM requires the client to execute an investment agreement with HCM.

Model Account Programs

For our Model Account Programs a potential conflict of interest exists regarding the trading of securities in HCM client accounts if trades are communicated to the programs on the same day that HCM is purchasing or selling securities. To minimize this potential conflict of interest, HCM does not submit portfolio change notifications to the model sponsors before client account trades have commenced. The timing of notifications and recommendations to sponsors may disadvantage participants in those programs to the limited extent that the entry of orders by the sponsors, if placed, would be after the transactions entered by HCM for its clients.

Schwab Institutional

HCM may recommend that clients establish brokerage accounts with the Schwab Institutional division of Charles Schwab & Co., Inc. (Schwab), a registered broker-dealer, member SIPC, to maintain custody of clients' assets and to effect trades for their accounts. HCM is independently owned and operated and not affiliated with Schwab. Schwab provides HCM with access to its institutional trading and custody services, which are typically not available to Schwab retail investors.

These services generally are available to independent investment advisors on an unsolicited basis, at no charge to them so long as a total of at least \$10 million of the HCM's clients' assets is maintained in accounts at Schwab Institutional and is not otherwise contingent upon HCM committing to Schwab any specific amount of business (assets in custody or trading). Schwab's services include brokerage, custody, research, and access to mutual funds and other investments that are otherwise generally available only to institutional investors or would require a significantly higher minimum initial investment.

For HCM's client accounts maintained in its custody, Schwab generally does not charge separately for custody but is compensated by account holders through commissions or other transaction-related fees for securities trades that are executed through Schwab or that settle into Schwab accounts.

Schwab also makes available to HCM other products and services that benefit HCM but may not benefit its clients' accounts. Some of these other products and services assist HCM in managing and administering clients' accounts. These include software and other technology that provide access to client account data (such as trade confirmations and account statements); facilitate trade execution (and allocation of aggregated trade orders for multiple client accounts); provide research, pricing information and other market data; facilitate payment of HCM's fees from its clients' accounts; and assist with back-office functions, recordkeeping and client reporting. Many of these services generally may be used to service all or a substantial number of HCM's accounts, including accounts not maintained at Schwab Institutional. Schwab Institutional also makes available to HCM other services intended to help HCM manage and further develop its business enterprise. These services may include consulting, publications and conferences on practice management, information technology, business succession, regulatory compliance, and marketing. In addition, Schwab may make available, arrange and/or pay for these types of services rendered to HCM by independent third parties. Schwab Institutional may discount or waive fees it would otherwise charge for some of these services or pay all or a part of the fees of a third-party providing these services to HCM. While as a fiduciary, HCM endeavors to act in its clients' best interests, and HCM's recommendation that clients maintain their assets in accounts at Schwab may be based in part on the benefit to HCM of the availability of some of the foregoing products and services and not solely on the nature, cost or quality of custody and brokerage services provided by Schwab, which may create a potential conflict of interest.

Directed Brokerage

HCM will place orders with brokerage firms pursuant to directions received from clients ("broker-dealer directed accounts"), including situations in which HCM has suggested or introduced clients to brokers. In broker-dealer directed accounts, it is the sole responsibility of the client, not HCM, to negotiate the commission rates. Clients should recognize that they may pay a higher brokerage commission or receive less favorable execution than might otherwise be possible.

Clients should also be aware of HCM's lack of authority to negotiate commissions, obtain volume discounts, and that best execution may not be achieved for broker-dealer directed accounts. Clients should also be aware that disparities in commission charges may exist between the commissions charged to other clients, or greater spreads or less favorable net prices for similar trades in various accounts, and that there is a potential conflict of interest on the part of HCM arising from the described referrals and directed brokerage practices. Additionally, directed brokerage accounts may be traded after discretionary accounts.

HCM receives no cash benefit, including commissions, from any non-client in connection with giving advice to clients. However, HCM has clients custodied at Schwab Institutional Services that may provide us with economic benefits not available to us otherwise, including but not limited to, electronic trading capabilities, bundled statements, access to compliance information/seminars and deduction of advisory fees when authorized by the client.

Aggregation

HCM aggregates trades for clients' portfolios when appropriate. This blocking of trades permits the trading of aggregate blocks of securities composed of assets from multiple client accounts. This aggregation is done in an effort to improve the timeliness and efficiency and to reduce the overall cost of trade execution for client portfolios. Client transactions that are aggregated receive an average share price and pro-rata share of commission costs. In circumstances where only a portion of the total order is executed, HCM utilizes the pro-rata allocation method. No employee personal security trades will ever be included in any client blocks.

Allocation of Investment Opportunities

As a matter of policy, HCM seeks to allocate investment opportunities and transactions on a fair and equitable basis for all clients over time and to not favor certain clients over others. In the unlikely event that limited investment opportunities or transactions would need to be allocated among advisory clients, we would allocate the investments or transactions fairly and equitably and typically on a pro-rata basis.

Principal and Agency Cross Transactions

As a matter of HCM policy and procedures, our firm does not engage in any principal trading or agency cross transactions on behalf of HCM or any of our firm affiliates for any advisory clients.

Trade Errors

HCM has adopted a policy and procedures for identifying and correcting any trade errors as promptly as possible. In the event a trade error occurs which is HCM's responsibility, any affected clients will not incur any loss as a result of the error and may benefit from any gain attributable to the error.

Item 13. Review of Accounts & Reports to Clients

Reviews of Accounts

Institutional and Individual Clients

The portfolio manager responsible for the client relationship reviews and monitors each managed account on a regular, periodic and continuing basis.

More frequent reviews may be triggered by changes in market, political or economic conditions, or a client's request.

Model Account Programs

For these programs, HCM will only recommend the securities to be held and the weighting of those securities based on an equity model portfolio.

The portfolio manager responsible for the model account reviews and monitors the underlying portfolio securities and weighting thereof on a regular, periodic and continuing basis.

The sponsors of the programs have the sole responsibility of investment discretion over client assets, client suitability for the programs, and monitoring changes in the client's financial situation or individual needs.

Wrap Fee Programs

The portfolio manager responsible for the client relationship reviews and monitors the wrap account on a regular, periodic and continuing basis.

More frequent reviews may be triggered by changes in market, political or economic conditions, or a client's request.

Reports to Clients

Institutional and Individual Clients

HCM provides its advisory clients with periodic reports that review the recent market and economic environment and outlook, as well as the investment strategy for the client's account and performance. HCM provides quarterly an investment summary and detail as well as a purchase and sale report outlining the activity in the account. Clients also receive monthly custodial statements reflecting activity and portfolio positions and confirmations of transactions.

Model Account Programs

For the Model Account Programs, clients participating in these programs will receive statements from the sponsoring firm and custodian. HCM does not provide any separate reports to participants in these programs.

Wrap Fee Programs

For Wrap Fee Programs, clients receive statements of holdings and activity from the wrap fee program sponsor as well as the quarterly reports as detailed above.

Clients will receive quarterly statements from HCM and should carefully review each statement. In order to ensure that all account transactions, holdings and values are correct and current, we urge clients to compare our firm's statements with the statements you receive directly from your independent brokerage or bank qualified custodian.

Item 14. Client Referrals

While HCM and LKCM are both registered investment management firms, and LKCM has become the majority owner of HCM, currently there are no referral arrangements between the two firms for compensating either firm for introducing clients or prospective clients to the other firm.

Further, HCM currently does not recommend or solicit potential investors for any of the LKCM private funds.

Schwab Advisor Network

HCM receives client referrals from Charles Schwab & Co., Inc. ("Schwab") through HCM's participation in Schwab Advisor Network ("the Service"). The Service is designed to help investors find an independent investment advisor. Schwab is a broker-dealer independent of and unaffiliated with HCM. Schwab does not supervise HCM and has no responsibility for HCM's management of clients' portfolios or HCM's other advice or services.

HCM pays Schwab fees to receive client referrals through the Service. HCM's participation in the Service may raise potential conflicts of interest described as follows: HCM pays Schwab a Participation Fee on all referred clients' accounts that are maintained in custody at Schwab and a Non-Schwab Custody Fee on all accounts that are maintained at, or transferred to, another custodian. The Participation Fee paid by HCM is a percentage of the value of the assets in the client's account. HCM pays Schwab the Participation Fee for so long as the referred client's account remains in custody at Schwab.

The Participation Fee is billed to HCM quarterly and may be increased, decreased, or waived by Schwab from time to time. The Participation Fee is paid by HCM and not by the client. HCM has agreed not to charge clients referred through the Service fees or costs greater than the fees or costs HCM charges clients with similar portfolios who were not referred through the Service.

HCM generally pays Schwab a Non-Schwab Custody Fee if custody of a referred client's account is not maintained by, or assets in the account are transferred from, Schwab. This fee does not apply if the client was solely responsible for the decision not to maintain custody at Schwab. The Non-Schwab Custody Fee is a one-time payment equal to a percentage of the assets placed with a custodian other than Schwab. The Non-Schwab Custody Fee is higher than the Participation Fees HCM generally would pay in a single year. Thus, HCM will have an incentive to recommend that client accounts be held in custody at Schwab.

The Participation and Non-Schwab Custody Fees will be based on assets in accounts of HCM's clients who were referred by Schwab and those referred clients' family members living in the same household. Thus, HCM will have incentives to encourage household members of clients referred through the Service to maintain custody of their accounts and execute transactions at Schwab and to instruct Schwab to debit HCM's fees directly from the accounts.

For accounts of HCM's clients maintained in custody at Schwab, Schwab will not charge the client separately for custody but will receive compensation from HCM's clients in the form of commissions or other transaction-related compensation on securities trades executed through Schwab. Schwab also will receive a fee (generally lower than the applicable commission on trades it executes) for clearance and settlement of trades executed through broker-dealers other than Schwab.

Schwab's fees for trades executed at other broker-dealers are in addition to the other broker-dealers' fees. Thus, HCM may have an incentive to cause trades to be executed through Schwab rather than another broker-dealer in an effort to reduce client transactions charges for trades done away from Schwab. HCM nevertheless, acknowledges its duty to seek best execution of trades for client accounts.

Trades for client accounts held in custody at Schwab may be executed through a different broker-dealer than trades for HCM's other clients. Thus, trades for accounts custodied at Schwab may be executed at different times and different prices than trades for other accounts that are executed at other broker-dealers.

Item 15. Custody

HCM is deemed to have “constructive custody” under regulatory guidelines as a result of HCM’s authority from certain clients for our firm to directly debit client advisory fees from their custodian accounts consistent with industry practices and regulatory guidelines.

Clients will receive monthly/quarterly statements from HCM and should carefully review each statement. In order to ensure that all account transactions, holdings and values are correct and current, we urge clients to compare our firm’s statements with the statements you receive directly from your independent brokerage or bank qualified custodian.

Item 16. Investment Discretion

HCM has the authority to determine the securities to be bought and sold without obtaining specific client consent, unless a client of HCM specifically requests that certain securities of corporations not be purchased in their accounts; e.g. no tobacco stocks. Certain clients have put restrictions on their accounts, such as retaining a particular security and/or tax considerations involving taxable accounts. In accounts with such restrictions, performance may be dissimilar to performance of HCM composite performance. Any limitations on our firm’s discretionary authority are to be provided by the client in writing, and any change or amendments of any investment restrictions or limitations are also to be provided by the client in writing.

HCM also has the authority to determine the amount of the securities to be bought or sold without obtaining specific client consent, subject to the restrictions outlined above. HCM will adhere to prudent diversification principles.

Item 17. Voting Client Securities

Proxy Voting

HCM has proxy voting responsibility for many client relationships. HCM has engaged RiskMetrics Group ISS Governance Services, (RiskMetrics/ISS), an independent and national proxy services firm, for proxy research, administration, voting and recordkeeping services. HCM recognizes that corporate governance and shareholder proposals can directly affect shareholder values. The purpose of the Proxy Voting Policy is to ensure that HCM client proxies are voted in the best interest of HCM clients so as to maximize portfolio values over time.

HCM has adopted the RiskMetrics/ISS U.S. Proxy Voting Guidelines and oversees RiskMetrics ISS voting of proxies for HCM's clients. HCM retains final authority and fiduciary responsibility for proxy voting. Matters may be reviewed individually on a case-by-case basis based on the recommendations of the proxy service that HCM has retained.

In those instances where client portfolio securities represent de minimis holdings, e.g. several hundred shares, proxies for such positions will be voted according to the RiskMetrics/ISS recommendations.

A complete copy of HCM's Proxy Voting Policy is available upon request. Additionally, HCM maintains records of proxy voting and will furnish its proxy voting record regarding a client's securities if so requested by the client.

Legal Proceedings

HCM, as a matter of policy and practice, may not provide legal advice or advice or act on behalf of clients for any legal proceedings, including class actions, bankruptcies or other proceedings, involving companies whose securities are held or previously held in client portfolios.

Item 18. Financial Information

As a matter of firm policy and practice, our firm will not charge or earn advisory fees in excess of \$1,200 more than six months in advance of the services rendered.

Also, our firm and its principal have no financial events or proceedings to disclose.