

## **FIRM BROCHURE**

**June 21, 2012**



### **SFE Investment Counsel Inc.**

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This brochure provides information about the qualifications and business practices of SFE Investment Counsel Inc. (SFE). If you have any questions about the contents of this brochure, please contact us at (213) 612-0220 or [tmccasland@sfeic.com](mailto:tmccasland@sfeic.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (SEC) or by any state securities authority. Additional information about SFE also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

Please note that the use of the term "registered investment adviser" and description of SFE as "registered" does not imply a certain level of skill or training. You are encouraged to review this brochure and brochure supplements for information on the qualifications of our firm and its employees.

## Item 2 – Material Changes

Under SEC rules that became effective in 2011, registered investment advisers like SFE have new requirements as to how we provide disclosure information about our firm. This brochure contains important information about SFE for current and prospective clients. It is prepared as instructed by the SEC in Part 2 of Form ADV.

In the future, if our brochure is amended and it contains material changes from our last annual update, we will identify and discuss those changes in this section.

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## Item 4 – Advisory Business

### ***Firm Description***

**SFE Investment Counsel (SFE)** is an independent investment advisory firm located in downtown Los Angeles. We have been providing investment advice and portfolio management services to individuals, families, trusts, charitable organizations, retirement plans, businesses and institutional investors since 1977. SFE is a California corporation and operates as an SEC Registered Investment Advisor (RIA). Our sister company, Stern Fisher Edwards Inc, is a FINRA/SIPC member broker-dealer.

SFE is an experienced, capable money management firm that is 100% employee-owned. Our investment professionals average over 20 years industry experience and more than 16 years tenure with the firm. SFE is financially sound, profitable and claims compliance with the Global Investment Performance Standards (GIPS). Our team approach and long-term transition plan provide continuity and stability for our clients.

### **Principal Owner**

SFE is owned by eight employees. Jon M. Kmett, president of SFE, is the only principal owner with more than 25 percent.

### ***Advisory Services***

SFE specializes in offering investment supervisory services with a personal touch. We provide investment advice to clients, and make investments for clients, based upon the individual needs of the client. These needs include the nature of other client assets and their personal and family obligations. We design and execute strategies to meet client financial objectives and actively manage the investment portfolio within those guidelines. We emphasize continuous and regular account supervision with some incidental planning and consultations.

A successful financial strategy often requires a team of trusted advisors including accountants, attorneys, administrators, and consultants, working in concert on behalf of the client. Client priorities and relationships determine which of these leads the effort. SFE has extensive experience in this collaborative model. We often take the lead role – managing all of the client's assets and coordinating with other trusted professionals. In the institutional market, SFE is comfortable in a supporting role – managing a portfolio in accordance with a specific mandate.

SFE's investment philosophy is founded upon our belief that asset allocation is the single most important determinant of portfolio performance. Accordingly, we adjust equities, fixed income, and cash positions in response to market and economic conditions to fulfill client objectives. Generally we are not market timers and prefer to invest for the long term. Through our disciplined investment approach, SFE seeks to produce equity returns that consistently outperform the S&P 500 Index while taking less-than-market risk. We strive to preserve capital and achieve long term appreciation by employing an opportunistic, total return approach to managing client accounts.

For equity investments, we seek companies of quality and value – the best in their fields. SFE focuses on companies that have established a competitive advantage in their industries, and/or have strong global franchises and generate significant revenue from their international operations.

To aid in our selections, we subscribe to many sources of independent research and perform our own fundamental and technical security analysis. Many of our equity selections are chosen for their dividend yield to enhance total return.

Fixed income allocations are primarily comprised of investment grade United States (US) government and agency securities, corporate bonds, exchange traded funds (ETFs), and tax-exempt municipal bonds (as appropriate), with maturities ranging from 2-10 years. These allocations typically reduce portfolio volatility and risk. Maturities are adjusted as needed to capture the sweet spot on the yield curve. Selected securities will be readily marketable and diversified by issuer.

SFE's core strength is the management of concentrated portfolios of US equities, frequently with a fixed income allocation. Portfolios are customized to meet specific client objectives. We typically construct a portfolio of 20-25 equity positions from our "*Merit Monitor*". The Merit Monitor is a list of stocks that have been approved for purchase by the SFE Investment Committee. This committee, comprised of SFE investment-adviser owners, meets regularly to review and update the list. As part of its asset allocation target, a portfolio may consist of individual stocks, bonds, ETFs, mutual funds, bank deposit programs and other public and private securities or investments.

SFE provides four types of advisory services more fully described below: separately managed accounts; dual-contract relationships; model portfolio services; and third party separate account manager programs.

### ***Separately Managed Account (SMA)***

SFE offers the following management service for its separately managed client accounts:

Our traditional *Investment Management Agreement* features a full range of investment supervisory services. We charge a fee based upon a percentage of assets under management. Custody of client assets is usually maintained and transactions executed through our affiliate broker-dealer Stern Fisher Edwards Inc and its clearing firm (National Financial Services LLC), through which transaction commissions are discounted. Clients may select other custodians or broker-dealers to effect transactions on their behalf. SFE will not be able to negotiate commission rates for client brokerage directed elsewhere.

SFE provides an SMA program for qualifying accounts through our *All Inclusive Investment Management Agreement*. This agreement allows SFE to provide investment supervisory services under a "wrap fee" arrangement. SFE will utilize Stern Fisher Edwards Inc to execute client transactions without commission charges, and provide custodial services through its clearing firm National Financial Services LLC. These services are provided for a single asset-based fee. Please see SFE's *All Inclusive Investment Management Wrap Fee Program Brochure* for further information on this wrap fee program.

For SMAs, the client's individual investment strategy is tailored to their specific needs and may include some or all of the security types mentioned above. Each portfolio will be initially designed to meet particular investment goals, which we determine to be suitable to the client's circumstances. Once the appropriate portfolio has been created, our portfolio management team strives to review the portfolio twice each quarter, and if necessary, rebalances the portfolio based upon the client's individual needs, stated goals and objectives.

As part of our SMA service, SFE evaluates each client's financial condition and risk tolerance in order to tailor its asset allocation and securities recommendations to meet the client's investment objectives and individual needs. Before specific recommendations are made about allocating assets or selecting which securities to buy or sell, an SFE client manager conducts an initial consultation with the prospective client. During this free consultation, we will ask the client about his or her investment goals, financial condition and risk tolerance. We then make an initial recommendation to the client and solicit client feedback. Any necessary changes are made. Once satisfied, the client will sign an SFE management agreement, which serves as the contract between the client and SFE, specifying the precise nature of services to be rendered by SFE and fees to be paid by the client. Each client has the opportunity to place reasonable restrictions on the types of investments to be held in the portfolio.

Our wrap fee and traditional fee SMAs are managed on an individualized basis according to the client's investment objectives, financial condition and risk tolerance. We do not manage wrap fee accounts in a different fashion than our traditional managed (non-wrap fee) accounts. As further described in our All Inclusive Investment Management Wrap Fee Program Brochure, we receive a portion of the wrap fee for our services.

The All Inclusive Managed Account ("Program") is a comprehensive investment advisory program sponsored by SFE. The Program fee is an asset-based fee that includes the management fee paid to SFE for its services as portfolio manager as well as compensation paid to Stern Fisher Edwards Inc for its custody (through clearing firms) and brokerage services.

### ***Dual-Contract Relationship***

SFE may also be retained by other RIAs to provide investment advisory services under a dual-contract relationship. These services primarily consist of portfolio management for assets of the clients of these RIAs and are not considered investment supervisory services. SFE will have exclusive authority to direct and manage the investment and reinvestment of all client assets on a fully discretionary basis, based upon client information and investment objectives as provided by the RIAs. Such discretionary authority shall include, without limitation, the right to purchase, sell, exchange and engage in other transactions with respect to all client assets under management. We will not have authority to select a custodian or negotiate commissions. These clients do not have access to the same level of personal service as clients who invest directly with SFE.

Further description of the programs, fees and services available will be provided to clients upon receipt and review of the RIA's disclosure brochures, investment management agreements, and account opening documents. Clients will sign an advisory agreement with the RIA and a discretionary portfolio management agreement with SFE.

### ***Model Portfolio Service***

SFE designs and manages model portfolios that are available to other advisor firms and investment professionals through select technology platforms. These model portfolios present specific investment strategies for turn-key use by subscribers on behalf of their clients. SFE is engaged and compensated through contractual agreements with the platform providers. Fees are calculated at a negotiated rate and remitted quarterly to SFE by the providers based upon their determination

of the aggregate market value of assets utilizing the strategies through their platforms. These clients do not have access to the same level of personal service as clients who invest directly with SFE.

### ***Third Party Separate Account Manager Program***

Our firm participates as a separate account manager in various access ("SAM Program") offered by certain third party retail and institutional advisers. Under such programs, the third party adviser enters into an account agreement with the SAM Program client. As part of the account agreement, the SAM Program client authorizes SFE to provide investment portfolio management services to the client on a discretionary basis.

Under the terms of a SAM Program, the third party adviser representative determines the suitability of SFE's investment strategies for the client. The adviser also provides custodial, brokerage, reporting, performance review and related services to SAM Program clients.

Once we accept a SAM Program client, the third party adviser will forward a copy of the program client's account agreement to us. This agreement includes suitability information and client account information. The adviser provides us with electronic access to view the program client's account holdings, values and transactions. We will manage such accounts according to the SFE investment strategies that have been approved by the adviser under the terms of the SAM Program. SFE also provides proxy voting where authority has been granted.

The third party adviser pays SFE for the portfolio management services we provide to SAM Program clients. Our fees are calculated by the adviser and paid to us monthly in arrears. Fees are calculated as a percentage of the total assets managed by SFE under the program and vary depending upon the amount of assets. Our minimum client account size for third party separate account programs is \$100,000.

A SAM Program client may terminate our designation as separate account manager at any time by written notice to the third party adviser. SFE may terminate our relationship with the client upon thirty (30) days' notice to the adviser.

### ***Client Assets***

SFE manages \$193,000,000 on a discretionary basis and \$28,900,000 on a non-discretionary basis as of September 30, 2011.

## Item 5 – Fees and Compensation

### ***SMA Advisory Fees***

SFE primarily offers investment advisory services to separately managed accounts for a fee based upon a percentage of assets under management. This fee is negotiable. Annualized rates are as follows:

<u>Account Assets</u>	<u>Traditional Managed Account</u>	<u>All Inclusive Managed Account</u>
First \$5 million	1.000%	1.50%
Next \$5 million	0.750%	1.25%
Next \$10 million	0.500%	1.00%
Over \$20 million	0.375%	0.75%

Fees for assets valued at less than one million dollars may differ from the above schedule and are determined by mutual agreement with the client.

### ***Other Advisory Fees***

SFE receives compensation for portfolio management services under a *Dual-Contract Relationship* pursuant to separate agreements with both the RIAs and their clients. SFE charges a quarterly management fee calculated as a percentage of the market value of such assets under management, as described in the Investment Management Agreement with client. The annualized rate is 0.50%, subject to a minimum annual fee of \$500. This fee is negotiable in select circumstances. Clients will compensate RIAs for both advisory and brokerage services provided by the RIAs and portfolio management services provided to them by SFE. As compensation for SFE's services, RIAs shall pay directly to SFE the amount of fees invoiced by SFE quarterly in advance as calculated based upon aggregate market value of client assets.

For our *Model Portfolio Service*, fees are negotiated separately with each platform provider. Fees are remitted quarterly to SFE by the providers based upon negotiated rates and their determination of the aggregate market value of assets utilizing the strategies through their platforms.

### ***Billing Practices***

Under our SMA program management agreements, fees are automatically deducted from client assets each quarter in advance. Fees are withdrawn from the managed account, or another designated account, and paid to us by the client's custodian. As part of this process, you understand and acknowledge the following:

- a) Your custodian sends statements to you at least quarterly that show all disbursements from your account, including the amount of the advisory fees paid to us; and
- b) You provide authorization that permits us to be directly paid by these terms.



Services provided under a dual-contract relationship are billed directly for fees incurred in advance. In certain limited circumstances, SMA clients may also be billed directly. Fees are calculated at the end of each calendar quarter as a percentage of the market value of the assets under management. Assets that are received into an account prior to a quarter billing date may be charged a pro-rata fee in arrears based upon value of assets at time of receipt. Such fees are included with the next quarterly billing. SFE's fees are billed and deducted from accounts quarterly, usually within 30 days following quarter end.

Fees are billed and payable quarterly in advance according to the investment management agreement. In the event that you wish to terminate our services before the end of a billing period, you must notify us, preferably in writing, 30 days beforehand. SFE would provide clients with 30 days' notice to move or liquidate their account in the event SFE decides to terminate its relationship with the client. Any advisory fee paid in advance will be pro-rated to the date of termination and any balance will be promptly refunded to you.

### ***Other Fees and Expenses***

Clients in our traditional managed account program will incur both brokerage commissions and other fees for securities transactions executed in their accounts. Clients in our wrap fee program incur other transaction fees as more fully described in our All Inclusive Investment Management Program Brochure, which are in addition to our advisory fees. Any transaction fees will be disclosed by your custodian on trade confirmations. Please refer to the information on our brokerage practices provided in Item 12 below.

Also, clients may pay charges indirectly assessed by a mutual fund, index fund, exchange traded fund, or bank deposit program, such as fund management fees, distribution fees and other costs. These expenses are disclosed in the fund's prospectus or offering memorandum. Other charges that the client may be responsible for include custodian fees, service fees, wire transfer fees, foreign taxes and IRA fees.

### ***Compensation for Securities Sales***

For an account held at our affiliate Stern Fisher Edwards Inc, it is important to know that we may benefit from any compensation paid to Stern Fisher Edwards Inc by our clients. We indirectly receive compensation from the sale of securities or other investment products through this affiliated broker-dealer. Likewise we would also receive compensation from asset-based sales charges and distribution fees from the sale of mutual funds, including money market accounts, included in client investments. Such service fees are based on the amount of the funds held in each account and invested in mutual funds or money market accounts. Fees vary depending upon the mutual fund and money market account in which client funds are invested. The minimum and maximum of such fees, expressed as a percentage of the funds invested in a particular fund, generally range between 0.00% and 0.25% annually. Stern Fisher Edwards Inc may also receive a portion of the fees received by its clearing firm from client funds invested in their bank deposit or money market sweep programs, based upon the amount of funds held in each account. The amount of such income, expressed as a percentage of the funds invested in a particular sweep program, will vary within the range of 0.00% and 0.25% annually as disclosed in the prospectus. On occasion, certain fees and/or commissions may be paid to Stern Fisher Edwards Inc by its investment banking clients issuing securities recommended by us. Such compensation varies by transaction and is

disclosed in the offering memorandum or other documentation. No additional fees or commissions are paid by our managed client for these type of securities.

As a broker-dealer, Stern Fisher Edwards Inc may execute securities transactions as agent or broker on behalf of our clients. In this regard, Stern Fisher Edwards Inc receives compensation that is disclosed on the confirmation of each transaction. The functional nature of a broker-dealer creates a basic conflict of interest in that Stern Fisher Edwards Inc and SFE have both a fiduciary duty to provide advice to clients and self interest in receiving commissions on transactions. Clients should also be aware that since Stern Fisher Edwards Inc executes advisory client transactions on an agency basis, the market-maker for a particular security would generally charge a markup or markdown in addition to the brokerage commission charged on over-the-counter securities transactions.

The practice of accepting commissions for the sale of securities presents a conflict of interest and gives us an incentive to recommend or trade in investment products based on the compensation received, rather than on your needs. We generally address possible sales conflicts through our account management process and our compensation policy. Our comprehensive client review process is designed to make portfolio recommendations focused solely on your needs. Transaction requests are typically initiated by a portfolio manager, approved by your client relationship manager, and reviewed after execution by our Investment Committee. If a conflict is noted, the transaction will not be executed or will be reversed. We feel our compensation policy also reduces the possibility of conflicts in that none of our employees receive compensation based upon commissions. There is no personal incentive to generate commissions from client accounts.

In our initial consultation with a prospective client, we explain that commissionable securities sales create a conflict. We discuss SFE's fiduciary duty to the client and how our client review process works. If a client prefers, we offer our All Inclusive Managed Account program (a "wrap" account) that effectively eliminates this conflict as commission charges are waived.

In certain cases, clients may have the option to purchase investment products we recommend through other brokers or agents that are not affiliated with us. Less than 30 percent of our fee revenue from advisory clients results from commissions and other compensation received by Stern Fisher Edwards Inc for the sale of investment products we recommend. We do not reduce our advisory fees to offset any commissions or markups charged.

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

SFE does not accept fees based on a share of capital gains or on capital appreciation of the assets of a client. We have no conflicts of interest because our client accounts are not managed side-by-side with accounts that are charged a performance-based fee.

## Item 7 – Types of Clients

SFE generally provides investment advice to individuals, retirement plans, charitable organizations, trusts, estates, corporations and other business entities. For our *separately managed account* portfolios, we generally have a minimum charge of \$500 per quarter. Our *dual-contract relationships* are subject to an annual minimum fee of \$500. Please see Items 4 and 5 above for additional information on these programs and fees.

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

SFE uses a disciplined approach when we formulate investment advice and manage assets. We strive to produce returns that consistently outperform our benchmarks while taking less-than-market risk. Our goal is to achieve long term growth and preserve capital by employing an opportunistic, total return approach to managing client accounts.

### ***Methods of Analysis***

SFE's core competence is managing concentrated portfolios of US listed equities, often with fixed income components. These portfolios are customized to meet specific client needs, risk tolerances and objectives. We use fundamental, technical and cyclical methods of analysis to identify potential investments.

Our equity analysis begins with a top-down evaluation of industry sectors to identify macro-economic trends and market cycles. This means we analyze the economy and various industries to make informed decisions as to which industry sectors are attractive, or unattractive, for investment. We then conduct a bottom-up analysis of select companies that will be affected by these trends. Our goal is to further identify companies that are the most attractive in each industry sector for inclusion in client portfolios.

Prior to purchase, we employ fundamental analysis tools to evaluate a company's characteristics in order to estimate and measure its intrinsic value. We want to understand a company's strengths and weaknesses, historical performance, growth potential, competitors, and management team. In addition, we also utilize technical analysis techniques as a means to reduce price and timing risk.

Fixed income securities are selected for portfolios based upon the client's investment objective and risk tolerance. We review and assess the tax aspects, credit quality, maturity, interest rate, liquidity and diversification of the securities to make sure they are appropriate for an account. The economic cycles and current market interest rates are also considered in our fixed income decisions.

### ***Investment Strategies***

SFE's investment philosophy is founded upon our belief that asset allocation is the single most important determinant of portfolio performance. Accordingly, we adjust equities, fixed income, and

cash positions in response to market and economic conditions to fulfill client objectives. Through our disciplined investment approach, we seek to produce equity returns that consistently outperform the S&P 500 Index while taking less-than-market risk. We strive to preserve capital and achieve long term appreciation by employing an opportunistic, total return approach to managing client accounts.

Generally we invest for the long term through the purchase of securities we expect to hold for more than a year. This strategy usually increases the after-tax performance of taxable accounts due to lower tax rates on long term capital gains. On occasion, we will modify our strategy to reflect a client's needs or take advantage of an opportunity we have identified. This may result in short term purchases where securities are sold within a year, or even trading where securities are sold within 30 days. In taxable accounts, sales of long term holdings typically have tax advantages over short term and trading positions.

For equity investments, we seek companies of quality and value – the best in their fields. We focus on domestic companies that have established a competitive advantage in their industries. Many have strong global franchises and generate significant revenue from their international operations. Our portfolios typically contain 20-30 equity positions. In picking stocks, we seek value in fundamentally sound businesses, regardless of size. To aid in our selections, we subscribe to many sources of independent research and perform our own fundamental and technical security analysis. Many of our equity selections are chosen for their meaningful dividend yield. We feel that dividends are an important component of total return. They contribute significantly to the performance of our accounts and lower the risk profile.

Fixed income allocations are primarily comprised of investment grade US government and agency securities, corporate bonds, exchange traded funds, and tax-exempt municipal bonds, with maturities ranging from 2-10 years. These allocations typically reduce portfolio volatility and risk. Selected securities will be readily marketable and diversified by issuer. Maturities are often laddered so that portfolios hold a number of fixed income securities with staggered maturity dates. This strategy offers more consistent returns when interest rates are volatile or the yield curve is steep. We generally prefer to hold fixed rate securities until maturity. We target maturities to capture the best rates available with shorter durations. This strategy helps reduce interest rate risk from holding longer maturities.

## ***Risk of Loss***

Investing in securities involves risk of loss that clients should be prepared to bear. It is important that you understand the risks associated with investing in securities. Your portfolio should be appropriately diversified to match your risk tolerance and investment time horizon. We strongly encourage you to ask us any questions you may have.

Both equity and fixed income investments are subject to risk of loss. Even an investment in a money market fund is not insured or guaranteed. Although a money market fund seeks to preserve the value of your investment, it is possible to lose money by investing in such a fund.

While investment risk does refer to the general risk of loss, it can be broken down into more specific classifications.

**Market Risk**

Also known as systematic risk, market risk is the likelihood that the value of a security will move in tandem with its overall market. For example, if the stock market is experiencing a decline, the stocks in your portfolio may decline as well. Or if bond prices are rising, the value of your bonds could go up.

**Interest-Rate Risk**

Most often associated with fixed income investments, this is the risk that the price of a bond will fall with rising interest rates. The value of bonds with long maturities will typically fluctuate by a larger amount than bonds with shorter maturities. Equity securities may also be negatively affected by a rise in rates.

**Inflation Risk**

This risk is that the real value of your portfolio will be eroded by a decline in the purchasing power of your savings as a result of inflation. Inflation risk needs to be considered when evaluating conservative investments, such as bonds and money market funds, as long-term investments. While your investment may post gains over time, it may actually be losing real value if it does not at least keep pace with the rate of inflation.

**Credit Risk**

It refers to a bond issuer's ability to repay its debt as promised when the bond matures. Bonds are given credit ratings by such agencies as Moody's and Standard & Poor's. In general, the higher the rating, the lower the credit risk. Investors who seek higher yields typically must accept a higher credit risk. Lower rated bonds are more volatile and less liquid.

**Other Risks**

Stocks and bonds may decline significantly in value due to economic and political events both domestically and globally. In addition, international investments involve such risks as fluctuating currency values (currency risk) as well as the potential for social, political, and economic upheavals that may affect a country's markets.

## Item 9 – Disciplinary Information

Advisors are required to disclose legal or disciplinary events that are material to the evaluation of our advisory business or the integrity of our management. SFE does not have any events to report.

## Item 10 – Other Financial Industry Activities and Affiliations

All of our management persons are registered representatives of Stern Fisher Edwards Inc, a broker-dealer and affiliate of SFE. The eight employee-owners of SFE also have identical ownership interests in Stern Fisher Edwards Inc.

Please see Item 5 of this brochure, under the heading *Compensation for Security Sales*, for a discussion of conflicts of interest and how we address them.

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

### ***Code of Ethics***

We believe in holding our employees to the highest possible ethical and regulatory standards and subject all employees to our Code of Ethics ("Code"). Our Code is based on the principle that all employees of SFE have a fiduciary duty to place the interest of clients ahead of their own and the firm. Employees must not engage in activities, interests, and relationships that might interfere with making decisions in the best interests of SFE's advisory clients. SFE's Code states general principles that cover the following standards of business conduct:

1. Compliance with Laws and Regulations
2. Conflicts of Interest
3. Insider Trading
4. Personal Securities Transactions
5. Gifts and Entertainment
6. Confidentiality
7. Other Outside Activities

The Code also addresses compliance procedures, record-keeping, and administration and enforcement of the Code. We require our personnel to conduct business with the highest level of ethical standards and to comply with federal and state securities laws at all times. Upon employment and annually thereafter, all employees will sign an acknowledgement that they have read, understand, and agree to comply with our Code. Our firm and all employees must conduct business in an honest, ethical, and fair manner and avoid all circumstances that might negatively affect or appear to affect our duty of complete loyalty to all clients. Upon request, we will provide a copy of the Code to any client or prospective client.

### ***Participation or Interest in Client Transactions***

We do not act as a principal where we would buy securities from or sell securities to a managed client. SFE will not execute transactions in which an advisory client's securities are sold to or bought from another advisory or brokerage client, so called "cross transactions".

### ***Personal Trading***

SFE employees may own some of the same securities that we recommend to clients. These securities are usually widely-held stocks or exchange-traded funds. Our personal trades are immaterial in size and therefore do not impact the trading volume or price of such securities. These securities may have been purchased either before or after the same stock is purchased for a

client. We recognize that the personal investment transactions of members of our firm demand the application of a high Code of Ethics and require that all such transactions be carried out in a way that does not endanger the interest of any client. At the same time, we believe that if investment goals are similar for clients and for members of our firm, it is logical and even desirable that there be common ownership of some securities. We feel common ownership aligns our interest with that of our clients, and does not present a conflict.

Occasionally, SFE or a related person buys or sells securities for itself that are also recommended to clients. We take steps to ensure that advisory clients obtain transaction benefits that are no less favorable than our own. If an SFE employee buys or sells a security for client accounts at or about the same time the security is bought or sold for their own account, such transactions will be accomplished as a block trade (aggregate orders) in order to ensure execution at the same price. If client transactions have been executed during such trading day and an employee's trade was not included therein as a block trade, trades will be executed on behalf of employee only at the close of such trading day at prices no more favorable than those obtained for clients during such day. All trades executed in the same security during any one trading day shall be reviewed and, if necessary, prices may be adjusted to assure that SFE or a related person do not receive a more favorable price than any advisory client.

In order to eliminate possible conflicts of interest and ensure that client interests are placed ahead of those of SFE and its personnel, our Personal Trading Policy also requires all related person transaction orders and executions be reviewed daily by management to verify that such trades conform to these criteria. In addition, the Chief Compliance Officer reviews employee holdings on a quarterly basis for any potential conflicts.

## Item 12 – Brokerage Practices

For our *traditional* separately managed account program, SFE typically executes trades through Stern Fisher Edwards Inc, our broker-dealer affiliate. We do not require clients to direct brokerage. Although commissions are discounted from our broker-dealer's retail commission schedule, clients may pay commissions higher or lower than those charged by other broker-dealers, especially discount brokers. A Stern Fisher Edwards Inc retail commission schedule will be provided upon request. Commission discounts are negotiable.

SFE believes that Stern Fisher Edwards Inc provides best execution based on the following qualitative factors:

- Its execution, clearance, and settlement capabilities
- The size of brokerage transactions accommodated
- The efficiency and timing of brokerage transactions
- The activity existing and anticipated in the market for a particular security
- The nature of the securities being purchased or sold and access to purchasers and sellers within the investing marketplace (which may be limited due to thin trading activity or unavailability of certain securities)
- Its financial stability and reputation

SFE will conduct a quantitative analysis of equity transactions for best execution purposes at the end of each quarter. We will undertake an annual review to study both quantitative and qualitative aspects of our best execution policy. This review will encompass service, execution and commissions at a sample number of brokerage firms, both full service and discount broker-dealers. We will document the review and make it available to clients upon request.

### ***Directed Brokerage***

As noted above, clients who participate in our SMA Programs may establish a brokerage account with Stern Fisher Edwards Inc, which serves as the broker-dealer. National Financial Services LLC ("NFS") serves as the custodian of client funds and securities and maintains these in brokerage accounts registered in the client's name. We do not require our clients to direct their brokerage business to our affiliated broker-dealer, as we may be unable to achieve most favorable execution and pricing for client transactions. SFE allows clients to establish brokerage arrangements with a firm other than Stern Fisher Edwards Inc upon request by a client. However, this may result in higher or lower costs depending upon the commission and fees charged by the directed broker dealer.

No SFE employee receives any commission compensation for trades executed at Stern Fisher Edwards Inc. Nevertheless, a conflict of interest exists. Stern Fisher Edwards Inc contracts with NFS to provide custodial and execution services for its clients. Commission revenue, in excess of clearing costs paid to NFS, provides income to Stern Fisher Edwards Inc. In turn, Stern Fisher Edwards Inc uses this income to reimburse us for operating costs we incur on behalf of Stern Fisher Edwards Inc. Therefore SFE and its owner-employees receive a financial benefit from directing commission transactions to Stern Fisher Edwards Inc.

Our *wrap fee* SMA Program offers commission-free trades that are required to be executed through Stern Fisher Edwards Inc as a condition to this contract. Please note that even though no commissions are charged, transactions are subject to a service fee imposed by our broker-dealer. This fee is used to partially offset the costs of executing the trade. Other fees are also imposed on sale transactions by NFS.

Directing brokerage to Stern Fisher Edwards Inc may not enable us to achieve most favorable quantitative execution of client transactions. This may cost clients more money. Likewise, on the occasion where a client directs brokerage to another specified broker-dealer, we may also be unable to achieve most favorable quantitative and/or qualitative execution of transactions for the client. Directing brokerage may cost clients more money. Clients will pay brokerage commissions and may receive less favorable prices.

Each client portfolio is separately managed and tailored to the needs of the client. Typically transaction orders are executed separately for each client at the direction of the portfolio manager. Execution is done in order of receipt at the time we submit transactions to the broker trade desk. On infrequent occasions we will aggregate the purchase or sale of securities for various client accounts. We may use block trades when adding a new position or selling out of a position on a firm wide basis. This may be done if we determine that a holding should be quickly removed from all accounts, or if a security should be purchased in multiple accounts due to limited opportunity. We do not utilize block trades when adding or trimming existing positions. Even when we aggregate trades they are usually not material in volume. Our clients do not incur additional costs



when we choose not to aggregate. Transaction costs would not be reduced nor would execution prices be negatively impacted due to our limited scale and method of order entry.

### Item 13 – Review of Accounts

Advisory accounts are continuously monitored by the individual client's primary investment counselor. In addition, each account is typically reviewed twice each quarter by the portfolio management team and client manager. Weekly Investment Committee meetings are held to review client portfolio transactions from the prior week. The Investment Committee is comprised of all eight employee-owners of SFE, namely Earl W. Fisher (Chairman), Fred M. Edwards (Vice Chairman), Jon M. Kmett (President), Charles E. Bohlen, Jr. (Vice President), Teri M. McCasland (Vice President), Edward J. Ternan (Vice President), David J. Thomsen (Vice President) and James T. Moylan (Senior Portfolio Manager).

During these reviews, the Investment Committee looks at specific client account holdings and recent transactions. The review is conducted to verify that the account is in line with the client's investment objectives and risk tolerance and is appropriately positioned based on market conditions. Any changes in client financial status or objectives are noted, as well as recent performance of the account. Such issues as market conditions, industry trends, economic and interest rate forecasts and related tax implications are also considered in the reviews.

We may review client accounts more frequently than described above. Among the factors which may trigger an off-cycle review are major market or economic events, the client's life events, or by client request.

Advisory clients receive monthly brokerage statements from Stern Fisher Edwards Inc or their account custodian. These reports include account holdings, description of activities, current market value and an income summary. In addition, on a quarterly basis, SFE provides a written report that includes an appraisal of the portfolio, a performance report, and our quarterly commentary on the economy and equity market. The portfolio appraisal includes the asset and sector allocations as a percentage of portfolio value, the market value and cost basis of each holding, and the annual income and yield of the securities.

### Item 14 – Client Referrals and Other Compensation

Please refer to Item 5 of this brochure, under the heading *Compensation for Security Sales*, for a discussion of certain other compensation received by our affiliate broker-dealer Stern Fisher Edwards Inc. Although SFE and Stern Fisher Edwards Inc are separate and distinct corporate entities, Stern Fisher Edwards Inc reimburses SFE monthly for certain administrative costs, such as payroll and operational functions, through a services agreement.

## Item 15 – Custody

We do not have custody of client funds or securities. Our broker-dealer affiliate Stern Fisher Edwards Inc contracts with National Financial Services LLC to provide custodial and execution services for its clients through a fully disclosed clearing agreement.

## Item 16 – Investment Discretion

We require discretionary authority to manage securities accounts on behalf of clients. Clients who invest directly with SFE generally are required to sign an investment management agreement giving us discretionary authority to manage securities on their behalf. That means we can determine the type and quantity of securities to be bought or sold without getting specific client permission in advance. Even so, discretionary investment decisions are based on the client's investment objectives, financial needs, and investment policies and guidelines, which have been pre-determined in communications with the client. On occasion, clients wish to place restrictions on this authority. For example, some clients do not want to invest in certain industries, or are prohibited from owning specific stocks by their employer. We are willing and able to accommodate any reasonable restrictions imposed by our clients.

## Item 17 – Voting Client Securities

Our firm votes client proxies only when required and instructed to do so as part of our participation in a Third Party Separate Account Manager Program (SAM Program). We understand our duty to vote client proxies and to do so in the best interest of SAM Program clients. Furthermore, we understand that any material conflicts between our interests and those of program clients with regard to proxy voting must be resolved before proxies are voted. We may subscribe to a proxy monitor and voting agent service ("Voting Service"). If so, our Voting Service will be instructed to vote on behalf of program clients in accordance with recommendations of each company's Board of Directors. At times we may instruct the Voting Service to vote differently on certain matters if we determine that such actions are in the best interest of our clients. It is important to note that we do not pay the Voting Service with soft dollars. If we do not use a Voting Service, we will vote proxies directly under the same guidelines provided to the Voting Service. Clients may request a copy of our written policies and procedures regarding proxy voting and/or information on how particular proxies were voted by contacting our Chief Compliance Officer, Teri McCasland, at (213) 612-0220 or [tmccasland@sfeic.com](mailto:tmccasland@sfeic.com).

We do not accept authority to vote client securities for client accounts for our SMA, Dual Contract or Model Portfolio clients. Such clients will receive their proxies or other solicitations directly from their custodian or a transfer agent. In the event that proxies are sent to our firm, we will forward them to the client and ask the party who sent them to mail them directly to the client in the future. Clients may call, write or email us to discuss questions they may have about particular proxy votes or other solicitations.

## Item 18 – Financial Information

SFE is required to disclose any financial condition that is reasonably likely to impair our ability to meet contractual commitments to clients. We have nothing to disclose in this regard.

## Item 19 – Requirements for State-Registered Advisers

We are an SEC registered adviser and therefore not registered with any state securities authorities.