

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5085 / December 20, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18948

In the Matter of

**STERLING GLOBAL
STRATEGIES LLC,**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 203(e) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Sterling Global Strategies LLC (“Respondent” or “Sterling”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. From at least 2010 through 2018 (the "relevant period"), Sterling, a registered investment adviser, made material misstatements and omissions to its clients and prospective clients in advertising the back-tested performance of the Sterling Tactical Rotation Index (the "Sterling Index"). During the relevant period, the Sterling Index replicated the Sterling Tactical Rotation Strategy (the "Strategy"), a rule-based momentum approach that rotated between six broad-based non-correlated global asset classes based on intermediate trends. Sterling's advertisements from 2010 to 2018 showed back-tested performance results from January 2000 through June 2010 that significantly outperformed the S&P 500 Index, including in the down market of 2008 when the Sterling Index avoided the significant downturn in the S&P 500 Index.

2. Since 2010, Sterling regularly advertised the back-tested performance results. The back-tested performance calculations contained material errors and deviated from the pricing methodology utilized during the live period that began in June 2010. First, the back-tested performance failed to implement a two-day lag between signal and investment, consistent with the approach used during the live period. Second, Sterling failed to ensure that the hypothetical portfolio's holdings were in accordance with the Sterling Index's model rules. On a cumulative basis, the failure to implement the lag and the portfolio holding errors inflated the Sterling Index's advertised performance by approximately 41.2% for the period from 2000 to June 2010.

3. In addition to these undisclosed issues that resulted in inflated back-tested performance, Sterling also failed to disclose that the back-tested performance was based in part on investment in a commodity index that investors could not have actually invested in during most of the back-tested period.

4. As a result, Sterling willfully violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by publishing, circulating, and distributing advertisements that contained an untrue statement of a material fact, or that was otherwise false or misleading. Sterling also failed to implement policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with its performance advertising, as required by Section 206(4) of the Advisers Act and Rule 206(4)-7.

Respondent

5. Sterling Global Strategies LLC (SEC File No. 801-80635) is an investment adviser that has been registered with the Commission since 2010. In 2014, Sterling changed its name from Sterling Wealth Management Group, Inc. to Sterling Global Strategies LLC. Sterling

¹ The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

is a Delaware Limited Liability Company founded in 2008 and headquartered in Carlsbad, California. As of December 31, 2017, Sterling had approximately \$223 million in regulatory assets under management, including approximately \$200 million in discretionary assets.

Facts

Sterling's Tactical Rotation Strategy

6. In 2010, Sterling began providing advisory services as an active manager. Sterling manages individual accounts, primarily for high net worth individuals, and provides portfolio management and signal provider services to institutional clients. Sterling uses several strategies, including the Sterling Tactical Rotation Strategy, to manage client accounts and earns a portion of the fees collected by institutional advisors from accounts placed in those strategies.

7. The Strategy is a rule-based momentum approach that rotated between six broad-based non-correlated global asset classes based on intermediate trends. The asset classes included domestic equities, domestic bonds, international equities, real estate, commodities, and cash. According to Sterling, based on relative strength and momentum signals, the Strategy selected two of the six asset classes each month, weighting each equally. The Strategy allowed for a 100% weighting to cash during market declines, which Sterling marketed as a risk management tool. Sterling represented that the Strategy was designed to outperform the domestic stock market while providing downside protection. Each month, Sterling would run the model to determine the Strategy's holdings.

8. In June of 2010, Sterling began using its Strategy to manage accounts (the "live period"). To provide hypothetical performance for the Sterling Index prior to the live period, Sterling contracted with a third-party index provider ("Index Provider") to calculate the back-tested performance for the time period 2000 to 2010. Sterling used that back-tested performance as the past performance of the Sterling Index. According to these calculations, the back-tested performance exceeded the S&P 500 Index, the benchmark originally selected by Sterling. In addition, the back-tested performance calculations exhibited downside protection during significant market declines. During the relevant period, Sterling used these calculations in many but not all advertisements to clients and prospective clients. In 2018, Sterling discontinued its use of back-tested performance calculations in response to concerns about the accuracy of the back-tested performance advertisements identified by Commission enforcement staff.

9. From 2013 through 2017, \$124 million to \$300 million of Sterling's assets under management were invested in this Strategy. Further, a significant percentage of investors placed into the Strategy were retail investors.

Sterling's Back-Tested Performance Calculations Deviated from the Strategy and Inflated Performance

10. Back-testing involves the retroactive application of an investment strategy or methodology to a historical set of data. Back-tested performance attempts to illustrate how a portfolio would have performed during a certain historical period if the portfolio had been in existence during that time. Here, Sterling's back-tested performance calculations deviated from

the actual Strategy methodology in at least three material respects, and Sterling failed to disclose this fact in its advertisements. Sterling's deviation from the actual Strategy resulted in inflated, back-tested performance.

11. First, the back-tested performance was calculated inconsistently with the approach Sterling actually used during the live period. For the back-tested period, Sterling calculated asset allocation signals based on the month-end closing price for the underlying asset class investments, the same date as the hypothetical investment. In contrast, during the live period, Sterling calculated asset allocation signals using the closing price that predated month end by two days, to allow time between the signal and the actual investment. The failure to use a two-day lag that was essential to execute the actual Strategy resulted in the back-tested performance being inflated by approximately 9.6%. This two-day lag embedded in the live performance but not in the back-tested performance was never disclosed in Sterling's advertisements even though Sterling's advertisements blended the back-tested performance (not using a lag) with the Strategy's performance (using a two-day lag).

12. Second, the Index Provider who was hired to calculate the back-tested performance inaccurately applied the model rules, selecting inaccurate portfolio holdings and returns in certain months. For example, according to the model, the Index Provider should have selected domestic bonds and domestic equities for the month of December 2002. Instead, the Index Provider selected commodities and domestic equities. As a result, the performance for that month was overstated by 3.2% (i.e. advertised performance was 1.4% instead of -1.8%). The errors resulted in both overstatements and understatements across the back-tested time period. Sterling failed to provide reasonable oversight of the Index Provider. With respect to the back-tested period, the model portfolio generally followed the trend of the advertised performance providing down-side protection and exceeded its benchmarks, but the inaccurate asset selection resulted in Sterling materially overstating the amount by which the Sterling Index exceeded its benchmark. In total, the months for which the Sterling Index holdings did not follow the Strategy's model resulted in the back-tested performance being inflated by approximately 31.6%. None of this was disclosed in Sterling's advertisements.

13. Together, the inflated performance caused by the failure to implement a two-day lag and the asset selection errors inflated the back-tested performance by approximately 41.2%.

14. The back-tested performance from 2000 to 2010 of the Sterling Index was also based in part on the Sterling Index's hypothetical investment in a well-known commodity index. The commodity index Sterling's model used from 2000 to 2006 was not actually an investment investors could invest in. But for the four years before the live period, the Sterling Index did use an investable commodity fund. However, Sterling did not disclose in its advertisements that back-tested performance for the period 2000 to 2006 was based in part on a commodity index that investors could not actually invest in or the change from the commodity index to the commodity fund.

Sterling Failed to Adopt Reasonable Policies and Procedures

15. Sterling failed to adopt policies and procedures reasonably designed to prevent inaccurate advertisements concerning its back-tested performance. Sterling's compliance policies

and supervisory procedures manual includes a section on advertising and marketing, which requires a pre-review of all advertisements to verify that the advertisement complies with Sterling's policies and procedures as well as applicable rules and regulations.

16. While the advertising section of Sterling's manual addressed advertising actual performance results and the means by which Sterling would verify the accuracy of such performance, it did not address specifically Sterling's use of back-tested performance results (e.g., noting the differences between live and back-tested performance calculations, disclosing any changes in investments used in the back-test, or verifying whether the back-tested performance was calculated accurately).

17. Based on the foregoing, Sterling failed to adopt and implement policies and procedures reasonably designed to prevent false and misleading advertisements.

Violations

18. As a result of the conduct described above, Respondent willfully² violated Section 206(2) of the Advisers Act, which prohibits any investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. A violation of Section 206(2) may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.*

19. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act to, among other things, directly or indirectly publish, circulate or distribute an advertisement which contains any untrue statement of material fact, or which is otherwise false or misleading. The marketing materials used by Sterling were written communications addressed to more than one person which offered investment advisory service with regard to securities, and were therefore advertisements as defined by Advisers Act Rule 206(4)-1(b). A violation of Section 206(4) and the rules thereunder does not require scienter, and may rest on a finding of simple negligence. *Steadman*, 967 F.2d at 647.

20. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require investment advisers registered or required to be registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

² A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Sterling's Remedial Efforts

21. In determining to accept Respondent's Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff. Sterling voluntarily removed all advertisements from its website when the Commission's enforcement staff inquired about Sterling's back-tested performance.

Undertakings

22. Notice to Advisory Clients. Within sixty (60) days of the entry of this Order, Respondent shall post prominently on its website a summary of this Order in a form and location acceptable to the Commission staff, with a hyperlink to the entire Order. Respondent Sterling shall maintain the posting and hyperlink on its website for a period of six (6) months from the entry of this Order. In addition, within sixty (60) days of the entry of this Order, Respondent shall mail a copy of this Order to all current investors in the Strategy.

23. Compliance Consultant.

- a. Respondent shall engage for one year a qualified consultant not unacceptable to the staff to assist Respondent in developing and implementing written compliance policies and procedures reasonably designed to promote Sterling's compliance with the Advisers Act with respect to the publication, circulation, or distribution of Sterling's advertisements concerning its investment models, strategies, and indices.
- b. Within six months after the date of issuance of this Order, Respondent shall require the consultant to submit a written report to Commission staff. The report shall describe the review; set forth the conclusions reached and the recommendations made by the consultant, as well as any proposals made by Respondent; and describe how Respondent is implementing the consultant's final recommendations. For good cause shown and upon timely application by the consultant or Respondent, the Commission's staff may extend the deadline set forth in this undertaking.

24. Certification of Compliance by Respondent. Respondent shall certify, in writing, compliance with each of these undertakings. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Robert Baker, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Sterling shall cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder.

B. Sterling is censured.

C. Sterling shall pay a civil penalty of \$175,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). Payment shall be made in the following installments: (1) \$75,000 within 10 days of the entry of the Order; (2) \$25,000 within 95 days of the entry of this Order; (3) \$25,000 within 185 days of the entry of this Order; (4) \$25,000 within 275 days of the entry of this Order; and (5) \$25,000 within 365 days of the entry of this Order. If any installment is not made by the date payment is required by this Order, the entire outstanding balance of civil penalty, plus any additional interest accrued pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application.

Payment must be made in one of the following ways:

- (1) Sterling may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Sterling may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Sterling may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Sterling as the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert Baker, Assistant Director, Asset

Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

E. Respondent shall comply with the undertakings enumerated in Paragraphs 22-24 above.

By the Commission.

Brent J. Fields
Secretary