



## **Vellum Financial, LLC**

Form ADV, Part 2A

Firm Brochure

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This brochure provides information about the qualifications and business practices of Vellum Financial, LLC ("VFL"). If you have any questions about the contents of this brochure, please contact us at (805) 546-1000 or [dito@vellumfinancial.com](mailto:dito@vellumfinancial.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission ("SEC") or by any state securities authority. Additional information about VFL is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). References herein to VFL as a "registered investment adviser" or any reference to being "registered" does not imply a certain level of skill or training.

## Item 2 – Material Changes

Since VFL's last Annual Amendment filing on March 31, 2014, this brochure was amended to enhance our prior disclosures regarding our investment advisory services in order to provide more insight into our Tactical Active Management Strategies and to disclose VFL's use of an algorithmic trading system created and maintained by AlphaGen Strategies, LLC in providing services to clients whose accounts are managed according to one or more of those strategies.

Additionally, we amended our prior disclosures regarding our investment advisory fees to more clearly represent our move away from standard fee schedules to individually negotiated advisory fee arrangements with clients and added disclosure to alert you that when negotiating advisory fee arrangements with clients, our goal is not to ensure that the advisory fees paid by each client result in the same level of net profitability for VFL, but rather that VFL and the client mutually agree that the negotiated advisory fee is fair in relation to the value of the services that we provide. Furthermore, we amended our prior disclosures in order to accurately reflect the method by which refunds of investment advisory fees will be determined by VFL for clients who terminate VFL's investment advisory services before the end of the quarter.

In addition, we have substantially enhanced our discussion of investment risks that our clients may face in the management of their accounts by VFL, including more specific risk disclosures relating to our Tactical Active Management Strategies. Furthermore, we added disclosure regarding VFL's potential conflict of interest when it recommends mutual funds that are not subject to any sales charges over other comparable mutual funds.

We have also added disclosure regarding our arrangements with AlphaGen Strategies, LLC, Argentus Capital Management, LLC, and FocusPoint Solutions, Inc., independent third-party firms which provide material services to VFL, and any potential conflicts of interest such arrangements may create. Additionally, we have amended our disclosures relating to the independent activities our investment adviser representatives may engage in, in their separate capacities as registered representatives of a broker-dealer and/or licensed insurance agents, and the sales based compensation that they generate from such activities.

Disclosure was also added regarding our new Selling Agreement with The Pacific Financial Group, Inc. as well as the solicitation arrangement between VFL and Melinda Monteen of Monteen Insurance and Investments, Inc. Additionally, we amended our disclosure to describe the relationship between VFL and Rohr & Associates CPAs, an accounting firm owned and operated by one of VFL's investment adviser representatives, Daniel Rohr, and the conflicts of interest arising from such relationships.

Finally, our Code of Ethics disclosures were amended to more accurately reflect the substance of VFL's Code of Ethics and we have amended our disclosures relating to our advisory services to provide information on the Vellum Managed Wrap Program, a wrap fee program that is sponsored by VFL, for which VFL also participates as a portfolio manager.

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## Item 4 – Advisory Business

### BACKGROUND

VFL is a limited liability company formed on August 4, 2009 in the State of California, which became registered as an investment adviser with the SEC on August 18, 2009. VFL is owned by: Kelly Smith, Partner; Bryan Sullivan, Founder and Managing Member; and Kevin Swanson, Partner.

As discussed below, VFL provides its clients with investment advisory services, and, to the extent specifically requested by a client, financial planning and related consulting services. Investment advisory services are tailored to the specific needs of each client. Before providing investment advisory services, an investment adviser representative (“IAR”) of VFL will ascertain the client’s investment objective(s), needs, and risk tolerances and, based on that information, recommend one or more of VFL’s Tactical Active Management Strategies and/or a portfolio of individual securities under VFL’s Traditional Asset Allocation Strategy.

Any portion of a client’s assets invested in a Tactical Active Management Strategy will, thereafter, be managed according to the respective model. For clients who elect to have all or a portion of their assets managed under VFL’s Traditional Asset Allocation Strategy, VFL will, thereafter, allocate or recommend that the client allocate investment assets consistent with their designated investment objective(s). Clients are advised that it is your responsibility to promptly notify VFL if there are ever any changes to your financial situation, goals, needs or investment objectives so that VFL may review, evaluate and/or revise its previous recommendations and/or the services currently provided.

All clients, regardless of investment strategy, have the ability to impose reasonable restrictions, at any time, on the types of investments to be held in their portfolios. Restrictions may be based on a company, security, industry sector, asset class, or any other restriction you request. You must, however, notify us in writing of any such investment restrictions or changes to such restrictions.

In performing our services, VFL is not required to verify any information received from the client or the client’s other professionals and your engagement of VFL’s services constitutes your express authorization for VFL to rely on such information without verification.

As of December 31, 2014, VFL had \$143,195,089 in assets under management, \$137,626,830 of which was managed on a discretionary basis by VFL.

### INVESTMENT STRATEGIES

#### **Tactical Active Management Strategies**

VFL’s Tactical Active Management Strategies are based on an active quantitative process that is designed to seek out and capture profits in up markets and take defensive positions during down markets by tracking the investment price movements of hundreds of potential investments, primarily

mutual funds, in an attempt to find advantageous entry and exit points. These strategies utilize an algorithmic trading system created and maintained by AlphaGen Strategies, LLC ("AlphaGen") and licensed to VFL. Each strategy consists of 11 different trading models, which, in turn, consist of 9 to 14 investments. VFL is responsible for determining and setting the specific parameters that AlphaGen's algorithmic trading system must operate within by determining which 11 trading models each strategy will utilize and then determining the universe of investments that AlphaGen's algorithmic trading system may choose from based on VFL's determination of what is appropriate for each strategy and/or model. Using mathematical algorithms that analyze market data, AlphaGen's trading system then provides VFL with daily recommendations on securities to buy, sell, and/or hold, which are then either accepted and implemented or rejected by VFL. A primary benefit of a quantitative investment strategy is the ability to exclude emotions from the investment decision-making process and, consequently, investment recommendations received by VFL from AlphaGen's algorithmic trading system that have been customized by VFL are generally accepted and implemented as opposed to rejected. VFL's Tactical Active Management Strategies are offered on a discretionary basis only.

VFL primarily offers five different Tactical Active Management Strategies, which are briefly described below:

- The Bond Portfolio is constructed in a manner that attempts to focus on fixed income-related investments while limiting the strategy's maximum exposure to equities to 10%.
- The *Conservative Portfolio* is constructed in a manner that attempts to limit the strategy's maximum exposure to equities to 30%.
- The *Moderate Portfolio* is constructed in a manner that attempts to limit the strategy's maximum exposure to equities to 60%.
- The *Moderate Growth Portfolio* is constructed in a manner that attempts to limit the strategy's maximum exposure to equities to 80%.
- The *Growth Portfolio* is constructed in a manner that includes no limitations on the strategy's maximum exposure to equities.

In addition to the five primary strategies, nine other models which are variations of either the Conservative, Moderate, Moderate Growth, or Growth Portfolios, which utilize exchange-traded funds ("ETFs") instead of mutual funds or which are designed to work within specific variable annuities are offered to clients.

### **Traditional Asset Allocation Strategy**

VFL also provides investment management services to clients, on a discretionary and non-discretionary basis, using a traditional asset allocation investment strategy that selects securities based on fundamental analysis. Client portfolios managed under the Traditional Asset Allocation Strategy will be tailored to the client's specific needs and may include some or all of the following securities: stocks/equities, bonds/fixed income, options and other public and private securities or investments, although the majority of client portfolios managed under this strategy will consist of mutual funds and ETFs. Client accounts are generally rebalanced or reallocated periodically in order to reestablish the

targeted percentages of the initial asset allocation. This rebalancing or reallocation will occur on the schedule set by the client in consultation with VFL, which emphasizes continuous and regular account supervision.

## **FINANCIAL PLANNING AND CONSULTING SERVICES (STAND-ALONE)**

To the extent requested by a client, VFL may provide financial planning and/or consulting services based on an analysis of the client's current situation, goals, and objectives. This planning or consulting may encompass one or more of the following areas: Investment Planning, Retirement Planning, Estate Planning, Charitable Planning, Education Planning, Cost Segregation Study, Corporate Structure, Real Estate Analysis, Mortgage/Debt Analysis, Insurance Analysis, Lines of Credit Evaluation, Business and Personal Financial Planning. VFL's written financial plans or financial consultations rendered to clients usually include general recommendations for a course of activity or specific actions to be taken by the client. For example, recommendations may be made that clients begin or revise investment programs, create or revise wills or trusts, obtain or revise insurance coverage, commence or alter retirement savings, or establish education or charitable giving programs. VFL is not a law firm or accounting firm and no portion of VFL's services should be construed as legal, tax, or accounting advice.

## **NON-INVESTMENT CONSULTING/IMPLEMENTATION SERVICES**

To the extent requested by a client, VFL may recommend the services of other professionals (e.g., attorneys, accountants, insurance agents) for certain non-investment implementation purposes, including IARs of VFL in their separate capacities as attorneys, accountants, insurance agents, etc... The client is under no obligation to engage the services of any such recommended professional(s) and retains absolute discretion over all such implementation decisions and is free to accept or reject any recommendation from VFL. If the client engages any such recommended professional, and a dispute arises thereafter relative to such engagement, the client agrees to seek recourse exclusively from and against the engaged professional.

## **VELLUM MANAGED WRAP PROGRAM**

VFL sponsors the Vellum Managed Wrap Program (the "Program") and offers the services of the Program to both its existing and prospective advisory clients. Under a wrap fee program, the wrap fee program sponsor arranges for the client to receive investment advisory services, the execution of securities brokerage transactions, custody and reporting services for a single specified fee. Participation in a wrap fee program may cost the clients more or less than purchasing such services separately. Clients who are recommended the services of the Program by VFL should receive a copy of Appendix 1 of VFL's Form ADV, Part 2A for the Program (the "Wrap Fee Program Brochure"), in addition to this Firm Brochure, which contains important information about the Program that should be read carefully. If you did not receive a copy of the Wrap Fee Program Brochure, please contact us at (805) 546-1000 or [dito@vellumfinancial.com](mailto:dito@vellumfinancial.com). In addition to sponsoring the Program, VFL also makes available its portfolio management services to the Program's wrap fee clients. There are no material differences in how VFL manages the accounts of the Program's wrap fee clients and VFL's other non-wrap fee clients. As compensation for its provision of portfolio management services to clients of the Program, VFL receives

a portion of the Program's wrap fee.

## Item 5 – Fees and Compensation

### INVESTMENT ADVISORY FEES

VFL's annual fees for investment advisory services, for both discretionary and non-discretionary accounts, are based on a percentage (%) of the market value of the assets under VFL's management and ranges from a minimum of 0.50% to a maximum of 2.50%. Certain advisory clients, however, may be grandfathered into fee arrangements for investment advisory services that are below the current minimum annual fee of 0.50%. All advisory fee arrangements are negotiated individually with each client based on various objective and subjective factors. These factors include, but are not limited to, the amount of the assets placed under VFL's management, the types of securities held by the client, the level and scope of the overall investment advisory services to be rendered and the complexity of the engagement.

Clients generally elect to have VFL's investment advisory fees deducted directly from their custodial account(s), but, in the alternative, may elect to be billed for such fees. Both VFL's Investment Advisory Agreement and the custodial/clearing agreement may authorize the custodian to debit client accounts for the amount of VFL's investment advisory fee and to remit such fee to VFL. In the limited event that VFL bills the client directly for investment advisory fees, payment is due upon receipt of VFL's invoice. Investment advisory fees are deducted or billed quarterly in advance, based on the market value of the assets under VFL's management on the last business day of the previous calendar quarter. Investment advisory fees are prorated for any new account opened during a calendar quarter.

The investment advisory agreement between VFL and the client will continue in effect until terminated by either party by written notice in accordance with the terms of the Investment Advisory Agreement. In the event that a client terminates its investment advisory agreement with VFL prior to the end of a quarter, the client will receive a refund of any unearned management fees that were deducted from their custodial account. The amount of the refund is calculated by dividing the number of market days that the account was under VFL's management, from the beginning of the quarter until the date of termination, and dividing that amount by the total number of market days in the quarter. That amount is then multiplied against the investment advisory fee that was billed in advance by VFL for the quarter, to determine the portion of the investment advisory fee to be retained by VFL. That amount is then deducted from the investment advisory fee that was billed in advance to determine the amount of the refund owed to the client. For purposes of this calculation, a "market day" represents any day that the New York Stock Exchange was, is, or is scheduled to be open.

VFL's investment advisory fees are exclusive of bank service fees, interest on loans and debit balances, wire transfer and electronic fund transfer fees, interest on margin accounts, borrowing charges on securities sold short, odd-lot differential fees, transfer taxes, and other fees and taxes on brokerage accounts and securities transactions. Additionally, for those clients not participating in the Program, VFL's investment advisory fees are also exclusive of brokerage commissions and/or transaction fees for

effecting certain securities transactions (e.g., transaction fees for certain no-load mutual funds and commissions on stocks/equity securities) and custodial fees. For those clients participating in the Program, clients should be aware that VFL has a conflict of interest when it recommends mutual funds available for purchase on a no-load and/or no-transaction fee basis over other comparable mutual funds that are subject to sales charges as the selection of such mutual funds ultimately reduces VFL's costs in providing advisory services and such cost savings are not passed through to the client.

Clients should also be aware that VFL may recommend ETFs and mutual funds as part of its investment strategies. Investments in ETFs and mutual funds, including closed-end mutual funds, however, generally include an embedded investment advisory fee paid to an unaffiliated third-party investment adviser. As such, clients with investments in these types of securities are subject to two layers of investment advisory fees. Please see "Item 10 – Other Financial Industry Activities and Affiliations" and "Item 12 – Brokerage Practices" below for discussions regarding certain expenses and brokerage, respectively, which may be relevant to this discussion of fees and your assessment of VFL's services.

**Fee Differentials:** Because VFL negotiates advisory fee arrangements individually with each client, VFL's clients could pay diverse fees for the same services. Additionally, Tactical Active Management Strategy accounts generally pay advisory fees that are higher than Traditional Asset Allocation Strategy accounts. Clients should be aware that while VFL may incur additional expenses in order to manage Tactical Active Management Strategy accounts as opposed to Traditional Asset Allocation Strategy accounts, the advisory fee arrangements that VFL negotiates with each client are not designed to result in the same level of net profitability for VFL. The services provided to Tactical Active Management Strategy and Traditional Asset Allocation Strategy accounts are fundamentally different and VFL believes that the advisory fee arrangements that VFL negotiates with each individual client are reflective of the value of the services that VFL provides to such clients. Finally, the services provided by VFL to any particular client may be available from other investment advisers for a lower fee.

Clients, consequently, are encouraged to review and assess the services that VFL provides and make their own independent determinations regarding our advisory fees prior to entering into an investment advisory agreement with VFL.

## **FINANCIAL PLANNING AND CONSULTING FEES (STAND-ALONE)**

VFL's financial planning and consulting fees are negotiable. On a fixed fee basis, VFL's planning and consulting fees generally range between \$1,000 to \$20,000 depending on the level and scope of the service(s) required and the professional(s) rendering the service(s). On an hourly basis, VFL charges \$300 per hour for financial advisors, \$150 per hour for para-planners and \$75 per hour for administrative time.

## **SALES-BASED COMPENSATION**

Certain IARs of VFL, in their individual capacities, may also be registered representatives of a broker-dealer that is unaffiliated with VFL, including Kevin Swanson, who is a registered representative of Comprehensive Asset Management and Servicing, Inc. (CRD No. 2528342), a FINRA member broker-



dealer. IARs of VFL who are also registered representatives of a broker-dealer do not receive any commission compensation as a result of any transactions recommended as part of VFL's investment advisory services. However, in addition to engaging VFL to provide investment advisory services, clients may engage the separate brokerage services of such registered representatives in order to purchase investment products on a commission basis. Any assets purchased on a commission basis are not part of VFL's investment advisory services and VFL does not charge any investment advisory fees on such assets.

In the event that a client chooses to purchase investment products on a commission-only basis in a brokerage account, the broker-dealer will charge commissions, loads, and/or transaction fees to effect such transactions, a portion of which will be paid by the broker-dealer to the IAR of VFL in their separate capacity as a registered representative. The brokerage commissions charged may be higher or lower than those charged by other broker-dealers. In addition to commissions, loads, and/or transaction fees, registered representatives, relative to mutual fund purchases, may also receive additional ongoing 12b-1 trailing commission compensation directly from the mutual fund company during the period that the client maintains the mutual fund investment.

**Conflict of Interest:** *Clients should be aware that the receipt of commissions may create an incentive for the registered representative to recommend investment products based on the compensation to be received, rather than the needs and/or the best interests of the client. While such brokerage activity by VFL's IARs is outside of the scope of VFL's investment advisory services, VFL would like to remind clients that they are never under any obligation to purchase any commission products from VFL's IARs.*

## Item 6 – Performance Based Fee and Side by Side Management

Neither VFL nor any IAR of VFL accepts performance-based fees.

## Item 7 – Types of Clients

VFL's clients primarily include individuals, high net worth individuals and corporations. VFL generally requires a minimum account opening balance of \$100,000. Multiple accounts of immediately-related family members, at the same mailing address, may be considered one consolidated account for purposes of meeting the minimum account opening balance threshold. Furthermore, VFL, in its sole discretion, may reduce or waive its minimum account opening balance requirement based on certain criteria (e.g., the anticipated future earning capacity of the prospective client, anticipated additional assets to be put under VFL's management, the dollar amount of assets to be managed, related accounts under VFL's management, account composition, and negotiations with client).

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

### METHODS OF ANALYSIS

VFL may use one or a combination of the following methods of securities analysis, directly or indirectly, as part of its overall investment management discipline.

#### **Fundamental Analysis**

This is a technique that attempts to determine a security's value by focusing on the underlying factors that affect a company's actual business and its future prospects. Fundamental analysis is about using real data to evaluate a security's value. It refers to the analysis of the economic well-being of a financial entity as opposed to only its price movements. One of the primary assumptions of fundamental analysis is that the market price for a security does not fully reflect the security's "real" value. VFL therefore uses a combination of qualitative and quantitative factors to identify undervalued securities, based on both macroeconomic factors, such as the overall economy and industry conditions, and company-specific factors such as financial condition and management.

In order to perform fundamental analysis, VFL relies on many resources, such as Morningstar, financial newspapers and magazines (e.g. the Wall Street Journal, Forbes, etc.), annual reports, prospectuses, SEC filings, press releases, corporate rating services, and company websites.

#### **Technical Analysis**

This is a technique that attempts to determine a security's value by developing models and trading rules based on price and volume transformation. Technical analysis assumes that market prices reflect all relevant information so the analysis focuses on the history of a security's trading behavior rather than external drivers such as economic, fundamental and news events. The practice of technical analysis incorporates the importance of understanding how market participants perceive and act on relevant information rather than focusing on the information itself. Ultimately, technical analysts develop trading models and rules by evaluating factors such as market trends, market participant behaviors, supply and demand and pricing patterns and correlations.

#### **Cyclical Analysis**

This is a technique that analyzes historical relationships between price and market trends, to forecast the direction of prices. VFL may use cyclical analysis in conjunction with other strategies to help determine if shifts are required for its clients' investment strategies depending on long and short-term trends in financial markets and the performance of the overall national and global economy.

### INVESTMENT STRATEGIES

With respect to Traditional Asset Allocation Strategy accounts, VFL primarily allocates client assets among various stocks/equities, bonds and other fixed income securities, as well as shares of mutual funds and/or ETFs in accordance with the client's designated investment objective(s). With respect to

accounts managed according to a Tactical Active Management Strategy, VFL primarily allocates client investment assets into shares of mutual funds and/or ETFs. Please see the “Item 4 – Advisory Business” section for a more fuller description of VFL’s Tactical Active Management and Traditional Asset Allocation Strategies, which are used to manage client assets.

When implementing investment advice given to clients, VFL may engage in the following types of transactions:

- Long Term Purchases (securities held at least a year)
- Short Term Purchases (securities sold within a year)
- Trading (securities sold within thirty (30) days)

With respect to Traditional Asset Allocation Strategy accounts, in addition to the types of transactions and/or securities discussed above, VFL may also implement and/or recommend the use of short selling, margin (using borrowed assets to purchase financial instruments), and/or options (contracts for the purchase or sale of a security at a predetermined price during a specific period of time) in the management of client accounts. Each of these strategies has a high level of inherent risk.

- **Short Selling:** Short selling transactions expose the seller to risks of loss greater than the initial investment, and such losses can increase rapidly and without effective limit. When short selling, there is the risk that the securities borrowed in connection with a short sale would need to be returned to the securities lender on short notice. If such request for return of securities occurs at a time when other short sellers of the subject security are receiving similar requests, a “short squeeze” can occur, wherein the seller might be compelled, at the most disadvantageous time, to replace the borrowed securities previously sold short with purchases on the open market, possibly at prices significantly in excess of the proceeds received earlier.
- **Margin:** A margin transaction occurs when an investor uses borrowed assets to purchase financial instruments. The investor generally obtains the borrowed assets by using other securities as collateral for the borrowed sum. The effect of purchasing a security using margin is to magnify any gains or losses sustained by the purchase of the financial instrument on margin.

**Conflict of Interest:** Clients should be aware that the market value of the client’s account and corresponding fee payable by the client to VFL is generally increased as a result of the use of margin and consequently, a conflict of interest exists when VFL recommends the use of margin to clients. Accordingly, the decision as to whether to employ margin is left totally to the discretion of client.

- **Options:** Option transactions establish a contract between two parties concerning the buying or selling of an asset at a predetermined price during a specific period of time. During the term of the option contract, the buyer of the option gains the right to demand fulfillment by the seller. Fulfillment may take the form of either selling or purchasing a security depending on the

nature of the option contract. Generally, VFL recommends the use of options in order to offset/hedge a potential market risk in a client's portfolio to help protect principal, but clients should be aware that certain options-related strategies (e.g., straddles and synthetic short positions), may, in and of themselves, produce principal volatility and/or risk. Thus, a client must be willing to accept the enhanced volatility and principal risks associated with such strategies.

## **RISK OF LOSS**

All investing involves risk of loss, including the possible loss of all amounts invested. No methodology or investment strategy is guaranteed to be successful or profitable. Furthermore, different types of investments involve varying degrees of risk, and it should not be assumed that the future performance of any specific investment or investment strategy, including the investments and/or investment strategies recommended or undertaken by VFL, will be profitable or equal any specific performance level(s).

While VFL uses tools to try to reduce risk, the risk of loss always exists. In some cases, the amount of potential loss may exceed the amount of principal invested if leveraging tactics, such as margin, are used in the management of your account. Investing generally works best when we understand your risk tolerance and when you communicate any changes to your investment objectives, needs, risk tolerances, and expectations promptly to us.

The material risks associated with VFL's investment strategies and the securities used to implement those strategies are set forth below. The following, however, is not meant to be a complete description of risks.

### **General Risks**

- **Business Risk**: These risks are associated with a particular industry or a particular company within an industry. For example, oil companies depend on finding oil and then refining it, a lengthy process, before they can generate a profit. They carry a higher risk of profitability than an electric company, which generates its income from a steady stream of customers who buy electricity no matter what the economic environment is like.
- **Counterparty Risk**: Certain assets will be exposed to the credit risk of the counterparties when engaging in exchange-traded or off-exchange transactions.
- **Currency Risk**: Overseas investments are subject to fluctuations in the value of the dollar against the currency of the investment's originating country. This is also referred to as exchange rate risk.
- **Financial Risk**: Excessive borrowing to finance a business' operations increases the risk of profitability, because the company must meet the terms of its obligations in good times and bad. During periods of financial stress, the inability to meet loan obligations may result in bankruptcy and/or a declining market value.
- **Foreign Market Risk**: The securities markets of many foreign countries, including emerging countries, have substantially less trading volume than the securities markets of the United

States, and securities of some foreign companies are less liquid and more volatile than securities of comparable United States companies. As a result, foreign securities markets may be subject to greater influence by adverse events generally affecting the market, by large investors trading significant blocks of securities, or by large dispositions of securities, than as it is in the United States. The limited liquidity of some foreign markets may negatively impact our ability to acquire or dispose of securities at a price and time that is advisable. Further, many foreign governments are less stable than that of the United States. There can be no assurance that any significant, sustained instability would not increase the risks of investing in the securities markets of certain countries.

- **Inflation Risk**: When inflation is present, a dollar today will not buy as much as a dollar next year, because purchasing power is eroding at the rate of inflation.
- **Interest-Rate Risk**: Fluctuations in interest rates may cause investment prices to fluctuate. For example, when interest rates rise, yields on existing bonds become less attractive, causing their market values to decline.
- **Liquidity Risk**: Liquidity is the ability to readily convert an investment into cash. Generally, assets are more liquid if many traders are interested in a standardized product. For example, Treasury Bills are highly liquid, while real estate properties are not. Certain instruments, such as trade claims, may have no readily available market or third-party pricing. Reduced liquidity may have an adverse impact on market price and the ability to sell particular securities when necessary to meet liquidity needs or in response to a specific economic event, such as the deterioration of the creditworthiness of an issuer.
- **Market Risk**: The price of any security, including bonds or mutual funds may drop in reaction to tangible and intangible events and conditions. This type of risk is caused by external factors independent of a security's particular underlying circumstances. For example, political, economic and social conditions may trigger market events.
- **Reinvestment Risk**: This is the risk that future proceeds from investments may have to be reinvested at a potentially lower rate of return (i.e. interest rate). This primarily relates to fixed income securities.

#### **Tactical Active Management Strategies – Additional Risks**

- **Model Risk**: All quantitative analysis carries a risk that the mathematical model used might be based on one or more incorrect assumptions.
- **Data Risk**: Algorithmic trading systems rely on the cleanliness and accuracy of the underlying data (such as stock or ETF prices) that are input into the algorithms to generate exposure recommendation signals. If input data is inaccurate, then the data output will be similarly tainted.
- **Hacking Risk**: There is a risk that unauthorized outside interference with the programming or distribution method of AlphaGen's algorithmic trading system could impair its ability to function as designed.
- **Quantitative Risk**: Rapidly changing and unforeseen market dynamics could lead to a decrease in the short-term effectiveness of an algorithmic trading system.
- **Macroeconomic Risk**: Unusual events, such as those resulting from shifts in geo-political,

systematic, economic, or social conditions may result in abrupt changes to a security's price, which could upset the model's ability to make accurate exposure recommendations.

- **Strategy Risk:** VFL's strategies are unlikely to be successful unless the assumptions underlying the models used to implement the investment strategies and the established rules of such investment strategies are and remain realistic and relevant in the future. If such assumptions are or become inaccurate and are not promptly adjusted, it is unlikely that reliable signals will be generated.
- **Licensing Risk:** As VFL is not the proprietary owner of the algorithmic trading system that it uses to manage client accounts, VFL may not be able to provide uninterrupted and/or consistent advisory services to clients who utilize VFL's Tactical Active Management Strategies in the event that AlphaGen terminates its arrangement with VFL.

### **Traditional Asset Allocation Strategy – Additional Risks**

To perform an accurate market analysis VFL must have access to current/new market information. VFL has no control over the dissemination rate of market information; therefore, unbeknownst to VFL, certain analyses may be compiled with outdated market information, limiting the value of VFL's analysis. Furthermore, an accurate market analysis can only produce a forecast of the direction of market values. There can be no assurances that a forecasted change in market value will materialize into actionable and/or profitable investment opportunities.

## **Item 9 – Disciplinary Information**

VFL has not been the subject of any legal or disciplinary events that are material to an evaluation of VFL's advisory business or the integrity of its management.

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

**Registered Representatives of Comprehensive Asset Management and Servicing, Inc.:** As noted above, Kevin Swanson is a registered representative of Comprehensive Asset Management and Servicing, Inc. ("Comprehensive"), a FINRA member broker-dealer. Clients may choose to engage Mr. Swanson for separate brokerage services, in his individual capacity as a registered representative of Comprehensive, in order to purchase investment products on a commission basis. Any assets purchased on a commission basis are not part of VFL's investment advisory services and VFL does not charge any investment advisory fees on such assets.

**Charles Schwab & Co., Inc. ("Schwab"):** Schwab has provided a loan to VFL to assist its business operations, and the loan is guaranteed by Bryan Sullivan. The terms of the loan require that investment advisory fees paid to VFL be paid to an account at Schwab for deduction of interest and principal payments pursuant to the loan before VFL may have access to that fee payment. The loan agreement contains various representations by VFL, including representations that VFL will maintain \$70 million in assets under management and will comply with all laws, contracts, licenses and permits, as well as

provisions covering various events of default. In the event of an unheeded default under the terms of the loan agreement, Schwab may terminate and/or accelerate the loan, which may have a material adverse effect on VFL's ability to perform its contractual commitments to clients.

Wellspring Capital Partners, LLC ("Wellspring"): Bryan Sullivan is the sole owner of another registered investment adviser, Wellspring, which operates out of VFL's offices. Wellspring is not currently engaging in any investment advisory activities.

The Pacific Financial Group, Inc. ("TPFG"): VFL has entered into a Selling Agreement with TPFG pursuant to which it provides investment allocation recommendations to the participants of retirement plans, which are clients of TPFG. In making investment allocation recommendations pursuant to this arrangement, plan participants should be aware that VFL has a conflict of interest because VFL is limited in the investment options that it may recommend to those plan participants to those offered by TPFG in order to be compensated under the Selling Agreement. Please see "Item 14 – Client Referrals and Other Compensation" for a more detailed discussion of the services provided by VFL under this Selling Agreement.

Rohr & Associates CPAs: Daniel Rohr, an IAR of VFL, is a Certified Public Accountant and the Managing Shareholder of Rohr & Associates CPAs, an accounting firm that operates out of VFL's branch office in Arroyo Grande, California. Clients of VFL assigned to Mr. Rohr may also be clients of Rohr & Associates CPAs and receive tax preparation and planning, bookkeeping, and accounting services, which are separate from VFL's investment advisory and financial planning services. Additionally, VFL and/or its other IARs may recommend Rohr & Associates CPAs to clients for tax preparation and planning, bookkeeping, and accounting services as described in "Item 4 – Advisory Business" under Non-Investment Consulting/Implementation Services. Neither VFL nor its other IARs receive any fees for such referrals. Mr. Rohr, in his fully disclosed capacity as an IAR of VFL, may solicit clients of Rohr & Associates CPAs to become clients of VFL. Consequently, a conflict of interest exists when Mr. Rohr solicits his tax and accounting clients to become investment advisory clients of VFL as it may result in increased compensation to him. VFL addresses this potential conflict of interest by disclosing it and reminding prospective clients that they are not under any obligation to engage the investment advisory services of VFL and that comparable investment advisory services may be available from other non-affiliated investment advisers.

Insurance Agents: Sean Newsom, an IAR of VFL, Kevin Swanson, and Kelly Smith are licensed insurance agents in their individual capacities and may sell certain insurance-related products on a commission basis to clients. Additionally, VFL and/or its other IARs may recommend the separate insurance services of Messrs. Newsom, Swanson, and/or Smith in order to obtain or revise insurance coverage as described in "Item 4 – Advisory Business" under Non-Investment Consulting/Implementation Services. Any insurance-related products sold to clients are not part of VFL's investment advisory services and VFL does not share in any commissions received from the sale of such products. The receipt of such commission compensation by VFL's IARs, however, may create a conflict of interest as the recommendation to purchase an insurance-related product may have been the result of financial planning and/or other consulting services provided by VFL to clients, and such recommendation may

have been influenced by the commission compensation to be received, rather than solely on the needs and best interests of the client. VFL addresses this potential conflict of interest by disclosing it and reminding clients that they are not under any obligation to follow the recommendation to purchase any insurance-related product and may also purchase insurance-related products recommended by VFL through other, non-affiliated insurance agents.

AlphaGen Strategies, LLC: As noted above in the discussion under “Item 4 – Advisory Business”, VFL has a material arrangement with AlphaGen, a developer of an algorithmic trading system that is marketed to financial advisors. Bryan Sullivan has been actively involved in assisting AlphaGen in developing its algorithmic trading system to meet the needs of financial advisors such as VFL, which currently utilizes AlphaGen’s algorithmic trading system in the management of Tactical Active Management Strategy accounts.

Argentus Capital Management, LLC (“Argentus”): VFL utilizes the back office services of Argentus. These services include, among others, the performance of daily administrative duties related to VFL’s advisory client accounts, preparing client reporting, calculating advisory fees to be deducted from client accounts, implementing trade recommendations on behalf of VFL, and performing due diligence on certain third party investment advisers. For its services, Argentus receives an annual asset-based fee of 11 basis points of the amount of VFL’s assets under management serviced by Argentus.

FocusPoint Solutions, Inc. (“FocusPoint”): VFL receives non-discretionary investment advisory services from FocusPoint, which generally consists of securities and asset allocation recommendations, which may be used in the management of VFL’s Traditional Asset Allocation Strategy accounts. As part of this service, VFL also receives access to FocusPoint’s portfolio managers to answer portfolio and/or market-related questions and weekly commentary from FocusPoint regarding their views on the economy and market. For these services, VFL pays FocusPoint an investment advisory fee based on the amount of VFL’s assets under management that utilize FocusPoint’s recommendations.

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

VFL maintains a Code of Ethics that includes 1) standards of business conduct that all of our supervised persons are expected to adhere to; 2) a prohibition on insider trading; 3) provisions relating to the receipt and giving of gifts, and 4) policies and procedures requiring the periodic reporting of personal securities transactions and holdings. As our client or prospective client you are entitled to a copy of our Code of Ethics upon request. You may request a copy of VFL’s Code of Ethics by contacting us at (805) 546-1000 or [dito@vellumfinancial.com](mailto:dito@vellumfinancial.com).

VFL and/or its supervised persons may buy or sell securities that are also held by or recommended to clients and may occasionally trade in securities in a personal account, at or about the same time that VFL trades in the same security, or a related security, for a client account. This may create potential conflicts of interest because 1) we may have an incentive not to recommend the sale of those securities to clients in



order to protect the value of a personal investment, and 2) we may have an incentive to place personal investment orders before those of clients in order to obtain a better price and/or otherwise materially benefit from the purchase or sale of those securities. When engaging in personal trading, we believe that we should place our clients' interests first and our supervised persons are reminded of VFL's fiduciary duty and their obligation to comply with VFL's standards of business conduct. Additionally, VFL monitors the personal securities transactions and holdings of its access persons for any activity that may indicate a violation of VFL's Code of Ethics.

## **Item 12 – Brokerage Practices**

### **RECOMMENDING BROKER-DEALERS**

In the event that a client requests that VFL recommend a custodian, VFL generally recommends that investment advisory accounts be maintained at Schwab or TD Ameritrade, Inc. ("TDA"). Under certain circumstances, VFL may also recommend the custodial services of Trust Company of America ("TCA") and/or Fidelity Brokerage Services LLC ("Fidelity"). VFL is not affiliated with Schwab, TDA, TCA or Fidelity. For clients who choose the custodial services of Schwab, TDA and/or Fidelity for their accounts, brokerage transactions for such accounts will generally be executed exclusively by the respective custodian, all three of which are registered broker-dealers. While VFL may be able to use other brokers-dealers to execute transactions for such accounts, if VFL were to do so, the client would generally be subject to or incur fees imposed by the custodian for trading away with another broker-dealer, which may significantly impair VFL's ability to obtain best execution for such transaction.

Consequently, when recommending the custodial services of Schwab, TDA, and Fidelity to clients, VFL also considers whether the custodian is capable of providing best execution to VFL's clients. Factors that VFL considers include historical relationship with VFL, financial strength, reputation, execution capabilities, commissions and transaction fees, research, and service. In addition, VFL considers the size, quality and depth of each broker-dealer custodian's mutual fund supermarket. While we may recommend that clients use Schwab, TDA and/or Fidelity as their custodian and thus also as their broker-dealer, the client is responsible for deciding which custodian(s) to engage by opening an account with the broker-dealer by entering into an account agreement directly with them. VFL does not open custodial accounts for you, although we may assist you in doing so.

Although the commissions and/or transaction fees paid by VFL's clients shall comply with VFL's duty to obtain best execution, a client may pay a commission that is higher than what another qualified broker-dealer might charge to effect the same transaction where VFL determines, in good faith, that the commission/transaction fee is reasonable in relation to the value of the brokerage and research services received. In seeking best execution, the determinative factor is not the lowest possible cost, but whether the transaction represents the best qualitative execution, taking into consideration the full range of a broker-dealer's services, including the value of research provided, execution capability, commission rates, and responsiveness. Accordingly, although VFL will seek competitive rates, it may not necessarily obtain the lowest possible commission rates for client account transactions. The brokerage commissions or transaction fees charged by the designated broker-dealer/custodian are

exclusive of, and in addition to, VFL's investment advisory fee.

## **RESEARCH AND ADDITIONAL BENEFITS**

VFL does not have any formal soft dollar arrangements. However, Schwab and TDA make available to us, without cost and/or at a discount, support services and/or products, some of which assist VFL in better monitoring and servicing client accounts, but some of which benefit VFL without directly benefiting you or your account(s). Included within the support services that may be obtained by VFL may be investment-related research, both proprietary and that of third parties; pricing information and market data; software and other technology that provide access to client account data; compliance and/or practice management-related publications; discounted or gratis consulting services; discounted or gratis attendance at conferences, meetings, and other educational and/or social events; marketing support; computer hardware and/or software and/or other products used by VFL in furtherance of its investment advisory business. Clients should be aware that VFL may use support services and/or products from Schwab and TDA to service and/or otherwise benefit all or a substantial number of VFL's client accounts, including accounts held in custody at another broker-dealer.

VFL's clients do not pay more for investment transactions effected and/or assets maintained at Schwab or TDA as a result of VFL's receipt of these support services and/or products. The availability of the services and/or products noted above from Schwab and TDA, however, benefit VFL because we do not have to produce or purchase them. Consequently, clients should be aware that the receipt of economic benefits by VFL and/or our related persons from Schwab and TDA in and of itself creates a potential conflict of interest and may indirectly influence our recommendation of Schwab and TDA for custody and brokerage services. The receipt of these benefits from Schwab and TDA, however, are not a material consideration of VFL's when determining whether to recommend that a client utilize the services of a particular broker-dealer custodian.

## **DIRECTED BROKERAGE**

VFL does not generally accept directed brokerage arrangements (i.e., when a client requires that account transactions be effected through a specific broker-dealer). If VFL agrees to a client's directed brokerage arrangement, the client is responsible for negotiating all terms, conditions and arrangements for their accounts with that broker-dealer. Furthermore, VFL will not seek or be able to obtain better execution from other broker-dealers for such accounts, will not be able to negotiate commissions and transaction fees for such accounts, and will not be able to "bunch" the client's transactions for execution through other broker-dealers with orders for other accounts managed by VFL to obtain volume discounts. As a result, the client may pay higher commissions, transaction costs or greater spreads, or receive less favorable net prices on transactions for the account than would otherwise be the case.

## **AGGREGATION OF ORDERS**

Transactions for each client account are generally effected independently, unless VFL decides to purchase or sell the same securities for several clients at approximately the same time. VFL may, but is not obligated to, combine or "bunch" such orders in order to obtain better execution, including the

ability to negotiate more favorable commission rates and/or to allocate equitably among participating clients, differences in prices and commissions or other transaction costs that might have resulted had such orders been placed independently. When a bunched trade is placed, each participating client receives a price that represents the average of the prices at which all of the transactions in a given bunch order were executed. If the order is not completely filled, the securities purchased or sold are distributed among participating clients on a pro rata basis or in some other equitable manner. Block trades are placed only when VFL reasonably believes that the combination of the transactions provides better prices for clients than placing individual transactions. No client participating in a block trade will be favored over any other client that also participates in the same block trade.

### Item 13 – Review of Accounts

For those clients to whom VFL provides investment advisory services, account reviews are conducted on an ongoing basis by the IAR assigned to the client, at least quarterly, but more frequently if agreed to between VFL and the client. Clients are advised that it is your responsibility to promptly notify VFL if there are ever any changes to your financial situation, goals, needs or investment objectives. All clients (in person or via telephone) are encouraged to review financial planning issues (to the extent applicable), investment objectives and account performance with VFL on an annual basis.

Account reviews may also be conducted on an ad hoc basis upon the occurrence of a triggering event, such as a change in a client's investment objectives and/or financial situation, market corrections and the receipt of a client request.

Clients are provided with written quarterly performance reports that contain holdings information, beginning and ending market values, asset allocation, and performance return information. VFL relies on information and data provided by the account custodian(s) and Argentus, which is believed by VFL to be reliable, however, no representations are made as to its accuracy or completeness. Written quarterly performance reports should not be relied on for tax purposes.

### Item 14 – Client Referrals and Other Compensation

As noted above in "Item 12 – Brokerage Practices", VFL receives certain economic benefits from Schwab and TDA, without cost or at a discount, which may or may not benefit clients, but benefit VFL because we do not have to produce or purchase them, which creates a potential conflict of interest as VFL's receipt of such benefits may influence VFL's recommendation of Schwab and TDA for custodial and brokerage services. Additionally, as noted above in "Item 10 – Other Financial Industry Activities and Affiliations", Schwab has provided a loan to VFL to assist its business operations, which under certain default conditions could have a material adverse effect on VFL's ability to perform its contractual commitments to clients. VFL's clients do not pay more for investment transactions effected and/or assets maintained at Schwab or TDA as a result of these arrangements.

VFL has entered into a Solicitor's Agreement with Melinda Monteen of Monteen Insurance and Investments, Inc. Pursuant to such agreement, Ms. Monteen introduces/refers prospective clients to VFL and assists them in establishing a relationship with VFL by explaining VFL's advisory services and, if requested or appropriate, maintaining periodic contact with such clients to obtain updated client information for VFL. For her services, Ms. Monteen received a fixed fee that was paid in 2014 and also receives a percentage of all net investment advisory fees received by VFL from clients obtained as a result of her efforts. As a result of this compensation arrangement, prospective clients should be aware that Ms. Monteen has a conflict of interest when she recommends VFL's advisory services.

VFL has entered into a Selling Agreement with The Pacific Financial Group, Inc. (CRD No. 105203), a SEC registered investment adviser that provides investment advisory services to, among others, the participants of retirement plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"). Pursuant to this arrangement, VFL assists plan participants in identifying their risk tolerance level. Based on their risk tolerance, VFL assists plan participants in making investment allocations within their Core account within the plan, making recommendations as to how much of their total plan account to allocate to their Self Directed Brokerage Account within the plan, and then recommending allocations within the Self-Directed Brokerage Account to managed portfolios (e.g., Income Portfolio, Absolute Return Portfolio, Balanced Portfolio, Equity Portfolio, Strategic Multi-Cap Portfolio, Global Portfolio) offered by TPFPG that ultimately invest exclusively in TPFPG's proprietary mutual funds. In return for these services, VFL receives an annual asset-based solicitation fee from TPFPG. In making investment allocation recommendations pursuant to this arrangement, plan participants should be aware that VFL has a conflict of interest because VFL is limited in the investment options that it may recommend to plan participants to those offered by TPFPG in order to be compensated under the Selling Agreement.

### Item 15 – Custody

Clients generally grant VFL the authority to directly deduct VFL's investment advisory fees from their custodial accounts. Consequently, clients are provided, at least quarterly, with account statements directly from the custodian. VFL encourages you to carefully review the information contained within your custodial account statements. Clients should be aware that account custodians do not verify the accuracy of VFL's advisory fee calculations.

VFL also provides clients with quarterly performance reports, which summarize account activity and performance. Clients are urged to compare the information contained within their custodial account statements with the information contained within the quarterly performance reports provided by VFL and to contact VFL promptly if you identify any discrepancies.

### Item 16 – Investment Discretion

Clients may engage VFL to provide investment advisory services on a discretionary basis. Prior to assuming discretionary authority over a client's account, VFL requires the client to execute an

Investment Advisory Agreement, which grants VFL full discretionary authority to buy, sell, or otherwise effect investment transactions, in the client's name, involving assets held within certain accounts. Clients who engage VFL on a discretionary basis may, at any time, impose restrictions, in writing, on VFL's discretionary authority (e.g., limit or exclude the purchase of certain securities in their account and limit or prohibit the use of margin, options, and/or short selling in their account).

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

VFL does not vote client proxies. Instead, clients will receive proxies and/or other solicitations directly from their account custodian and maintain exclusive responsibility for (1) directing the manner in which proxies solicited by issuers of securities owned by the client shall be voted, and (2) making all elections relative to any mergers, acquisitions, tender offers, bankruptcy proceedings or other types of events pertaining to the client's investment assets. Clients, however, may contact VFL to discuss any questions they may have with a particular solicitation.

### **Item 18 – Financial Information**

VFL is unaware of any financial condition that is reasonably likely to impair its ability to meet its contractual commitments to clients.