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Disclosure Brochure, Form ADV Part 2A

Heartwood Investments, Inc. is registered as an investment adviser. Registration does not imply a certain level of skill or training. 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.

This brochure provides information about the qualifications and business practices of Heartwood Investments, Inc. If you have any questions about the contents of this brochure, please call us at 319-233-1717 or send an e-mail to [Invest@HeartwoodInvestments.com](mailto:Invest@HeartwoodInvestments.com).

Additional information about Heartwood Investments, Inc. also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). You can search this site by a unique identifying number, known as a CRD number. The CRD number for Heartwood is 145668.

We tried to write in a conversational way that is somewhat informal. For example, we typically refer to Heartwood Investments, Inc. as simply "Heartwood". Personal pronouns such as "we", "us", and "our" refer to Heartwood. We may refer to our clients with words like "they", "their", "him or her", and "them". When we refer to you, our reader, we will say, "you."

We are delighted by your interest in our company and eager to tell you more about us.



## Item 2. Material Changes

Our company filed its most recent, annual update of this disclosure brochure (as Form ADV Part 2) on March 2, 2012. This section discusses *only* material changes since that last annual update of our brochure.

Due to changes in federal regulation that transfers regulation of certain Registered Investment Advisers, such as firms like ours, to state securities regulators, we will be transitioning our firm's registration from the United States Securities and Exchange Commission (SEC) to one or more state securities regulators in accordance with applicable state laws and regulations. This change does not affect the way we conduct business or the services we provide. It simply means that we will be subject to regulation and regular examination by state securities regulators rather than the SEC. If you have any questions regarding this or any other matter, please contact us at the address or phone number on the front page of this brochure.

Form ADV Part 2 requires registered investment advisers like us to amend our brochure when information becomes materially inaccurate. If there are any material changes to our disclosure brochure, then we are required to notify you and provide you with a description of the material changes.

Generally, Heartwood Investments, Inc. will notify clients of material changes on an annual basis. However, where we determine that an interim notification is either meaningful or required, we will notify our clients promptly.

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## **Item 4. Advisory Business**

### ***Description of Our Firm and Principal Owner***

Heartwood Investments, Inc. is registered as an investment adviser based in Waterloo, Iowa.. We offer personalized investment account management services to individuals, trusts, estates, charitable organizations, corporations, and other business entities.

We are a corporation formed in 2007 under the laws of the State of Iowa. David G. Sparks, CFA, is founder and sole owner of Heartwood Investments, Inc. Our registration as an investment adviser became effective December 3, 2007 and we began providing investment advisory services to clients later that month.

This narrative provides information regarding our company, qualifications, business practices, and the nature of our advisory services. We encourage you to consider this information carefully before deciding whether to become an advisory client. It is our goal to fully inform investors about our company. If you have any questions about us that we did not answer in this document, please contact David G. Sparks, President and Chief Compliance Officer, at (319) 233-1717 or by mail at P.O. Box 1197, Waterloo, IA, 50704-1197.

### ***Advisory Services We Offer***

Heartwood provides discretionary portfolio management on an ongoing basis. In limited circumstances and at its sole discretion, Heartwood may enter into non-discretionary arrangements with clients, where Heartwood will obtain client approval prior to the execution of any trades on behalf of the client account(s). In either case, portfolio management services will not be rendered prior to the client entering into a written agreement for services, which shall be maintained in the client file.

Subject to a grant of discretionary authority, our portfolio managers will invest and reinvest the securities, cash, or other property held in your account at an independent, qualified

custodian in accordance with your stated investment objectives. The types of securities we primarily recommend include common stocks, government, corporate or municipal bonds, certificates of deposit, exchange-traded mutual funds (ETFs) that seek to obtain the returns of a broad market index, and open-end mutual funds that invest in some or all of these types of securities. We make our best effort to tailor the investments to the individual needs of each client as documented in the client's Investment Plan. This Investment Plan is discussed more fully below, in the section titled "How We Tailor Our Services to Individual Clients."

You would grant investment discretion to us by means of an authorization provided in the executed agreement for services, and again when you sign the qualified custodian's account application. Both of these documents are maintained in your file.

This grant of discretion means that Heartwood is authorized to perform various functions, at your expense, without further approval from you. Such functions include the determination of securities to be purchased or sold and the amount of securities to be purchased or sold.

After the portfolio is constructed, Heartwood provides ongoing supervision and rebalancing of the portfolio as provided in the client's Investment Plan, changes in market conditions or client circumstances. Rebalancing means sales or purchases calculated to bring the percentage of market value of each holding closer to its respective target level, as set forth in the Investment Plan.

Based on your needs and investment objectives, a portfolio may include common stocks of companies based in the U.S. or other countries, fixed-income securities such as bonds or certificates of deposit, cash-equivalent investments such as money market funds, mutual funds, and index funds including exchange-traded funds (ETFs.) This list is provided for informational purposes and is not intended to limit our selection. Investments are selected based on fundamental financial data, valuation, and your individual objectives. We seek investments generally for long-term returns, and do not typically pursue short-term, market-timing strategies.

Margin transactions are not generally recommended as part of Heartwood's core investment strategy. A margin transaction is a securities transaction in which an investor borrows money to purchase a security, in which case the security serves as collateral on the loan. We discourage the use of margin because investing with borrowed money magnifies the gain or loss when investment prices fluctuate. You would want to consider potential tax consequences, interest rates, transaction fees, commissions, and increased advisory fees before engaging in such transactions. However, if you specifically request and we believe it is suitable given your objectives and risk tolerance, then we may agree to employ margin strategies on a limited basis. Margin transactions are discussed at greater length below, in the section titled "Fees and Compensation."

Additionally, while it is not part of our core strategy, from time to time, we may make short-term purchases or sales for you to address unexpected cash flow/liquidity needs or in volatile markets. We may consider protective long or short positions in put or call options where appropriate for risk adjustment. Options are complex, "derivative" instruments that are not for every investor. A qualified custodian would require you to request option-trading authority before options transactions could start. We normally do not ask clients to set up options trading authority. If we would ever feel that your account would benefit from options transactions we would provide extensive, additional disclosure at that time.

As a part of our service to advisory clients and prospective clients, we occasionally write a commentary called *Thoughts*. In it, we share our observations on the economy and investment markets, and sometimes comment in a general way about how these views inform our investment decisions. It is not intended as specific investment advice standing on its own; rather, it is supplementary information about our work for those we serve and those considering our services. It is not offered by subscription. We gladly circulate the *Thoughts* piece at no charge to clients, prospective clients, and other people whom we believe are genuinely interested in our approach to investing. A one-time, complimentary copy is available to anyone on request.

## **Services That We Do Not Provide**

We do not consider ourselves to be financial planners. A financial planner might attempt to assess every aspect of your financial life—including saving, investments, insurance, taxes, retirement, and estate planning—in an effort to help you develop a detailed strategy or financial plan for meeting all your financial goals. By contrast, Heartwood Investments focuses primarily on managing our clients' portfolios of stocks, bonds, mutual funds, and exchange-traded funds. We will of course occasionally discuss other aspects of a client's financial situation in order to better understand his or her investment objectives and constraints, or to help with a special situation. However, we always encourage clients to take specific questions regarding personal risk management (insurance), legal or tax matters to specialists who are licensed to practice in those areas.

## ***How We Tailor Our Services to Individual Clients***

Our investment strategies and advice may vary depending upon each client's specific financial situation. As such, we determine investments and allocations based upon your predetermined objectives, risk tolerance, time horizon, financial horizon, financial information, liquidity needs, and other various suitability factors. Your restrictions and guidelines may affect the composition of your portfolio. We write this information down in a customized Investment Plan for your account. Your Investment Plan would be designed to provide a framework for investing, supervising, and evaluating the performance of your portfolio. The Investment Plan will address your objectives for returns, objectives for risk, time horizon, liquidity requirements, possible tax constraints, possible legal constraints, and any unique needs, circumstances and/or preferences. Our investment management agreement refers to this Investment Plan as Client Documentation. Even though we might write it down for you, the Investment Plan becomes your Client Documentation after you tell us it is in effect.

We offer an initial complimentary consultation in which we collect pertinent information about your personal and financial circumstances and objectives. If you decide to engage us



for account management services, we will work with you to develop an Investment Plan based on your individual circumstances. The purpose of the Investment Plan is to establish a record of your individual objectives and constraints, guide our work toward meeting your goals, and provide a framework for evaluating results. Of course, having an Investment Plan does not guarantee profits or protect against losses.

When your circumstances or objectives change, the Investment Plan may be updated or amended to establish new guidelines for managing your portfolio. You may amend your Investment Plan by telling us what changes you want to make, either verbally or in writing. If the change is small, we may simply document it in a memo and file it with the Investment Plan. If you or we feel the change is significant enough, then we would prepare an updated Investment Plan document and send you a copy. In our sole discretion, we may ask you to approve the Investment Plan by signing it. If we do not ask you to sign the Investment Plan then we go over your copy with you and ask for your verbal approval. In that event we document your approval with a memo to the file, or a letter.

You may impose restrictions on investing in certain securities or types of securities. Such restrictions are documented in the Investment Plan. You should consider your individual objectives and tolerance for risk, including the potential for loss of opportunity, which may result from placing restrictions on investments. Such restriction would affect only your account(s), and would not prevent us from buying or selling the same security or type of security for other clients.

### ***Client Assets We Manage***

- We provided investment account management services on a discretionary basis for \$40,615,566 of assets based on market value as of December 31, 2011.
- In limited circumstances and at its sole discretion, Heartwood may enter into non-discretionary arrangements with clients, where Heartwood will obtain client approval prior to the execution of any trades on behalf of the client account(s). As of December 31,

2011 we were not providing portfolio management services for any assets on a non-discretionary basis.

- An additional \$2,302,962.57 of investor assets were held in separate accounts for which Heartwood does not provide management services. These accounts were maintained for the convenience of individuals for whom we had agreed to provide certain administrative services. Heartwood does not charge management fees or report investment performance on these administrative accounts. We reserve the right to accept, decline, or discontinue such administrative accounts on a case-by-case basis.

Heartwood does not impose a minimum account size. We do reserve the right to decline an engagement in our sole discretion, based on our judgment as to the suitability of our services in a particular situation. We do not have to explain or give a reason for declining an account.

## **Item 5. Fees and Compensation**

### ***Management Fee Based on Percentage of Assets***

Our sole form of compensation is an investment management fee that our clients pay to us based on a percentage of the market value of the assets we manage. The fee is calculated quarterly in arrears, meaning after the end of the quarter, and billed directly to our clients' accounts as described below.

To determine our fee for each account for a calendar quarter, we calculate both the Annual Fee Percentage Rate and the Average Daily Market Value. The concept of Average Daily Market Value is defined and explained in more detail in the following section. On an annualized basis, our Annual Fee Percentage Rate for portfolio management services is determined according to the following scale:

<b>Average Daily Market Value</b>	<b>Annual Fee Percentage Rate</b>
First \$500,000	1.5%

Next \$500,000	1.0%
Above \$1,000,000	0.5%

These fee percentage rates are negotiable, which means that in limited circumstances and at its sole discretion Heartwood may agree to a different fee schedule for certain accounts or clients. One example is a charity, where we might agree to a lower rate as a way to support their cause. Depending on the circumstances, Heartwood may also agree to aggregate the market values of several accounts together and base its fee on the total. For example, we would typically aggregate market values for the accounts owned by a single family living together at the same address. A third example might be a client whose rate was established under a different fee schedule in the past. We consider a number of factors in determining the fee percentage rate for a client, and approach each situation individually.

## **How We Calculate and Bill For Management Fees**

The fee for portfolio management services is billed quarterly in arrears. That means we charge at the end of the quarter, not in advance. The steps in calculating the quarterly fee for an account are as follows:

1. Calculate the Average Daily Market Value by adding the actual market values of the account for each day in the calendar quarter, then dividing the sum by the number of days in the calendar quarter. If we are aggregating the market values of several accounts, we add Average Daily Market Value for each account together to obtain the Aggregate Average Market Value.

Days in which the account value was zero (such as those before we began to manage, or after our management ceased) are included in number of days used to calculate the average. By including these “zero balance” days, the average is made smaller. This adjustment has the effect of pro-rating our fee in situations where we did not provide management services for a full quarter.

2. Calculate the Annual Fee Percentage Rate based on the Fee Schedule. If we are aggregating several accounts, the percentage rate will be calculated using the aggregate market value and then that same rate will be applied to each account.
3. Calculate the Annualized Fee Amount for each account by applying the Annual Fee Percentage Rate to the Average Daily Market Value.
4. Divide the Annualized Fee Amount by four to obtain the amount of the quarterly fee.

The following example illustrates steps #2 through #4 to calculate the quarterly fee for an account having an Average Daily Market Value of \$2,000,000.

Step 2. Calculate the Preliminary Annualized Fee Amount:

	Market Value			Fee
First	\$500,000	times 1.5%	=	\$7,500
Next	500,000	times 1.0%	=	5,000
Last	1,000,000	times 0.5%	=	<u>5,000</u>
Total	2,000,000	Preliminary Annualized Fee Amount:		17,500

If we are figuring the fee for a single account, then skip to step 4. Otherwise, if we are aggregating the market values of several accounts, then do steps 3.a. and 3.b. to figure the fee for each account.

Step 3.a. Divide the Pro Forma Annualized Fee Amount by the Aggregate Daily Market Value:

$$\text{Annual Fee Percentage Rate} = \frac{17,500}{2,000,000} = 0.00875 = 0.875\%$$

Step 3.b. Multiply the Average Daily Market Value of each account times the Annual Fee Percentage Rate:

Annualized Fee Amount =  $\$2,000,000 \times 0.875\% = \$17,500$

Step 4. Divide the Annualized Fee Amount by four:  $\frac{\$17,500}{4} = \$4,375$

The quarterly fee is found to be \$4,375.

### ***How We Deduct Our Fee From Client Accounts***

Heartwood sends an invoice for the quarterly fee several weeks after the end of the quarter. In rare circumstances and at our sole discretion, we may agree to accept payment of the fee by check. However, we would typically ask you to authorize direct billing of our fees to your accounts. This means that our fee will be collected for us by the custodian holding your funds and securities, subject to a procedure designed to keep you well informed and protect your accounts. The procedure for authorizing and conducting direct billing is as follows:

- You would grant written authorization permitting the fees to be paid directly from your account held by the custodian. If we manage more than one account for you, you can tell us to charge the fee for an account to a different account. You might want to consider doing this for tax reasons, such as the possible deductibility of fees, or because you want to have one of your accounts pay the fee as a benefit to the other. Heartwood does not have authority to access your funds for payment of fees without your consent in writing. This authorization is included in the management agreement you would sign with us, and also in the brokerage account application you would sign and submit to the qualified custodian.

- Heartwood sends you an invoice showing the amount of the fee, the market value of the assets on which the fee is based, and the specific manner in which the fee was calculated. The invoice gives notice that the fee will be collected from the account and reminds you to verify the accuracy of the fee calculation. In the case where you have asked us to collect our fee from a different account, that information will be noted and the other account identified on the invoice.
- About a week after sending your invoice to you, Heartwood will send a message to the custodian indicating only the account number and the amount of the fee to be paid. If the fees for more than one account are being paid from an account, only the total will be transmitted. The custodian will not determine whether the fee is properly calculated, because the invoice previously sent to you had given you notice of the fee amount and an opportunity to verify its accuracy. The custodian will deduct the fee amount from the account and transfer it to Heartwood's account at the same custodian.
- The custodian agrees to send both you and Heartwood a statement, at least quarterly, indicating all amounts dispersed from your account, including the amount of advisory fees paid to Heartwood. The fee is clearly identified on the account statement. You should compare the fee amounts shown on your custodial statements with those shown on our invoice.

### ***Additional Fees and Expenses***

The fee you would pay us for investment account management services is the only compensation that we would receive from your business. However, it is not necessarily the only expense you would incur.

As part of our investment advisory services to you, we may invest, or recommend that you invest, in mutual funds and exchange traded funds. The fees that you pay to our firm for investment advisory services are separate and distinct from the fees and expenses charged by

mutual funds or exchange traded funds (described in each fund's prospectus) to their shareholders. These fees will generally include a management fee and other fund expenses. As discussed in more detail in the section entitled "No Compensation for Sale of Investment Products," below, we do not share in any portion of the fees and expenses charged by mutual funds and exchange traded funds. You will also incur transaction charges and/or brokerage fees when purchasing or selling securities. These charges and fees are typically imposed by the broker-dealer or custodian through whom your account transactions are executed. We do not share in any portion of the brokerage fees/transaction charges imposed by the broker-dealer or custodian. To fully understand the total cost you will incur, you should review all the fees charged by mutual funds, exchange traded funds, our firm, and others. For information on our brokerage practices, please refer to the "Brokerage Practices" section of this brochure.

As discussed above, we may trade client accounts on margin in rare situations where we determine it is in a client's interest to do so. However, broker-dealer custodians such as Fidelity require a client to sign a separate margin account agreement before margin credit is extended to that client account. Heartwood typically does not ask clients to sign a margin agreement when setting up an account, which means that it would have to be specially requested at the time margin transactions were first being considered. Fees for advice and execution on securities held in a margin account are based on the total asset value of the account, which includes the value of the securities purchased on margin. While a negative amount may show on a client's statement for the margined security as the result of a lower net market value, the amount of the fee is based on the absolute market value. The use of margin transactions could create a conflict of interest where we would have an incentive to encourage the use of margin to create a higher market value and therefore receive a higher fee. The use of margin will result in interest charges and heightened risk in addition to all other fees and expenses associated with the security involved. However, as noted above, we typically do not use margin transactions.

## ***Management Fee Charged in Arrears, Not in Advance***

As noted above in the section titled, “How We Bill For and Deduct Management Fees,” our fee for portfolio management services is billed quarterly in arrears. That means we charge at the end of the quarter, not in advance. Because fees are payable in arrears, refunds are not applicable. If you terminate the management agreement during a quarter, the fee will be prorated for that quarter by the same method of calculation described above.

## ***No Compensation for Sale of Investment Products***

We are not affiliated with any brokerage firm, and therefore your purchases of investment products recommended by us will take place through brokers or agents that are not affiliated with Heartwood Investments. We generally recommend that clients select Fidelity Investments to be custodian of the accounts we manage. You may choose a different custodian, keeping in mind that we reserve the right to decline to manage an account at that custodian. After you and we agree on your choice of qualified custodian, we prefer that you allow us to buy and sell investments for your account through that custodian. Heartwood Investments does not sell investment products and receives no commissions or other payments in connection with the sale or purchase of investment products, including asset-based service fees. The same is true for our employees. We believe that this policy helps us to prevent conflicts of interest by removing incentives to recommend specific products and basing our recommendations and actions solely on the needs of our clients.

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

A performance-based fee is based on a measure of investment return, instead of a percentage of the market value of assets under management. Heartwood does not manage any account for a performance-based fee.

Side-by-side management refers to a situation where an adviser has some clients that pay a performance-based fee and different clients that pay some other way, such as a percentage of



assets under management. In this situation, an adviser has to take extra precautions to ensure that all clients are participating equitably and fairly in the adviser's investment process so that the difference in how the fee is determined does not lead the adviser to favor one type of client over the other. Because Heartwood has only one type of fee—a percentage of the market value of the accounts we manage—side-by-side management is not a consideration.

## **Item 7. Types of Clients**

The accounts we serve presently include:

- Individual and Joint accounts
- High net worth individuals and Joint Accounts
- Individual Retirement Accounts
- Trusts under Wills where a different person is Trustee
- Charitable Remainder Trusts
- Revocable Trusts where the Grantor is also Trustee
- Revocable Trusts where a different person is Trustee

In addition to those listed above, we are prepared to offer our services to other types of clients including, without limitation:

- Corporations
- Charitable Foundations
- Charitable Endowment Funds

There are a few types of accounts to which we do not presently offer or plan to offer advisory services because we believe that they require specialized legal or tax expertise. These account types include:

- Pensions
- Wrap Fee Programs
- Governmental entities
- Investment Companies
- Pooled Investment Vehicles

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

We manage diversified portfolios of stocks, bonds, mutual funds, and exchange-traded funds. In general, we prefer investments like those mentioned, because they are fairly liquid and can be held by almost any qualified custodian.

We analyze stocks and bonds by looking at a number of fundamental financial measures of the issuer, including: assets and liabilities, profit margins, and cash flow. Where it is available, we use this information to develop measures that may indicate an issuer's ability to repay debt or plow profits back into the business for growth. We consider valuation yardsticks such as price ratios and seek opportunities across many economic sectors and geographic regions. We get much of our information from publicly available sources, such as company financial statements and publications or bond rating agencies. In addition, we purchase analyst reports from independent research vendors.

Heartwood reserves the right to advise clients on any other type of investment that it deems appropriate based on the client's stated goals and objectives. We may also provide advice on any type of investment held in a client's portfolio at the inception of the advisory relationship or at other times on any investment for which the client requests advice.

### ***Methods of Analysis and Investment Strategies We Use***

Heartwood Investments manages client accounts with diversified portfolios of publicly traded stocks and fixed income-securities or publicly offered mutual funds and exchange-traded funds that invest in those same instruments. We make our best effort to analyze the fundamental financial characteristics of investments using publicly available information.

Our equity approach is a combination of a top-down framework for major categories plus a bottom-up approach for individual security selection. The top-down approach involves

establishing a global equity model portfolio in which a certain percentage weight is assigned to each of the following categories:

- Large, U.S. companies
- Mid-size, U.S. Companies
- Smaller U.S. companies
- International companies in developed countries
- International companies in emerging economies

We recommend primarily exchange-traded index funds (ETFs) for the mid- and small-size U.S., and international components of our global model. For our large, U.S. component we choose one or the other of two approaches, based on the size of the account. For smaller-size accounts, we primarily recommend an appropriate ETF that embodies a broad market index. For larger-size accounts, we maintain a Core Equity model portfolio consisting of 40 to 50 individual stocks covering a wide range of different economic sectors. These stocks may include mid-size and non-U.S. companies along with large, U.S.-based companies. A target percentage of the model is established for each stock. If we use the Core Equity model in your account, it would typically own all of the stocks in the model, in similar proportions to their respective target percentages in the model.

Our fixed-income approach starts with analysis of liquidity needs, that is, the amounts you might be likely to withdraw from your portfolio and when you would want to take it out. We try to match your anticipated needs for cash with high-investment-grade fixed-income securities expected to pay interest and repay principal in similar amounts and time frame. In addition to these liquidity-motivated investments, we may select other fixed-income securities having longer terms to maturity or credit ratings below investment-grade if your investment objectives call for it and your ability and willingness to take risk allows.

Investing in securities involves risk, including risk of loss. Clients should be prepared to experience fluctuation in the value of their portfolios, and to bear losses if they occur.

## ***Explanations of Our Methods and Strategies***

We select stocks for our Core Equity model portfolio based on fundamental financial characteristics. For each company we consider, we obtain and analyze current and historical financial statement data, independent research reports, and company-provided information such as management presentations and news releases. We examine a number of financial ratios and other measures then compare them both over time and between companies in the same industry, to help us evaluate a company's investment potential. Our process leads to a judgment about a company's long-term investment attraction. We do not focus primarily on recent or anticipated price levels; that is, we do not engage in market timing.

We select ETFs based on both quantitative and qualitative criteria. Since our goal with an ETF is to obtain broad market exposure to an entire category of stocks, we look for funds that embody an appropriate, broad market index. Qualitative criteria include ascertaining that the ETF actually invests in substantially all of the stocks making up the index, and does not use some approximation or replication strategy. Quantitative criteria include measuring the internal expenses of the fund, and how closely its returns compare to the returns of the corresponding index. Low internal expense and close correlation to the index are preferred.

Our company employs undergraduate students as research assistants, working under the supervision of Investment Committee members. We recruit students majoring in Finance, Accounting, Economics, or similarly rigorous, business-oriented fields who have completed most of their required course work for graduation and have shown an interest in investment management as a profession. These persons primarily do the “leg work” of gathering basic fundamental information on companies we wish to study and organizing it for analysis. Their work is then reviewed and extended by Mr. Henningsen or Mr. Sparks. We invite them to participate in Investment Committee meetings where they can assist with further investigation of companies under discussion and observe the decision making process. We believe this experience benefits them educationally and feel fortunate to have two institutions of higher education located nearby where we may seek future recruits to keep a good program going.

In addition to fundamental analysis described above, we may or may not use one or more of the following methods of analysis or investment strategies when providing advice to you or managing your investment account:

- Modern Portfolio Theory (MPT) is a theory of investment which attempts to maximize portfolio expected return for a given amount of portfolio risk, or equivalently minimize risk for a given level of expected return, by carefully diversifying the proportions of various assets.
- Long Term Purchases – securities purchased with the expectation that the value of those securities will grow over a relatively long period of time, generally greater than one year.
- Short Term Purchases – securities purchased with the expectation that they will be sold within a relatively short period of time, generally less than one year, to take advantage of the securities’ short-term price fluctuations.
- Option Writing – a securities transaction that involves selling an option. An option is the right, but not the obligation, to buy or sell a particular security at a specified price before the expiration date of the option. When an investor sells an option, he or she must deliver to the buyer a specified number of shares if the buyer exercises the option. The seller pays the buyer a premium (the market price of the option at a particular time) in exchange for writing the option.
- Protective Puts – a securities transaction that involves purchasing a put option. A put option is the right, but not the obligation, to sell a particular security at a specified price (called the exercise price) before the expiration date of the option. When an investor purchases a put option, he or she may elect to exercise it and thus sell the specified number of shares at the exercise price. However, the investor is not required to do so and likely would not do so if the security price were higher than the exercise price. When an investor already owns the specified number of shares, purchasing a put option effectively “protects” a minimum price at which the investor could sell those shares, during the life of the option. The investor pays a premium (the market price of the option at a particular time) in exchange for buying the option. This premium would have the effect of reducing the net proceeds that an investor would get for selling shares.

Investing in securities involves risk, including risk of loss. Clients should be prepared to experience fluctuation in the value of their portfolios, and to bear losses if they occur.

## ***Risks of Our Methods and Strategies***

The following is an important discussion of risks relating to all of the strategies that we might consider for your account based on your objectives, circumstances, and preferences. Not all of the risks described below will apply to your account if we are managing it for you. The reason is because not all of the strategies discussed below would typically be used in your account. The strategies and types of securities to be used in your account would be specified in your Investment Plan.

Strategies using margin or options are not typically used in the accounts we manage. You would know if we were going to use strategies involving margin or options because we would inform you of such in advance, and as your Custodian would require you to sign additional paperwork before that type of trading could start. You would receive additional disclosures for these strategies from us, also, and we would ask you to approve an amended Investment Plan allowing the strategies.

### **Risk of Loss**

Investing in securities involves risk of loss that you should be prepared to bear. We do not represent or guarantee that our services or methods of analysis can or will predict future results, successfully identify market tops or bottoms, or insulate clients from losses due to market corrections or declines. We cannot offer any guarantees or promises that your financial goals and objectives will be met. Past performance is in no way an indication of future performance.

The following paragraphs provide general discussion of other risk factors for our strategies and methods listed above.

Fundamental Analysis - The risk of fundamental analysis is that information obtained may be incorrect and the analysis may not provide an accurate estimate of earnings or cash flows,

which may be the basis for a stock's value. If securities prices adjust rapidly to new information, utilizing fundamental analysis may not result in favorable performance.

**Short-term trades** - Short-term trading is not a fundamental part of our overall investment strategy, but we do not rule it out. We may sell a security soon after purchasing it on occasions when we determine that there is a reasonable basis for the sale and it is suitable given your stated investment objectives and tolerance for risk. We want to point out something that we consider on such occasions. Short-term trades are treated differently for tax purposes compared to long-term transactions. Short-term gains in taxable accounts are subject to federal income tax at higher rates than long-term gains, while losses realized on securities held 30 days or less are generally not tax-deductible. These differences in tax treatment are disadvantages of short-term trades for taxable investors. That is why we generally try to avoid short-term trades by selecting securities that we are confident can be held for long-term returns.

**Tax Considerations** - Our strategies and investments may have unique and significant tax implications. However, unless we specifically agree otherwise, and in writing, tax efficiency is not our primary consideration in the management of your assets. Regardless of your account size or any other factors, we strongly recommend that you continuously consult with a tax professional prior to and throughout the investing of your assets.

As a result of revised IRS regulations, custodians and broker-dealers began reporting the cost basis of equities (stocks) acquired in client accounts on or after January 1, 2011 and mutual funds acquired after January 1, 2012. Your custodian will default to the FIFO (First-In First-Out) accounting method for selecting tax lots when we sell equities and the Average Cost method for mutual funds. You are responsible for contacting your tax advisor to determine if these accounting methods are the right choice for you. If your tax advisor believes a different accounting method is more advantageous, please provide written notice to our firm immediately and we will alert your account custodian of your preferred tax lot selection method. Please note that decisions about cost basis accounting methods will need to be made before trades settle, as the cost basis method cannot be changed after settlement.

As disclosed under the “Advisory Business” section in this brochure, above, we primarily recommend the following types of securities:

- common stocks,
- government, corporate or municipal bonds,
- certificates of deposit insured by the FDIC,
- exchange-traded mutual funds (ETFs) that seek to obtain the returns of a broad market index,
- open-end mutual funds that invest in some or all of these types of securities.

You should be advised of the following risks when investing in these types of securities:

#### Fixed Income Securities

Fixed-income securities of all types are subject to the risk of a price change whenever the level of interest rates changes. There is a mathematical relationship between a bond’s price and the yield an investor expects to receive from holding the bond to maturity. When interest rates change, the price of a bond is likely to adjust up or down so that its yield, based on the new price, is in line with the new level of interest rates. For a typical bond with fixed payments, the math works out this way: when the yield goes up, the price goes down, and vice versa. This means you can lose money on a bond you own if interest rates go up after you buy it. Interest rate risk is probably the most significant risk facing investors in fixed income securities because it affects all bonds similarly.

It may be possible to minimize the risk of price change by holding a bond until it matures, when it may be redeemed for its stated redemption value. By contrast, mutual funds investing in bonds typically do not have a maturity date, which means they remain subject to price risk.

A related risk is inflation, which means the rate of increase in consumer prices. It is possible for the rate of inflation to exceed the return on a fixed-income security. In that case, the purchasing power of an investment can be reduced relative to the cost of goods and services, even if the investment makes all of its scheduled interest and principal payments. An



unexpected increase in the inflation rate can lead to a rise in the level of interest rates and a likely decrease in the price of a bond, as discussed above.

The other major category of risk has to do with credit worthiness, that is, the market's perception of the bond issuer's ability to pay interest and repay principal. Credit risk refers to the chance that the issuer might not pay when payment is due, resulting in a loss of money for the investor. Bonds differ in their exposure to credit risk. We distinguish bonds into two groups based on published credit ratings: investment-grade, and below-investment-grade.

Ratings agencies such as Standard & Poor's and Moody's publish credit ratings. Both of these companies use "AAA" as their top rating, ranging down to a single "D". We identify investment-grade bonds as having a credit rating of BBB- or better from Standard & Poor's, or "Baa3" from Moody's. We will typically buy investment-grade bonds directly in your account.

Bonds having a rating of "BB+" or "Ba1" or lower are considered below investment grade. These bonds typically afford higher interest rates to compensate investors for their greater risk. The extra risk comes several ways. First, the low credit rating indicates a higher chance that the issuer may fail to pay interest or repay principal fully on time. They are also likely to fluctuate more widely in price compared to investment-grade bonds because the "market spread", or difference between yield level on investment- and non-investment-grade bonds changes from time to time. Bonds like these are often difficult to buy and sell individually without incurring significant transaction costs. We will typically access below-investment-grade bonds by investing in mutual funds that specialize in such bonds, instead of buying them individually. Mutual fund internal fees add to the expense of holding bonds this way but transaction costs may be lower for mutual funds compared to buying bonds directly. As with all fees, internal fees of mutual funds make positive returns smaller and losses larger than you would experience without the fees, holding all else equal.

Below-investment-grade bonds and similar products, such as leveraged bank loans, are not suitable for everyone. We consider a number of factors relating to suitability, including an

investor's liquidity needs, desire for taxable current income, diversification needs, and risk tolerance including both willingness and capacity to take risk. We would use these types of securities in your account only if we judge them to be suitable and your Investment Plan permits below-investment-grade bonds.

Certificates of deposit are generally seen as having very little credit risk since deposits up to a certain amount of principal are insured by the Federal Deposit Insurance Corporation ("FDIC"), an agency of the federal government. However, because the returns are generally very low compared to other investments, it is more likely for the rate of inflation to exceed the return on CDs. Likewise, US Treasury securities are backed by the full faith and credit of the United States government, and U.S. Government Agency securities are backed by the issuing Agency. However, because the returns are generally very low on CDs and government-backed bonds compared to other investments, it is more likely for the rate of inflation to exceed their returns. CDs have slightly more risk than U.S. government securities despite the fact that both are backed by the government, for two reasons:

1. First, the CD protection is provided in the form of insurance from the FDIC, with limits on the maximum insurance amount. If an investment in a CD exceeds the maximum insurance, you could lose money on the uninsured amount if the issuing bank is unable to repay such amount at maturity. U.S. Treasury and Agency securities, by contrast, have direct, unlimited backing by their respective issuers.
2. A second difference between CDs and government securities comes from the way the FDIC insurance operates when a bank is taken over by the FDIC. It can take some time for the insurance to get paid out. During that time, you might not be able to access the money in a CD, and the FDIC can decide to stop paying interest on your money after the takeover date.

Municipal securities have been generally thought of as safe because historically the frequency of default has been low. However, these bonds are issued by State and local government entities, not the Federal government. They can have significant risks associated

with them including, but not limited to: the ability of the governmental entity that issues the bond to pay interest and repay principal; the stability of the revenue stream that is used to make the interest and principal payments to the bondholders; the length of time until the bond is due to mature; and, whether or not the bond can be “called,” that is, paid off prior to maturity. When a bond is called, it may not be possible to replace it with a bond of equal character paying the same amount of interest or yield to maturity.

A money market fund is technically a security. The fund managers attempt to keep the share price constant at \$1/share. However, there is no guarantee that the share price will stay at \$1/share. If the share price goes down, you can lose some or your entire principal. The SEC notes that, “While investor losses in money market funds have been rare, they are possible.” In return for this risk, you should earn a greater return on your cash than you would expect from an FDIC insured savings account (money market funds are not FDIC insured).

Money market fund rates are variable. In other words, you do not know how much you will earn on your investment next month. The rate could go up or down. If it goes up, that may be a good thing. However, if it goes down and you earn less than you expected, you can end up needing more cash.

A final risk you are taking with money market funds has to do with inflation. Because money market funds are considered to be safer than other investments like stocks, long-term average returns on money market funds tends to be less than long-term average returns on riskier investments. Over long periods of time, inflation can eat away at your returns.

There are numerous ways of measuring the risk of equity securities (also known simply as “equities” or “stock”). In very broad terms, the value of a stock depends on the financial health of the company issuing it. However, stock prices can be affected by many other factors including, but not limited to the class of stock (for example, preferred or common); the health of the market sector of the issuing company; and, the overall health of the economy. In general, larger, better established companies (“large cap”) tend to be safer than

smaller start-up companies (“small cap”) but the mere size of an issuer is not, by itself, an indicator of the safety of the investment.

Mutual funds and exchange traded funds are professionally managed collective investment systems that pool money from many investors and invest in stocks, bonds, short-term money market instruments, other mutual funds, other securities, or any combination thereof. The fund will have a manager that trades the fund's investments in accordance with the fund's investment objective. While mutual funds and ETFs generally provide diversification, risks can be significantly increased if the fund is concentrated in a particular sector of the market, primarily invests in small cap or speculative companies, uses leverage (i.e., borrows money) to a significant degree, or concentrates in a particular type of security (i.e., equities) rather than balancing the fund with different types of securities. Exchange traded funds differ from mutual funds since they can be bought and sold throughout the day like stock and their price can fluctuate throughout the day. The returns on mutual funds and ETFs can be reduced by the costs to manage the funds. Also, while some mutual funds are “no load” and charge no fee to buy into, or sell out of, the fund, other types of mutual funds charge such fees which can also reduce returns. Mutual funds can also be “closed end” or “open end.” So-called “open end” mutual funds continue to allow in new investors indefinitely which can dilute other investors’ interests. Closed-end funds have a fixed number of shares but may trade at prices above or below the net asset value (NAV) of their assets. Buying above (or selling below) the NAV can decrease profit or increase loss compared to an open-end fund.

Exchange traded funds differ from mutual funds since they can be bought and sold throughout the day like stock and their price can fluctuate throughout the day. During time of extreme market volatility ETF pricing may lag in comparison with the actual underlying asset values. This lag usually resolves itself in a short period of time (usually less than one day) however there is no guarantee this relationship will always occur.

Corporate debt securities (or “bonds”) are typically safer investments than equity securities, but their risk can also vary widely based on: the financial health of the issuer; the risk that the issuer might default; when the bond is set to mature; and, whether or not the bond can be

“called” prior to maturity. When a bond is called, it may not be possible to replace it with a bond of equal character paying the same rate of return.

We do not typically buy and sell options to seek trading profits, nor do we “write” options to collect extra cash income from the premiums received. However, we would consider using options in certain, very limited and specific situations as part of a risk management strategy. Options are complex financial instruments that involve magnified risks and are not suitable for everyone. Option trading can be speculative in nature and carries substantial risk of loss. The two types of options are calls and puts.

A call gives the holder the right to buy an asset at a certain price within a specific period of time. Speculative buyers of calls may profit if the asset price rises substantially before the option expires. They may lose the entire purchase price of the option if the asset price does not rise much, or goes down. Sellers of calls receive a premium paid by the option buyer but may lose money if the asset price rises before the option expires.

A put gives the holder the right to sell an asset at a certain price within a specific period of time. Speculative buyers of puts may profit if the price of the asset price declines significantly before the option expires. They may lose the entire purchase price of the option if the asset price does not go down much, or goes up. Sellers of puts receive a premium paid by the option buyer but may lose money if the asset price declines before the option expires.

As noted above, Heartwood Investments does not ordinarily use put or call options in its investment strategies. In a rare situation, it may be suitable to consider using these instruments to help manage the risk of holding a stock. For example, holding a put option in combination with a stock can reduce the risk of losing money if the stock price goes down because a gain on the put could offset some of the loss on the stock. An investor with a large gain in a stock might want to sell it but desires some flexibility as to the timing of a sale, perhaps for tax reasons. Buying a put may obtain a degree of short-term protection against a stock price decline until the option expires. Of course, the cost of the put would tend to reduce any profit on the stock.

If you were in a similar situation, we would help you to analyze how using options might affect your potential for return and risk. We would provide you with additional disclosures and ask you to approve a revised Investment Plan allowing the strategy, before proceeding.

### **We Try to Avoid Frequent Trading**

Heartwood Investments believes that frequent trading is seldom appropriate for the kinds of long-term investment goals we typically serve. Frequent trading may affect investment performance through increased brokerage commissions and other transaction costs and taxes. With that in mind, we make our best efforts to select securities with a view to long-term holding periods of more than one year.

### ***We Primarily Recommend Publicly-Traded Securities***

We have done our best to disclose the risks of publicly traded securities in the preceding paragraphs. However, no one can foresee all possible sources or occurrences of risk. Events such as (but not limited to) an outbreak of war, disruption of international trade, natural disasters such as earthquakes or floods, and failure of a large debtor country or major corporation to pay its debts, are all examples of things that can make investments go down in value but cannot be foreseen.

## **Item 9. Disciplinary Information**

Heartwood Investments believes that good ethics are the cornerstone of investor confidence and sound capital markets. We are very pleased to be able to say that our track record is consistent with our belief. At no time in the past has either our firm or any related person been involved as a subject in any material legal or disciplinary events regarding investment-related business. As a result, there is no disciplinary information to disclose.

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

### ***No Broker-Dealer Registration***

Neither Heartwood Investments nor any of its management persons is presently registered or has an application pending to register as a broker-dealer or a registered representative of a broker-dealer. Certain personnel may have been registered with a broker-dealer at a previous employer, but these relationships have been terminated and none of these persons any longer has any association with his or her former employer.

### ***No Futures Commission Merchant or Commodities Pool Operator Registration***

We are not registered nor have an application pending to register as a futures commission merchant, commodity pool operator, commodity trading advisor, or an associated person of any of those entities. The same is true for our managers and employees.

### ***No Affiliation With Other Financial Industry Entities***

Our company and its management persons believe that we have no relationship that is material to our advisory business, or our clients, with any other financial industry entity. We engage in no other investment-related business other than the discretionary management of our clients' portfolios for a fee. We seek to prevent conflicts of interest that could come between us and our clients involving the following entities or any other organization in the investment business:

1. broker-dealer, municipal securities dealer, or government securities dealer or broker
2. investment company or other pooled investment vehicle (including a mutual fund, closed-end investment company, unit investment trust, private investment company or "hedge fund," and offshore fund)
3. other investment adviser or financial planner
4. futures commission merchant, commodity pool operator, or commodity trading advisor
5. banking or thrift institution
6. accountant or accounting firm
7. lawyer or law firm

8. insurance company or agency
9. pension consultant
10. real estate broker or dealer
11. sponsor or syndicator of limited partnerships.

### ***Other Investment Advisers***

If we bring in another adviser to manage assets for you, that other adviser would be called a third-party money manager. As discussed in the following section, we do not presently recommend or select third-party money managers for our clients. However, our standard investment advisory agreement does include the authority for us to bring in third-party money managers to help us manage your account if your investment objectives, circumstances, and preferences indicate that it would benefit you. You would know if we were considering a third-party money manager because we would discuss this with you carefully, you would receive additional disclosures from both us and the third-party money manager at the same time, and most of all because we would ask you to sign a separate investment advisory agreement with any such third-party money manager and set up a separate account for the purpose before they would be allowed to manage any of your money.

If we ever do recommend or bring in a third-party money manager for your account, we would not accept any payment from that third-party money manager, because we would want to remain independent.

We would maintain independence from the third-party money manager by requiring that your account being managed by a third-party money manager would pay the third-party money manager's fee directly. This would mean two things. First, you would actually be paying two fees: both the third-party money manager's and ours. Second, you would be aware of the third-party money manager's fee because you would have signed the third-party money manager's agreement and would see both fees in the account statement provided by the qualified custodian.



Heartwood would continue to be responsible for supervising the work of the third-party money manager, and we would retain the authority to terminate the third-party money manager at our sole discretion. To be clear, however, we would like to emphasize that we do not presently recommend or select other investment advisers for our clients.

## **Criteria for Recommendation or Selection of Other Advisers**

If your investment objectives, circumstances, or preferences call for it, a third-party money manager could be selected based on its potential ability to extend your portfolio into new asset classes or investment techniques. For example, a specialized third-party money manager might be able to provide otherwise unavailable skill with international equity investing, or access to an illiquid asset class such as privately placed debt. A client with sufficient ability and willingness to take risk might desire us to assist him or her to gain access to investment opportunities available through such a specialized third-party money manager.

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

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

As a registered investment adviser, Heartwood Investments adopted a Code of Ethics in keeping with SEC Rule 204A-1 and/or similar state rules. We will gladly provide a copy of our Code of Ethics to any client or prospective client upon request. The following gives a general overview of our Code.

Heartwood Investments is a fiduciary for our investment advisory clients. Because of this fiduciary relationship, it is generally improper for our company or employees to:

- use for their own benefit (or the benefit of anyone other than the client) information about the Company's trading or recommendations for client accounts; or
- take advantage of investment opportunities that would otherwise be available for the Company's clients.

In addition, as a matter of business policy, we want to avoid even the appearance that our company, its employees, or others receive any improper benefit from information about client trading or accounts or from our relationships with our clients or with the brokerage community.

We expect all employees to comply with the spirit of the Code, as well as the specific rules contained in the Code.

We would treat violations of this Code (including violations of the spirit of the Code) very seriously. If one of our employees were to violate either the letter or the spirit of our Code, we may take disciplinary measures including, without limitation, imposing penalties or fines, reducing the employee's compensation, demoting him or her, requiring unwinding of an improper trade, requiring disgorgement of trading gains, suspending or terminating employment, or any combination of these steps.

Improper trading activity by an employee can constitute a violation of our Code. Nevertheless, an employee can also violate our Code by failing to file required reports, or by making inaccurate or misleading reports or statements concerning trading activity or securities accounts. We consider that employee conduct can violate this Code even if no clients are harmed by the conduct.

Our Code addresses a number of topics, some of which are discussed further in the sections below. The list of topics includes, without limitation:

- definitions of who and what are covered by the Code,
- potential conflicts of interest with clients,
- personal trading policies,
- prohibited and restricted personal transactions,
- a prohibition against insider trading, and
- policies respecting material, non-public information,

## ***How We Handle Potential Conflicts of Interest Involving Securities***

Heartwood Investments has clear practices that effectively prevent our company or employees from buying or selling securities for client accounts in which one of us has a material financial interest. To be specific:

1. We do not buy securities from or sell securities to our clients.
2. We do not act as a general partner in any partnership in which we solicit client investments (and in fact, we do not solicit investments in partnerships.)
3. We do not act as an investment adviser to an investment company that we recommend to clients.

The same three statements are true of our employees, including related persons.

We consider that a conflict could be perceived to exist where one of us has a large, personal stake in an investment even when there is no direct transaction between one of us and a client.

## ***How We Handle Potential Conflicts of Interest Involving Personal Trading***

Heartwood Investments, as a company, does not maintain an investment position in securities we buy or sell for clients. However, we do allow our employees to invest in the same securities we buy or sell for clients, subject to strict procedures designed to guard against conflicts of interest. First of all, client transactions have precedence over personal trades, meaning that personal trades in any of the securities we buy or sell for clients must wait until after client trades have been completed. In general, we require our employees to obtain prior, specific, written permission from our chief compliance officer before making any personal investment transaction. The reason we do this is to keep the firm aware of what our employees are buying and selling personally, to help us maintain separation in time between our clients' transactions and our own, and to avoid a situation where an employee would sell while we were buying for clients, or vice versa.

Some of our employees or members of their families have hired Heartwood Investments to manage their portfolios. They pay our fee and we are duty-bound to treat those accounts as clients. This means that those accounts will routinely invest in the same securities as our clients. Some family member clients who are not employees are not subject to the Code of Ethics—a parent living in another state, for example. Transactions for their managed accounts are handled right along with those for any other client. A special difference applies to discretionary managed accounts for employees subject to our Code. These accounts would still purchase or sell the same investments as our other clients. However, the trades for those accounts have to wait until client trades in the same security are completed. This policy is discussed more fully in the following section on aggregated, “block” trades.

## **Item 12. Brokerage Practices**

### ***Selecting or Recommending Broker-Dealers for Client Transactions***

Heartwood will generally recommend that securities be purchased through the facilities of the account custodian. Presently, we recommend that all of our clients use Fidelity Investments as a custodian. It may be the case that Fidelity Investments charges a higher fee than another broker charges for a particular type of service, such as commission rates. In selecting Fidelity Investments as the broker dealer to recommend for its client accounts, we believe that Fidelity Investments provides quality services to clients for reasonable costs.

### **Determining the Reasonableness of Broker-Dealer Compensation**

The reasonableness of commissions is based on several factors, including the broker’s ability to provide professional services, competitive commission rates, volume discounts, execution price negotiations, and other services.

## **Services We Purchase From or Through Fidelity**

Heartwood Investments purchases certain services from or through Fidelity. These services (for which we pay regularly) include:

- Independent, third-party investment research
- Our portfolio management software database system, Advent APX, and
- Our market quotation system, ThomsonOne

We understand that we can purchase these or similar services independently of Fidelity. However, we find it convenient to pay for the services by means of a direct deduction from our firm's account at Fidelity. This account is funded solely with money Heartwood deposits or receives as client fees.

We believe that Fidelity has negotiated certain discounts on services from third-party vendors, which may allow us to purchase those services for less than we would pay directly. Importantly, however, we believe that Fidelity holds out substantially the same discounts to all advisory firms. It is our understanding that Fidelity does this solely for competitive reasons and treats Heartwood the same as any other firm in respect to these discounts.

## **No Soft-Dollar Benefits**

Heartwood is not aware of any discount that is dependent on a certain level of commissions, product selection, or transactions volume. Fidelity does not give us any money to help us pay for the things we buy through them. In other words, we have no "soft-dollar" arrangements with Fidelity, or any other company.

## **No Client Referrals From Broker-Dealers**

We do not receive client referrals from any Broker-Dealer, including Fidelity.

## **Directed Brokerage**

Heartwood finds that it is in our clients' interests to place transactions directly through the brokerage provided by the qualified custodian of their account or accounts. By placing transactions with your custodian we may be unable to achieve the most favorable execution of your transactions and this practice could cost you more money.

## ***Aggregation of Purchases and Sales***

If it is consistent with achieving best execution for various client accounts and if it is deemed to be in the best interests of participating clients, orders for the same security entered on behalf of multiple clients may be aggregated. All Clients participating in each aggregated order shall receive the weighted average price and pay a trade commission based on the account agreement with the custodian. Smaller accounts may bear higher charges if they fail to meet the minimum account sizes set by the broker.

The appropriate share amount of each buy or sell of a particular security is determined prior to placing the trade. Allocations of orders among client accounts must be made in a fair and equitable manner. Each participating client in an aggregated trade receives the pre-determined number of shares in the trade allocation process. In the unusual event of a partial fill of an aggregated order, then just and equitable allocation is made to the client accounts in proportion to the pre-trade allocation. For example, if only 80 percent of a block trade gets filled then each account would be allocated 80 percent of its respective pre-trade allocation.

As a rule, allocations among accounts with the same or similar investment objective are made in proportion to account size. We do not base allocations to an account or set of accounts on account performance or the amount or structure of management fees. When such concurrent authorizations occur, the objective will be to allocate the executions in a manner that is deemed equitable to the accounts involved. However, the following factors may justify an allocation that deviates from the general rule.

- Specific allocations may be chosen in order to adjust or maintain the overall ratios of specific securities held by client accounts.
- Specific allocations may be chosen based upon an account's existing positions in securities.
- Specific allocations may be chosen because of the cash availability of one or more particular accounts.
- Specific allocations may be chosen for tax reasons.
- An account's allocation may be eliminated, reduced, or increased because of investment policies and restrictions, account guideline limitations, or investment objectives. Clients with specific investment policies, restrictions, or limitations may not be able to participate in certain aggregated transactions, and therefore, may not benefit from averaged pricing.

Aggregated orders may include proprietary or related accounts. Related accounts are those which are owned or controlled by Associated Persons (as defined in The Code of Ethics) of Heartwood. Orders for the Related account will not be included with client orders in the aggregated (block) trade. Instead, those orders will be identified and prepared but not entered until after the client block trade has been completed. Completion ordinarily means we receive a report from the executing broker that all shares in the block trade have been traded. At that time, we can then enter order(s) for Related accounts. In the case where an aggregated trade for client accounts is not completed, Related account trades would not be entered until after we resolve the unfilled block.

## **Item 13. Review of Accounts**

David G. Sparks, President, and/or Todd C. Henningsen, Portfolio Manager, monitor client accounts on an ongoing basis. These individuals are both portfolio managers and members of our both our Portfolio Management and Investment Committees. The Investment Committee meets regularly to review individual securities holdings and consider new investments. It also determines the composition and allocation of the model portfolios that guide the selection and amount of individual securities and asset classes in client accounts. The Committee uses

information about the amount and value of holdings in individual accounts in the course of its work. For example, the size of individual account holdings of a security or the amount of realized or unrealized gain or loss may be considered for each account when we approach a decision to sell. This attention to account-specific information keeps the Committee members directly engaged in supervising client accounts while at the same time determining the makeup of our model portfolios.

### ***Periodic Review***

We strive to visit in person or by phone with our clients on a quarterly basis. This is not always possible due to scheduling challenges. Preparation for a client visit typically includes an internal review of the Investment Plan and any updates to it, investment positions, transactions and account performance. This review is done by one of the portfolio managers named above and then presented to the Portfolio Management Committee.

### ***Review on Other Occasions***

Triggering factors that may stimulate additional reviews of a client's account include, but are not limited to, the following: changes in economic conditions, changes in the client's financial situation or investment objectives, and/or the client's request for an additional review of the account

### ***Reports We Provide Regularly to Clients***

On a quarterly basis, we mail reports to our clients that we generate using a portfolio management software database. These reports typically include a portfolio appraisal detailing account holdings, schedule of purchases and sales, and an investment performance report showing percentage rate of return net of fees. Other reports may be provided based on the specific situation, needs or preferences of the account or client.

We strive to keep our database and reports as accurate as possible. However, we remind clients that our reports are supplemental in nature. The official record of account holdings



and transactions is the monthly or quarterly statement that the qualified custodian sends directly to the client. We urge clients to compare our reports to the custodian's statements and, if they have any questions, to contact the custodian or us.

It is important that clients ensure they are receiving statements from their custodian. We urge clients to tell us if they are not receiving custodial statements.

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

### ***No Economic Benefits Other Than Client Fees***

Heartwood Investments has only one source of revenue: a quarterly fee that our clients pay us based on a percentage of the market value of the assets we manage. No other person who is not a client provides any economic benefit to us for providing investment advice or other advisory services to our clients. We are mindful that economic benefits can include many different things, such as sales awards or other prizes. We do not receive these kinds of benefits because we do not sell any investment products or services for others. We like it that way because we want to stay independent and base our decisions solely on what is in the best interest of our clients.

### ***Payment for Referrals***

Heartwood Investments does not currently compensate any person (individual or entity) for client referrals, or the development of new advisory business.

## **Item 15. Custody**

We do not hold client money or securities at Heartwood Investments. Instead, all of the assets we manage are held in accounts registered in our clients' names at qualified custodians. A qualified custodian is an institution such as a bank, mutual fund, or brokerage firm. For example, Fidelity Investments is a qualified custodian. Our company believes there should be clear separation between our role as investment manager and the qualified

custodian responsible for holding our clients' assets that we manage. Keeping management and custody separate and mutually independent establishes important checks and balances to protect client assets.

The custodian sends account statements at least quarterly, typically monthly, directly to clients. These statements are the official record of the holdings and transactions in the accounts we manage. You should carefully review those statements. If you are not receiving statements from the custodian, we urge you to notify us so we can help ensure that the statements are coming to you. . Heartwood also sends reports to clients, using a different system. We urge you to compare the account statements you receive from the qualified custodian with those you receive from us.

## **Item 16. Investment Discretion**

Clients generally grant Heartwood complete discretion over the selection and amount of securities to be purchased or sold for their account without obtaining their prior consent or approval. As detailed previously in the section titled Advisory Business, this grant of discretionary authority is made in writing in both our investment advisory agreement and the qualified custodian's brokerage account agreement. You must sign both of these agreements before we assume discretionary authority for your account. There is yet a third step that we require before managing a discretionary account: documenting your investment guidelines by completing the Investment Plan described previously. This is important because the Investment Plan may limit our investment authority to specified investment objectives, guidelines, and/or conditions imposed by you

In the unlikely event that Heartwood enters into a non-discretionary arrangement with a client, we will obtain client approval prior to the execution of a trade. However, we do not presently have any non-discretionary arrangements and would be reluctant to enter into one.

## **Item 17. Voting Client Securities**

### ***Proxy Voting***

Heartwood will not vote proxies on your behalf. Instead, proxies or other solicitations relating to the issuers of securities you own will be sent to you directly from your qualified custodian or a transfer agent working with a particular security. However, we encourage you to call us with any questions about your investments, including proxies, and we may offer you advice regarding corporate actions and the exercise of proxy voting rights.

## **Item 18. Financial Information**

Investment advisers that charge management fees above a certain amount in advance must disclose audited financial information. Heartwood Investments charges its management fee in arrears, not in advance. Accordingly, we are not required to disclose audited financial information.

We are still required to disclose information about any material financial condition that would imperil our ability to perform our contractual obligations to clients. As of December 31, 2011, Heartwood Investments, Inc. believes that we have no such material financial condition to disclose because, based on our best estimation, our financial condition is sound and adequate to ensure that we can meet our contractual obligations.

## **Item 19. Requirements for State-Registered Advisers**

### ***Principal officers and management persons.***

David G. Sparks, CFA, President, and Chief Compliance Officer. Mr. Sparks received a BA degree in Speech and Communications from the University of Northern Iowa in 1975. He earned the Chartered Financial Analyst professional designation from the CFA Institute in 1986. Mr. Sparks has more than 33 years of investment experience. He has served the CFA Institute in a variety of capacities since 1999. In addition, he taught courses in Security

Analysis, Principles of Investments, Options and Futures, and Corporation Finance as an instructor at the University of Northern Iowa between 1991 and 2009.

Todd C. Henningsen, Portfolio Manager. Mr. Henningsen received a BA degree in Finance and Real Estate from the University of Northern Iowa in 2009. He has passed all three levels of the Chartered Financial Analyst (CFA) Exams. He has three years of investment experience with Heartwood Investments. Prior to joining Heartwood, Todd gained experience during a full-semester undergraduate internship in the commercial loan investment division of a major, global insurance company.

### ***Other business activities.***

Heartwood Investments does not engage in any business activities other than giving investment advice by managing investment accounts. Mr. Sparks volunteers from time to time with the CFA Institute, a global organization of investment professionals. In the past few years he has devoted up to five weeks per year in that way.

### ***Performance-based fees.***

Neither our company nor any supervised person is compensated for advisory services with performance-based fees.

### ***Certain Disciplinary Events.***

At no time in the past has either our firm or any related person been involved as a subject in any material legal or disciplinary events regarding investment-related business. As a result, there is no disciplinary information to disclose.

### ***Relationships with Issuers of Securities.***

Neither our company nor any management person has any relationship or arrangement with any issuer of securities.



216 E. 4<sup>th</sup> Street | PO Box 1197 | Waterloo, IA 50704  
Phone: 319-233-1717 | Fax: 319-233-1987  
[www.HeartwoodInvestments.com](http://www.HeartwoodInvestments.com)

Form ADV Part 2B Disclosure Brochure Supplement

David G. Sparks, CFA

January 30, 2012

This brochure supplement provides information about David G. Sparks, CFA that supplements the Heartwood Investments, Inc. brochure. You should have received a copy of that brochure. Please contact David G. Sparks, CFA, at the above address or telephone number if you did not receive Heartwood Investments, Inc.'s brochure or if you have any questions about the contents of this supplement.

Additional information about David G. Sparks, CFA, is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

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## ***Educational Background and Business Experience***

David G. Sparks, CFA, was born in 1949. He graduated in 1967 from Hillcrest High School, Simpsonville, South Carolina. He attended the University of the South, Sewanee, Tennessee and graduated from the University of Northern Iowa, Cedar Falls, Iowa in 1976 with a BA degree in Speech and Communications.

In 1979 Mr. Sparks began his career in the investment industry with the regional brokerage firm of Blunt, Ellis & Loewi, as a Registered Representative in the firm's Waterloo, Iowa office. His responsibilities included investment sales and services to private clients, businesses, and charitable institutions. He remained with Loewi until 1990.

In 1990 he joined Piper, Jaffray, Inc. as Vice President-Sales in its Waterloo, Iowa office. His responsibilities included investment sales and services to private clients, businesses, and charitable institutions. He remained with Piper Jaffray until 1996.

In 1996 he joined Securities Corporation of Iowa as Senior Vice President – Branch Manager of its Waterloo, Iowa office. His responsibilities included hiring and supervision of other brokerage sales and service personnel in the office, along with his own work with investment clients. SCI was sold to Wells Fargo Investments, LLC in 2001. At that time, his supervisory responsibilities were shifted to a central office. Mr. Sparks continued providing investment sales and services to individuals, businesses, and charitable institutions until his retirement from Wells Fargo in 2007.

In 2007 Mr. Sparks founded Heartwood Investments, Inc. and became its president. He continues in that capacity today, also serving as Chief Compliance Officer of Heartwood.

In 1986 Mr. Sparks completed the CFA Candidate Program and was awarded the Chartered Financial Analyst (CFA) professional designation by the CFA Institute, Charlottesville, Virginia.

First introduced in 1963, the Chartered Financial Analyst designation, or CFA charter, has become a globally recognized investment credential. To earn the CFA charter a candidate must:

- have four years of qualified investment work experience,
- become a member of CFA Institute,
- pledge to adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct on an annual basis,
- apply for membership to a local CFA member society, and,
- complete the CFA Program.

The CFA Program is organized into three levels, each culminating in a six-hour exam. Completing the Program takes most candidates between two and five years. The CFA Program reflects a broad Candidate Body of Knowledge™ (CBOK) developed and continuously updated by active practitioners in today's global investment industry. Topic areas in the CBOK include:

- I. Ethical and Professional Standards
- II. Quantitative Methods
- III. Economics
- V. Financial Reporting and Analysis
- V. Corporate Finance
- VI. Equity Investments
- VII. Fixed Income
- VIII. Derivatives
- IX. Alternative Investments
- X. Portfolio Management and Wealth Planning

In 1991, while working in the investment industry, Mr. Sparks began also teaching college courses in finance and investments as an Adjunct Instructor in the Finance department of the College of Business Administration at the University of Northern Iowa, Cedar Falls, Iowa. Between 1991 and 2003 courses he taught included Corporation Finance, Principles of Investments, and Security Analysis. He resumed teaching at UNI in 2007 as a full-time Instructor of Finance, teaching courses in Corporation Finance, Principles of Investments, and Options and Futures. Mr. Sparks stopped teaching after the spring semester of 2009, to devote full time to Heartwood Investments.

### ***Disciplinary Information***

Mr. Sparks has not been involved in any legal or disciplinary events during his career in the investment industry.

### ***Other Business Activities***

Mr. Sparks is NOT actively engaged in any investment-related business or occupation, except for Heartwood Investments. He does NOT receive any commissions, bonuses or other compensation, in cash or any other form, based on the sale of securities or other investment products, including as a broker-dealer or registered representative, and including distribution or service (“trail”) fees from the sale of mutual funds.

Mr. Sparks and his wife jointly own farms that produce more than 10% of their annual income. The farms are professionally managed and thus do not require a substantial commitment of time.

Mr. Sparks has served in a variety of different roles as both an employee and private contractor with the CFA Institute since 1999. This work has required up to 10% of Mr. Sparks’s professional time in recent years, and contributed more than 10% of his annual income.



### ***Additional Compensation***

Mr. Sparks receives NO economic benefit, compensation, bonus, or any other reward or prize, from any person who is not a client, for providing investment advisory services. His sole compensation for this work consists of salary and/or bonus he earns as an employee of Heartwood Investments, or dividends paid to him as a shareholder of Heartwood. Mr. Sparks's bonus as a Heartwood employee and/or dividend as a shareholder is based on the financial profit performance of the firm net of expenses. This performance may be affected, at least in part, by the number or amount of sales, client referrals, or new accounts.

### ***Supervision***

Mr. Sparks is the sole stockholder, sole director, chief executive officer, and president of Heartwood Investments, Inc. He is the firm's designated Chief Compliance Officer. The fact is that he is responsible for supervising his own work on behalf of Heartwood. Mr. Sparks can be reached at the following telephone number: 319-233-1717.

### ***Requirements for State-Registered Advisers***

Mr. Sparks has not been involved in any arbitration claim alleging damages in excess of \$2,500.

He has not been subject to an award or otherwise found liable in a civil, self-regulatory, or administrative proceeding.

He has not been the subject of any bankruptcy proceeding.



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Form Adv Part 2B Disclosure Brochure Supplement

Todd C. Henningsen

January 30, 2012

This brochure supplement provides information about Todd C. Henningsen that supplements the Heartwood Investments, Inc. brochure. You should have received a copy of that brochure. Please contact David G. Sparks, CFA, Chief Compliance Officer, at the above address or telephone number if you did not receive Heartwood Investments, Inc.'s brochure or if you have any questions about the contents of this supplement.

Additional information about Todd C. Henningsen is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

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## ***Educational Background and Business Experience***

Todd C. Henningsen was born in 1985. He graduated in 2004 from Grundy Center High School, Grundy Center, Iowa. He graduated from the University of Northern Iowa, Cedar Falls, Iowa in 2009 with a BA degree in Finance and Real Estate.

In 2008 Mr. Henningsen was awarded a seven-month undergraduate internship with Aegon, U.S.A., working with its Commercial Real Estate Investment arm in Louisville, Kentucky.

In 2009 Mr. Henningsen began his career in the investment advisory industry as a Portfolio Analyst with Heartwood Investments, Inc. His responsibilities included investment security analysis and preparation of research reports for the firm's investment committee.

In 2009 Mr. Henningsen entered the CFA Candidate Program sponsored by the CFA Institute, Charlottesville, Virginia. He passed the CFA Level One exam in 2009, the CFA Level Two exam in 2010, and completed the Program by passing the CFA Level Three exam in 2011.

First introduced in 1963, the Chartered Financial Analyst designation, also referred to as the CFA charter, has become a globally recognized investment credential. To earn the CFA charter a candidate must:

- have four years of qualified investment work experience,
- become a member of CFA Institute,
- pledge to adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct on an annual basis,
- apply for membership to a local CFA member society, and,
- complete the CFA Program.

The CFA Program is organized into three levels, each culminating in a six-hour exam. Completing the Program takes most candidates between two and five years. The CFA Program reflects a broad Candidate Body of Knowledge™ (CBOK) developed and continuously updated by active practitioners in today's global investment industry. Topic areas in the CBOK include:

- I. Ethical and Professional Standards
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- V. Financial Reporting and Analysis
- V. Corporate Finance
- VI. Equity Investments
- VII. Fixed Income
- VIII. Derivatives
- IX. Alternative Investments
- X. Portfolio Management and Wealth Planning

## ***Disciplinary Information***

Mr. Henningsen has not been involved in any legal or disciplinary events during his career in the investment industry.

## ***Other Business Activities***

Mr. Henningsen is NOT actively engaged in any investment-related business or occupation, except for Heartwood Investments. He does NOT receive any commissions, bonuses or other compensation, in cash or any other form, based on the sale of securities or other investment products, including as a broker-dealer or registered representative, and including distribution or service (“trail”) fees from the sale of mutual funds.

## ***Additional Compensation***

Mr. Henningsen receives NO economic benefit, compensation, bonus, or any other reward or prize, from any person who is not a client, for providing investment advisory services. His sole compensation for this work consists of salary he earns as an employee of Heartwood Investments.

## ***Supervision***

Mr. Henningsen is supervised by David G. Sparks, CFA, chief executive officer and president of Heartwood Investments, Inc. Mr. Sparks is our company’s designated Chief Compliance Officer, also. He can be reached at the following telephone number: 319-233-1717.

## ***Requirements for State-Registered Advisers***

Mr. Henningsen has not been involved in any arbitration claim alleging damages in excess of \$2,500.

He has not been subject to an award or otherwise found liable in a civil, self-regulatory, or administrative proceeding.

He has not been the subject of any bankruptcy proceeding.