



An SEC Registered Investment Advisor

**Kovack Advisors, Inc.  
ADV Part 2A  
Firm Brochure  
March 30, 2017**

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*This Disclosure Brochure provides prospective clients with information about Kovack Advisors, Inc. that should be considered before or at the time of obtaining the firm's advisory services. Registration with the SEC does not imply a certain level of skill or training.*

This brochure provides information about the qualifications and business practices of Kovack Advisors, Inc. Please contact the firm at 866-564-6574 and/or [kaigroup@kovackadvisors.com](mailto:kaigroup@kovackadvisors.com) with questions about the brochure. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about Kovack Advisors, Inc. also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The searchable IARD/CRD number for Kovack Advisors, Inc. is 140808.



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## **Item 2**

### **Material Changes**

This section is used to identify any material changes since the Kovack Advisors last annual update.

Each year KAI will deliver to clients, by no later than April 30<sup>th</sup>, a free updated Disclosure Brochure that includes, or is accompanied by, a summary of material changes; or a summary of material changes and an offer to provide a copy of the updated Disclosure Brochure and how to obtain it.

The following material changes have occurred since the last Annual Update filed on March 30, 2016:

None.



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### **Item 3**

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## Item 4

### Advisory Business

#### *Firm Description and Principal Owners*

Established in March 2004, Kovack Advisors, Inc. is based in Fort Lauderdale, Florida and was founded by Ronald and Brian Kovack. They are the principal owners of the firm.

Kovack Advisors, Inc. (“KAI”) is registered with the U.S. Securities and Exchange Commission (“SEC”) as a Registered Investment Advisor. KAI may act as investment advisor for retail and institutional clients. KAI maintains contractual relationships with Investment Advisor Representatives (“IAR”) who are registered with the states as required and may provide financial advice to clients. The IAR will evaluate the client’s investment needs and objectives to determine suitability for the various programs offered through KAI.

The services provided by KAI include financial planning services, portfolio management for individuals and/or small businesses, portfolio management for businesses or institutional clients other than investment companies, and a selection of other advisors. KAI does not specialize in a particular type of advisory service and does not provide investment advice limited to specific types of investments.

The individualized advice from IARs is largely based on the information provided by the client through client completion of account opening documents and IAR consultation with the client. Information regarding their financial circumstances, investment objectives, and any special instructions or limits that should be followed in managing the account(s) is gathered. In addition, clients are advised to notify KAI promptly of any significant change in their information that might affect the way account(s) should be managed. These include changes such as significant changes in financial circumstances or investment objectives. Clients must also agree to provide KAI with such additional information as KAI may request from time-to-time to assist in the management of the account(s). Clients may impose restrictions on investing in certain securities or types of securities (such as a product type, specific companies, specific sectors, etc.) by providing a signed and dated written notification.

#### *Types of Advisory Services*

### Wealth Management

KAI offers a number of managed account programs based on investment goals and objectives called **CHOICES**. Depending on the program, the CHOICE selection may be managed internally by your IAR, or may be a Turnkey Asset Management Program (“TAMP”).

#### Turnkey Asset Management Programs (“TAMP”)

KAI may offer advisory clients the option of investing in a platform through a TAMP, thereby providing access to third-party money managers outside of KAI. These accounts are not managed by KAI but are managed on a discretionary basis by various third-party money managers who are unaffiliated registered investment advisors. Account minimums for these platforms vary, and are dependent upon the requirements imposed by the TAMP.

KAI, in providing the services agreed upon with the client, may recommend another registered investment advisor hereafter (“the sub-advisor”) that sponsors a TAMP based upon client risk tolerance, investment objectives and



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investment experience. The sub-advisor is an investment adviser registered under applicable securities laws, and acts as a sub-advisor to manage all or a portion of the managed assets in the account. Here, KAI is responsible for the continuing supervision of the account, and the actions of the sub-advisor in connection with the account and the managed assets. The client is a KAI client, and will complete a KAI Investment Advisory Agreement, in addition to the documents required by the other registered investment advisor that is sponsoring the TAMP and performing the portfolio management. The entire advisory fee is directly debited by the sub-advisor; the sub-advisor retains the portion of the fee agreed upon with KAI, and pays the remaining fee to KAI.

In some instances the client's IAR may be considered a solicitor for referring to the TAMP. In these cases, a Solicitor's Disclosure Document will be signed by the client disclosing the allocation of the advisory fee to KAI as well as the fee to the TAMP.

### Sub-Advisory Services

In addition to recommending the TAMP programs of sub-advisors as described above, KAI may also *act* as a sub-advisor for other independently registered investment advisors. KAI acts as a sub-advisor, also known as a third party money manager ("TPM"), to Advisors that select KAI for its asset management services. In these instances, an unaffiliated registered investment advisor ("Advisor") selects KAI to provide asset management services for its clients, and for this service the Advisor shares a portion of their stated fees with KAI. The Advisor discloses a total stated advisory fee to their client, which is disclosed in the Advisor's brochure, and the total fee is allocated between the Advisor and KAI. The allocation amount is also disclosed in the Advisor's brochure. The allocation depends on the negotiated agreement between the Advisor and KAI. KAI's portion of the advisory fee may be lower when acting as a TPM for an Advisor than if a client worked directly with KAI because the services KAI provides as a TPM are limited in scope and do not include the entire realm of advisory services as provided to direct clients of KAI.

Below are the CHOICE platforms that are available to KAI clients. These options include those that are managed internally by KAI as well as those managed by outside managers.



**CHOICE Advisor** is a flexible, low-cost advisor-directed account which allows virtually unlimited flexibility to independently select the appropriate mix of investments. Approved investment strategies include:

- No-load Mutual Funds
- Stocks
- Exchange Traded Funds
- Bonds
- Alternative Investments
- Variable Annuities
- Options

Client accounts are opened through one of KAI's approved clearing firms. When choosing the fee structure, the IAR has several flexible options. CHOICE Advisor accounts have the following features:

- Non-Discretionary trading
- Asset Based or Transaction Based pricing
- \$50,000 minimum account size



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KAI currently has clearing agreements with National Financial Services, Pershing, TD Ameritrade and Fidelity's Institutional Wealth Services (IWS).



**CHOICE UMA** or Unified Managed Account (“UMA”) provides an Advisor the opportunity to combine multiple programs types into one “unified” or “core” account. Through the use of “sleeves”, assets can be assigned so that a client can combine the unique benefits of individual security ownership through individually managed accounts with those of traditional mutual funds and ETFs, without having to open multiple accounts.

- Account sleeves can include approved UMA Managers.
- Professional “overlay” management of all investment products and underlying securities
- Minimum account size is \$50,000 per sleeve



**CHOICE SMA** is the classic institutional investment program. A Separately Managed Account (“SMA”) provides clients direct access to some of the world's leading investment managers and ownership of all underlying investments. Advisors may choose from a diverse list of non-proprietary institutional money managers, allowing for the most appropriate selections based on individual wants and needs. Individual ownership gives clients their own cost basis, conferring greater flexibility, more control and significant tax advantages over other investment vehicles. CHOICE SMA can be ideal for clients seeking a long-term, customized, goals-driven approach to investment management.

- All accounts are managed by professional third party investment managers
- All contractual relationships, i.e., custodian, broker-dealer, investment manager, etc., are managed by KAI
- All transactions, settlements, income receipts and reconciliation are automated
- Minimum account size typically is \$100,000



**CHOICE ETF** is a professionally managed multi-strategy Exchange Traded Fund (“ETF”) investment program. KAI brings together in a single portfolio, multiple asset classes and investment strategies, which offer multiple sources of potential return and may improve a client's risk-reward profile relative to less diversified approaches. In addition, the portfolio is monitored on an ongoing basis and adjusted to stay on track with a client's goals as the markets change. CHOICE ETF provides the following unique benefits:

- Diversification
- Goal-Based Asset Allocation
- Risk Management
- Disciplined Rebalancing



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- Tax Aware Implementation
- \$50,000 Account Minimum



**CHOICE Fund** is a professionally managed multi-strategy mutual fund investment program. KAI brings together in a single portfolio multiple asset classes, investment strategies and investment managers, each with their own area of expertise. Multi-strategy portfolios offer multiple sources of potential return and may improve a client's risk-reward profile relative to less diversified approaches. In addition, the portfolio is monitored on an ongoing basis and adjusted to stay on track with a client's goals as the market changes. CHOICE Fund provides the following unique advantages:

- Diversification
- Goal-Based Asset Allocation
- Multi-Manager Portfolio Construction
- Manager Monitoring
- Risk Management
- Disciplined Rebalancing
- Tax Aware Implementation
- \$30,000 Account Minimum



**Choice Annuity Account** is designed to use with an investor's existing Variable Annuity ("VA") investments. This program helps manage and control risk through the active management of VA investments.

A VA is a contract between the purchaser and an insurance company, under which the insurer agrees to make periodic payments either at the onset of the purchase or at some future date. The structure of a VA is such that the investor carries the risks and rewards associated with the underlying investments, which may include stocks, bonds, and money market instruments.

- Accounts are actively managed by the investment advisor representative.
- Minimum account size is \$50,000.

At KAI's discretion, the minimum account size may be waived.

KAI may offer the services above as Wrap Fee Program accounts, as well as Non-Wrap Fee Program accounts. A "wrap fee program" is a program under which investment advisory and brokerage execution services are provided for a single "wrapped" fee that is not based on the transactions in a client account. KAI provides discretionary and non-discretionary investment advisory services to some of its clients through a managed account program ("the Wrap Fee Program"). KAI will assist clients in determining the suitability of the KAI Wrap Fee Program for the client. The client's advisory fee may be higher in a Wrap Fee Program account than in a Non-Wrap Fee Program account, since the fee would include transaction costs. Please consult with your IAR as well as refer to



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KAI's Wrap Fee Program Brochure for more detailed information on which programs may be considered Wrap Fee Program Accounts.

Generally, if the account is custodied at Pershing, LLC, the following programs described above may be offered as Wrap Fee Program accounts:

- CHOICE Advisor
- CHOICE UMA
- CHOICE SMA
- CHOICE ETF
- CHOICE Fund

Other custodians may charge additional charges, such as transactional fees.

KAI offers the CHOICE Annuity account as a WRAP Fee Program account since KAI manages the sub-accounts for a single fee. Variable annuity carriers have separate charges/costs, which may include transaction costs.

#### *WRAP FEE PROGRAM*

KAI's Wrap Fee Program is offered as a part of the Asset Management Services described above. KAI provides portfolio management services for this program based on the client's investment goals and objectives. Generally, KAI provides investment advice to the following types of clients:

- Individuals
- High net worth individuals
- Bank or thrift institutions
- Pension and profit sharing plans
- Charitable organizations
- Corporations or other businesses

#### **Financial Planning**

KAI provides financial planning for individual clients. The term "financial planning" refers to formulating the client's financial goals into understandable reports so that the client may then determine how to best utilize available financial resources. A financial plan can encompass all areas of financial significance, or can be targeted in nature and address only certain areas. The reports generally include a summary of the client's financial condition, together with planning concepts designed to reduce taxes, protect against interruption of earning capabilities, plan for premature death, and retirement planning. An initial plan is prepared for the Client and, thereafter, a periodic review is recommended. A plan update is recommended when the client's financial circumstances change significantly. .

#### *Assets Under Management*

On a discretionary basis, KAI managed \$1,256,336,087 as of December 31st, 2016. On a non-discretionary basis, KAI managed as of \$434,422,494 December 31st, 2016.





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## Item 5

### Fees and Compensation

KAI's fee for its portfolio and investment management services is generally directly debited from the account(s) for which KAI is providing management services. The account(s) will be debited quarterly in advance on approximately January 1st, April 1st, July 1st, and October 1st. Clients may request that the fee be charged to one of their other KAI/KSI accounts. Fees between 0% and 3.25% may be charged for its Investment Management Programs. The initial quarterly fee will be prorated based on the number of billing days in the initial quarter. Fees may be negotiable.

KAI may charge its clients an hourly rate for providing financial planning services. In all cases, the hourly rate may not exceed \$350. Fixed fees for services are negotiated with each client individually. Financial planning clients have a variety of payment options. In every case, clients who wish to terminate the planning process prior to completion may do so with written notice. KAI will promptly refund any unused pre-paid fee. A client may terminate an advisory agreement without being assessed any fees or expenses within five (5) days of its signing.

In calculating the value of the account for purposes of computing the account fee, KAI generally includes all assets invested in the account. The account fee does not include the following:

- Underwriting or dealer concessions or related compensation in connection with securities acquired in underwritten offerings;
- Certain odd-lot differentials, transfer taxes, transaction fees mandated by the Securities Act of 1934, postage and handling fees, and charges imposed by law with regard to transactions in the client's account(s); and
- Advisory fees and expenses of mutual funds including money market funds, closed-end investment companies or other managed investments if any are held in the account(s).

The client may pay these fees. The total client program fees may vary from client to client.

The cost of these programs to the client, if provided separately with the equivalent trading activity in the account(s), may cost more or less than purchasing such services through the KAI programs. The IAR representing this program receives compensation as a result of participation in the program. This compensation may be more or less than the IAR would have received for other investment advice, brokerage and/or other services or investment programs.

Accounts will be debited quarterly in advance for KAI account fees. If the advisory contract is terminated before the end of the billing period, any unearned fees resulting from the advance fee will be returned. Clients may terminate investment advisory services obtained from KAI, without penalty, upon written notice within five (5) business days after entering into the advisory agreement with KAI. Thereafter, the client may terminate advisory services upon written notice delivered to and received by Kovack Advisors, Inc. Clients who terminate investment advisory services during a quarter are charged a prorated advisory fee based on the date of KAI's receipt of client's written notice to terminate. Any earned but unpaid fees are immediately due and payable.

When mutual fund or closed-end investment company shares are purchased in the account, Kovack Securities, Inc. ("KSI") may receive a proportionate share of such fees or expenses (i.e. 12b-1 or shareholder servicing fees). However, if KSI receives any such compensation from a mutual fund or other issuer related to a security or other asset included in calculating the account fee, the amount of that compensation may reduce the account fee



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otherwise payable by the client. The factors impacting the relative cost of a program to a particular client include the following:

- The size of the account(s),
- The type of account(s) (such as equity or fixed income),
- The size of the assets devoted to a particular strategy, and
- The manager(s) selected.

**ERISA Plans:** In this Brochure, KAI is disclosing potential conflicts of interest: receiving additional compensation from third parties (such as 12b-1 fees, sub-transfer agent fees and revenue sharing payments), and providing marketing, recordkeeping, or other services in connection with certain investments. KAI adopted policies and procedures that are designed to ensure compliance with the prohibited transaction rules under the Employee Retirement Income Security Act of 1974 (“ERISA”), as amended. KAI addresses the potential conflict of interest of advisors who receive compensation for services provided to ERISA plans with the following steps:

- First, the IAR negotiates the compensation with ERISA plan sponsors or participants. The compensation is either an annual fee for ongoing services based on a percentage of assets under management, a flat fee, or an hourly rate.
- Second, to the extent that an IAR receives additional compensation from a third party, the IAR must report it to KAI to enable the additional compensation to be offset against the fees that the ERISA clients would otherwise pay for the advisor representative’s services.
- Third, KAI has established a policy not to influence any IAR’s advice or management of assets at any time or for any reason based on any compensation that KAI or the IAR might receive from third parties. KAI does not allow IARs to provide advice or manage assets for ERISA clients if they have conflicts of interest that KAI believes are prohibited by ERISA.

U.S. Department of Labor created new regulations on fee disclosures, effective July 16, 2011, for covered service provider to ERISA plans. Since KAI and its IARs may be considered covered service providers, KAI and its IARs will disclose the following:

- Direct compensation received from ERISA clients,
- Indirect compensation such as 12b-1 fees received from third parties, and
- Transaction-based compensation such as commissions or other similar compensation shared with related parties servicing the ERISA plan.

KAI will make these fee disclosures before entering into, renewing, or extending the advisory service agreement with the ERISA client.

### **Additional Fees and Expenses**

In addition to advisory fees paid to KAI as explained above, clients are charged for custody services, account maintenance, transactions, postage/handling costs, and other fees associated with maintaining the account. KAI pays some or all of these fees for designated Wrap Accounts, so some of these fees are **included** in the fees stated above. These fees vary by broker dealer and/or custodian. Additionally, for any mutual funds purchased, the client may pay their proportionate share of the funds’ distribution, internal management, investment advisory and administrative fees. Such fees are not shared with KAI and are compensation to the fund manager. Clients are urged to read the mutual fund prospectus prior to investing.



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Mutual fund companies impose internal fees and expenses on clients. These fees are in addition to the costs associated with the investment advisory services as described above. Complete details of such internal expenses are specified and disclosed in each mutual fund company's prospectus. Clients are strongly advised to review the prospectus(es) prior to investing in the funds.

Clients may purchase shares of mutual funds directly from the mutual fund issuer, its principal underwriter, or a distributor without purchasing the services of KAI or paying the advisory fee on such shares (but subject to any applicable sales charges). Certain mutual funds are offered to the public without a sales charge. In the case of mutual funds offered with a sales charge, the prevailing sales charge (as described in the mutual fund prospectus) may be more or less than the applicable advisory fee. However, clients would not receive KAI's assistance in developing an investment strategy, selecting securities, monitoring performance of the account, and making changes as necessary.

## **Item 6**

### ***Performance-Based Fees and Side-By-Side Management***

KAI does not charge performance-based fees or participate in side-by-side management. Side-by-side management refers to the practice of managing accounts that are charged performance-based fees while at the same time managing accounts that are not charged performance-based fees. Performance-based fees are fees that are based on a share of capital gains or appreciation of the assets of a client. Fees are calculated as described in Fees and Compensation section above, and are not charged on the basis of the performance the advisory account.

## **Item 7**

### ***Types of Clients***

KAI generally provides investment advice to the following types of clients:

- Individuals
- High net worth individuals
- Bank or thrift institutions
- Pension and profit sharing plans
- Charitable organizations
- Corporations or other businesses

KAI CHOICE programs each have different account minimums, as described in Item 4 – Advisory Services above, beginning with \$30,000 in the CHOICE Fund Program. At the firm's discretion, KAI may waive the minimum account size. KAI may also combine household accounts to meet the stated minimum.

## **Item 8**

### ***Methods of Analysis, Investment Strategies, and Risk of Loss***

KAI employs a wide range of methods to manage portfolios and evaluate investments, and uses research when making investment decisions. KAI's methods of analysis and investment strategies incorporate the client's



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financial needs and investment objectives, time horizon, and risk tolerance. KAI is not bound to a specific investment strategy for the management of investment portfolios, and instead considers the risk tolerance levels determined at the account opening, as well as monitoring risk tolerance on an on-going basis. Examples of methodologies that KAI's investment strategies may incorporate include:

**Asset Allocation** – Asset Allocation is a broad term used to define the process of selecting a mix of asset classes and the efficient allocation of capital to those assets by matching rates of return to a specified and quantifiable tolerance for risk.

**Dollar-Cost Averaging** – Dollar-cost averaging is the technique of buying a fixed dollar amount of securities at regularly scheduled intervals, regardless of the price per share. This will gradually, over time, decrease the average share price of the security. Dollar-cost averaging lessens the risk of investing a large amount in a single investment at the wrong time.

**Technical Analysis** – involves studying past price patterns and trends in the financial markets to predict the direction of both the overall market and specific stocks.

**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.

KAI's strategies and investments may have unique and significant tax implications. Regardless of account size or other factors, the firm strongly recommends continuous consultation with a tax professional prior to investing, and throughout investing.

Investing in securities involves risk of loss that clients should be prepared to bear. Although KAI manages client portfolios with strategies and in a manner consistent with risk tolerances, there can be no guarantee that the firm's efforts will be successful. Investors must be prepared to bear the risk of loss.

All investments involve the risk of loss, including (among other things) loss of principal, a reduction in earnings (including interest, dividends, and other distributions), and the loss of future earnings. These risks include market risk, interest rate risk, issuer risk, political risk and general economic risk. Regardless of the methods of analysis or strategies suggested for particular investment goals, risks that may be associated with each investment or strategy should be carefully considered.

KAI believes in diversified asset class exposure obtained primarily through a diversified mix of low cost mutual funds and ETFs that represent desired asset classes. Mutual funds and ETFs recommended by KAI may invest in some or all of the following types of securities:

- U.S. Stocks (Small-, Mid- or Large-Capitalization)
- Foreign Stocks, including Emerging Markets
- Investment Grade Fixed Income Securities
- Non-Investment Grade Fixed Income Securities
- Tax-Exempt Municipal Bonds
- U.S. Government and Government Agency Securities
- Derivatives



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## Real Estate Investment Trusts (Domestic and Foreign)

### *Sources of Information*

The main sources of information utilized by KAI in making its investment decisions are financial publications, research materials, corporate rating services and annual reports, prospectuses and other SEC filings. Through these sources and the Client's goals and objectives, KAI will determine what type of investments and investment strategies to recommend to clients.

### *Principal Investment Strategies*

Asset allocation models and specific funds recommended to clients typically are set forth in the client's Investment Policy Statement. KAI primarily recommends low cost mutual funds for the reason that mutual funds can provide a diversified portfolio that is designed to limit the impact of large fluctuations in values of individual stocks and bonds. Mutual funds do not offer protection from market volatility. At times, different funds may be recommended to improve client portfolios. KAI generally invests for the long-term and does not engage in short-term market timing.

KAI typically recommends mutual funds and ETFs to implement its recommended investment strategies. However, KAI also may recommend exchange-listed stocks, investment grade corporate bonds and other debt securities, municipal securities, U.S. Government securities or alternative investments, depending upon the particular Client's financial profile and investment objectives. KAI generally does not recommend individual stocks or bonds, but certain exceptions may be made in cases where the stocks were obtained before becoming a client or are requested by the client. KAI will monitor individual stock exposure in the overall portfolio only upon written agreement with the client.

KAI may give advice and take action with respect to clients that is different from the advice, timing, and nature of action taken with respect to other clients. Timing, allocation, and types of investments are determined as part of each client's overall financial plan.

### *Principal Risks*

KAI's primary goal for investing is to help the client maintain purchasing power over the long term. This may result in short term variability and loss of principal. Time horizon and risk tolerance are key determinates of the proper asset allocation. KAI's approach focuses on taking appropriate risks for which clients are compensated (i.e. market risk) and seeking to limit or eliminate risks that do not provide compensation over the long term (i.e. individual stock risk or lack of portfolio risk).

Below are some more specific risks of investing:

**Market Risk.** The prices of securities in which clients invest may decline in response to certain events taking place around the world, including those directly involving the companies whose securities are owned by the client or an underlying fund; conditions affecting the general economy; overall market changes; local, regional or global political, social or economic instability; and currency, interest rate and commodity price fluctuations. Investors should have a long-term perspective and be able to tolerate potentially sharp declines in market value.



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**Management Risk.** KAI's investment approach may fail to produce the intended results. If our perception of the performance of a specific asset class or underlying fund is not realized in the expected time frame, the overall performance of client's portfolio may suffer.

**Equity Risk.** Equity securities tend to be more volatile than other investment choices. The value of an individual mutual fund or ETF can be more volatile than the market as a whole. This volatility affects the value of the client's overall portfolio. Small- and mid-cap companies are subject to additional risks. Smaller companies may experience greater volatility, higher failure rates, more limited markets, product lines, financial resources, and less management experience than larger companies. Smaller companies may also have a lower trading volume, which may disproportionately affect their market price, tending to make them fall more in response to selling pressure than is the case with larger companies.

**Fixed Income Risk.** The issuer of a fixed income security may not be able to make interest and principal payments when due. Generally, the lower the credit rating of a security, the greater the risk that the issuer will default on its obligation. If a rating agency gives a debt security a lower rating, the value of the debt security will decline because investors will demand a higher rate of return. As nominal interest rates rise, the value of fixed income securities is likely to decrease. A nominal interest rate is the sum of a real interest rate and an expected inflation rate.

**Municipal Securities Risk.** The value of municipal obligations can fluctuate over time, and may be affected by adverse political, legislative and tax changes, as well as by financial developments that affect the municipal issuers. Because many municipal obligations are issued to finance similar projects by municipalities (e.g., housing, healthcare, water and sewer projects, etc.), conditions in the sector related to the project can affect the overall municipal market. Payment of municipal obligations may depend on an issuer's general unrestricted revenues, revenue generated by a specific project, the operator of the project, or government appropriation or aid. There is a greater risk if investors can look only to the revenue generated by the project. In addition, municipal bonds generally are traded in the "over-the-counter" market among dealers and other large institutional investors. From time to time, liquidity in the municipal bond market (the ability to buy and sell bonds readily) may be reduced in response to overall economic conditions and credit tightening.

**Investment Company and ETF Risk.** When a client invests in open end mutual funds or ETFs, the client indirectly bears its proportionate share of any fees and expenses payable directly by those funds. Therefore, the client will incur higher expenses, many of which may be duplicative. In addition, the client's overall portfolio may be affected by losses of an underlying fund and the level of risk arising from the investment practices of an underlying fund (such as the use of derivatives). ETFs are also subject to the following risks: (i) an ETF's shares may trade at a market price that is above or below their net asset value; (ii) the ETF may employ an investment strategy that utilizes high leverage ratios; or (iii) trading of an ETF's shares may be halted if the listing exchange's officials deem such action appropriate, the shares are de-listed from the exchange, or the activation of market-wide "circuit breakers" (which are tied to large decreases in stock prices) halts stock trading generally. KAI has no control over the risks taken by the underlying funds.

**Derivatives Risk.** Funds in a client's portfolio may use derivative instruments. The value of these derivative instruments derives from the value of an underlying asset, currency or index. Derivative investments by mutual funds or ETFs in which the client invests involve the risk that the value of the underlying fund's derivatives may rise or fall more rapidly than other investments, and the risk that it may lose more than the amount that it invested in the derivative instrument itself. Derivative instruments also involve the risk that other parties to the derivative contract may fail to meet their obligations, which could cause losses.



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**Foreign Securities Risk.** Funds in which clients invest may invest in foreign securities. Foreign securities are subject to additional risks not typically associated with investments in domestic securities. These risks may include, among others, currency risk, country risks (political, diplomatic, regional conflicts, terrorism, war, social and economic instability, currency devaluations and policies that have the effect of limiting or restricting foreign investment or the movement of assets), different trading practices, less government supervision, less publicly available information, limited trading markets and greater volatility. To the extent that underlying funds invest in issuers located in emerging markets, the risk may be heightened by political changes, changes in taxation, or currency controls that could adversely affect the values of these investments. Emerging markets have been more volatile than the markets of developed countries with more mature economies.

## **Item 9**

### **Disciplinary Information**

This section is used to disclose any disciplinary events that are material to a client's or prospective client's evaluation of KAI. KAI has had no material disciplinary events to disclose.

## **Item 10**

### **Other Financial Industry Activities and Affiliations**

The owners of KAI also own Kovack Securities, Inc. ("KSI") and Kovack International Securities, Inc. ("KIS"), both full service broker/dealers registered with the Financial Industry Regulatory Authority ("FINRA"), and Kovack International Advisors ("KIA") an SEC Registered Investment Adviser. Additionally, KAI is affiliated with a law firm, Brian J. Kovack, PA. Where permitted by law, KSI and its representatives may receive mutual fund 12b-1 fees, services fees, due diligence fees, marketing reimbursements, or other payments relating to a client's investment. KAI, as the investment advisor, sponsor, or other service provider to investment advisory programs, receives compensation for its services. Clients should be aware that these fees, payments, and other compensation may present a conflict of interest since KAI/KSI and its IARs may have a greater incentive to recommend those products or programs that provide additional compensation to KAI/KSI or to IARs.

All KAI management persons are registered with KSI. Neither KAI nor any of its management persons are registered or have an application to register as a futures commission merchant, commodity pool operator, a commodity trading advisor, or an associated person of these entities.

In addition, IARs of KAI may be independent insurance agents for various companies, tax professionals, or have other financial related businesses not affiliated with KAI or KSI. These practices represent conflicts of interest because it gives the IAR an incentive to recommend products based on the compensation amount received from their other business activity. This conflict is mitigated by the fact that IARs with KAI have a fiduciary responsibility to place the best interest of the client first and the clients are not required to purchase any other services. Clients have the option to purchase these products through another company of their choosing for insurance, tax, or other financial related services.

## **Item 11**

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



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KAI's Code of Ethics includes guidelines for professional standards of conduct for the firm's Associated Persons pursuant to SEC Rule 204A-1. KAI's goal is to protect client interests at all times and to demonstrate commitment to fiduciary duties of honesty, good faith, and fair dealing. All of KAI's Associated Persons are expected to strictly adhere to these guidelines. Persons associated with KAI are also required to report any violations to the Code of Ethics. Additionally, the firm maintains and enforces written policies reasonably designed to prevent the misuse or dissemination of material, non-public information about clients or client accounts by persons associated with the firm.

KAI and its employees may buy or sell securities that are also held by clients. It is KAI's express policy that no person employed by the firm purchase or sell any security prior to the transaction being implemented for an advisory account so as to prevent employees from benefiting from transactions placed on behalf of the advisory clients.

The advisor may have an interest or position in a certain security, which may also be recommended to the client. As these situations may present a conflict of interest, the advisor has established the following restrictions in order to ensure its fiduciary responsibilities:

1. A director, officer or employee of KAI shall not buy or sell a security for their personal portfolio(s) where their decision is substantially derived, in whole or part, by reason of his or her employment, unless the information is also available to the investing public. No owner/employee of KAI shall prefer their own interest to that of the client.
2. IARs are required to have duplicate confirms and statements submitted for all brokerage accounts holding stocks and bonds. These confirms are cross-checked against IAR clients trades on an as-needed basis, and monthly statements are reviewed.
3. KAI requires that all employees must act in accordance with all applicable Federal and State regulations governing registered investment advisors.
4. KAI ensures that clients are not at a disadvantage if KAI blocks personal trades with those of clients, and allocates the trades in a like manner.

KAI's Code of Ethics is available upon request by contacting the Compliance Department at (954) 782-4771.

## **Item 12**

### **Brokerage Practices**

KAI recommends broker-dealers based on the broker's services. In considering which independent qualified custodian will be the best fit for KAI's business model, KAI evaluates the following factors, including, but not limited to:

- Financial strength
- Reputation
- Reporting capabilities
- Execution capabilities
- Pricing, and
- Types and quality of research

While clients are free to choose any broker-dealer or other service provider, KAI recommends establishing an account with a brokerage firm that the firm has an existing relationship. Such relationships may include benefits





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provided to the firm, including research, market information, and administrative services that help KAI manage accounts. KAI believes that recommended broker-dealers provide quality execution service at competitive prices. However, price is not the sole factor considered in evaluating best execution. KAI also considers the quality of the brokerage services provided by the recommended broker-dealers, including the value of research provided, the firm's reputation, execution capabilities, commission rates, and client responsiveness.

Clients may request in to use a particular broker-dealer to execute some or all of the transactions for their account. In these cases, the client is responsible for negotiating the terms and arrangements for the account with that broker-dealer. KAI may not be able to negotiate commissions, obtain volume discounts, or best execution. In addition, under these circumstances a difference in commission charges may exist between the commissions charged to clients who direct KAI to use a particular broker or dealer and other clients who do not.

KAI does not have any soft dollar arrangements.

KAI does not receive client referrals from broker-dealers in exchange for cash or other compensation, such as brokerage services or research.

KAI may buy or sell the same security for two or more clients (including the firm's personal accounts), when concurrent orders are placed to be executed together as a single "block" in order to facilitate orderly and efficient execution. Each client account will be charged or credited with the average price per unit. KAI receives no additional compensation or remuneration of any kind because we aggregate client transactions, and no client is favored over any other client.

A potential conflict of interest may exist when KAI executes transactions through its affiliate broker-dealer, KSI. This potential conflict of interest is mitigated by the fact that KAI has a fiduciary duty to act in the client's best interests.

## **Item 13**

### **Review of Accounts**

KAI periodically reviews client accounts. KAI reviewers may include KAI's Executive Vice President, President, Chairman, Vice President(s), and Compliance Officer(s). At account opening, clients will choose a general investment category that reflects their risk tolerance, investment objectives, and financial objectives. KAI Personnel will review the allocations in the account against the chosen investment category.

Other factors may trigger an account review. For example, significant changes to a client's financial condition, risk tolerance or investment objectives may trigger an account review. Additionally, activity that raises concerns with regards to anti-money laundering regulations will also result in an account review.

No less than quarterly, clients receive statements of account activity from the account's custodian firm.

## **Item 14**

### **Client Referrals and Other Compensation**

KAI does not receive any economic benefit from someone who is not a client for providing investment advice or other advisory services.



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KAI may have relationships with unaffiliated persons that refer clients to KAI for a fee. All referring parties sign an agreement with KAI. The referring parties will not provide investment advisory or supervisory services to clients. The referring party must provide the potential client with a copy of KAI's Firm Brochure (this document), along with a copy of KAI's solicitor disclosure statements and client acknowledgement.

The referring party may receive a referral fee that is a portion of the annual investment advisory fee paid to KAI by the client. The fee charged to the client is not greater than it would have been without a referring party.

Other investment advisors may be recommended or selected for clients. KAI may receive compensation directly or indirectly from those advisors. Clients should be aware that this compensation may create a material conflict of interest because KAI or its IARs may have a great incentive to recommend those products or programs that provide additional compensation.

## **Item 15**

### **Custody**

Any investment advisor having custody or access to customer funds or securities must comply with certain rules and regulations designed to protect the clients' assets. Rule 206(4)-2 of the Investment Advisers Act of 1940 details strict requirements governing investment advisors that have "custody" over client securities or funds. KAI meets the definition of having custody due to the following circumstances:

- KAI directly debits fees from client accounts

KAI does not have physical custody of any client funds and/or securities. Client funds and securities will be held with a bank, broker dealer, or other independent qualified custodian. Clients receive account statements from the independent, qualified custodian holding the investments. The account statement from the custodian will indicate the amount of advisory fees deducted for each billing cycle. Clients should carefully review statements received from the custodian. KAI also sends quarterly invoices detailing the manner and amount of advisory fees to all clients. All checks deposited into client's custodial accounts must be made payable either to the custodian or for the benefit of the account name.

All accounts receive at least quarterly statements directly from the custodian. Clients should carefully review their account statements, and are encouraged to compare any reports received by KAI with their custodial statements and to promptly report any issues.

## **Item 16**

### **Investment Discretion**

#### *Discretionary Trading Authority*

KAI will assist clients in opening an account with an independent custodian or broker-dealer. Pursuant to a written agreement, clients grant KAI discretionary authority over the client's account to determine the securities to be bought and sold, to place trades, and periodically to rebalance the client's account back to the recommended allocation. KAI has no obligation to supervise or direct investments held in client accounts that were not recommended, or that are not subject to review, by KAI and for which the client does not pay an advisory fee.



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### *Limited Power of Attorney*

Clients grant KAI a limited power of attorney for trading purposes only with respect to the Client's brokerage account. KAI will exercise discretion to place transactions in the client's account based on a strategy selected by the client. Discretion also will be exercised when KAI rebalances the allocation of Client's portfolio to ensure that it remains consistent with the Client's investment objectives.

### *Trade Errors*

Trades are reviewed by KAI's Trading Department, to ensure that trade execution is consistent with instructions given to the executing broker-dealer by KAI. On occasion, an error may be made in executing a trade. For example, a security may be purchased (instead of sold) or the wrong number of shares may be purchased (or sold). In these situations, KAI will rectify the error by placing the client account in the same position as it would have been had there been no error. Clients will not recognize any net loss due to a transaction error by KAI. The client will be made whole as soon as possible upon discovery of the error. All errors will be reviewed and documented accordingly.

## **Item 17**

### **Voting Client Securities**

KAI does not vote proxies on behalf of advisory accounts. At the client's request, KAI may offer advice regarding corporate actions and the exercise proxy voting rights. Shares can only be voted by the client.

## **Item 18**

### **Financial Information**

This section is used to disclose certain financial information if KAI requires clients to pay advisory fees six months or more in advance. KAI does not require or solicit prepayment of more than \$1200 in fees more than six months in advance. KAI has not been the subject of a bankruptcy petition at any time in the past ten years.

## **Item 19**

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

This section is not applicable as KAI is an SEC Registered Investment Advisor.