

## **FIRM BROCHURE**

**October 21, 2019**



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

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

## Item 2 – Material Changes

Since our last annual updating amendment on December 12, 2018 we have the following material changes to disclose:

- We have removed any reference to Highmore Sustainable All Cap Equity Fund (RIC) and any affiliations with Highmore Advisors.

## Item 3 – Table of Contents

Item 1 – Cover Page.....	i
Item 2 – Material Changes.....	ii
Item 3 – Table of Contents.....	iii
Item 4 – Advisory Business.....	1
Item 5 – Fees and Compensation.....	4
Item 6 – Performance-Based Fees and Side-By-Side Management .....	6
Item 7 – Types of Clients and Account Requirements .....	6
Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss .....	6
Item 9 – Disciplinary Information.....	9
Item 10 – Other Financial Industry Activities and Affiliations.....	9
Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading.....	9
Item 12 – Brokerage Practices.....	11
Item 13 – Review of Accounts .....	14
Item 14 – Client Referrals and Other Compensation .....	15
Item 15 – Custody.....	15
Item 16 – Investment Discretion .....	15
Item 17 – Voting Client Securities.....	15
Item 18 – Financial Information.....	16
Item 19 – Requirements for State-Registered Advisers .....	16

## Item 4 – Advisory Business

### ***Firm Description***

**SFE Investment Counsel (SFE)** is an independent investment advisory firm located in downtown Los Angeles. We have been providing investment advice and portfolio management services to individuals, families, trusts, charitable organizations, retirement plans, businesses and institutional investors since 1977. SFE is a California corporation and operates as an SEC Registered Investment Advisor (RIA).

SFE is an experienced, capable money management firm that is 100% employee-owned. Our five investment professionals average over 28 years industry experience and more than 21 years tenure with the firm. SFE is financially sound, profitable and claims compliance with the Global Investment Performance Standards (GIPS). Our team approach and long-term transition plan provide continuity and stability for our clients.

### ***Principal Owner***

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

### ***Advisory Services***

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

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

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

For equity investments, we seek companies of quality and value – the best in their fields. SFE focuses on companies that have established a competitive advantage in their industries, and/or have strong global franchises and generate significant revenue from their international operations. To aid in our selections, we subscribe to many sources of independent research and perform our own fundamental and technical security analysis. Many of our equity selections are chosen for their dividend yield to enhance total return. Fixed income allocations are primarily comprised of United States (US) government and agency securities, corporate bonds, exchange traded funds (ETFs), and tax-exempt municipal bonds (as appropriate), with maturities ranging from 2-10 years. These allocations typically reduce portfolio volatility and risk. Maturities are adjusted as needed to capture the sweet spot on the yield curve. Selected securities will be readily marketable and diversified by issuer.

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

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

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

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

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

SFE may also be retained by other RIAs to provide investment advisory services under a dual-contract relationship. These services primarily consist of portfolio management for assets of the clients of these RIAs and are not considered investment supervisory services. SFE will have exclusive authority to direct and manage the investment and reinvestment of all client assets on a fully discretionary basis, based upon client information and investment objectives as provided by the RIAs. Such discretionary

authority shall include, without limitation, the right to purchase, sell, exchange and engage in other transactions with respect to all client assets under management. We will not have authority to select a custodian or negotiate commissions. These clients do not have access to the same level of personal service as clients who invest directly with SFE.

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

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

SFE designs and manages model portfolios that are available to other advisor firms and investment professionals through select technology platforms. These model portfolios present specific investment strategies for turn-key use by subscribers on behalf of their clients. SFE is engaged and compensated through contractual agreements with the platform providers. Fees are calculated at a negotiated rate and remitted quarterly to SFE by the providers based upon their determination of the aggregate market value of assets utilizing the strategies through their platforms. These clients do not have access to the same level of personal service as clients who invest directly with SFE.

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

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

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

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

The third-party adviser pays SFE for the portfolio management services we provide to SAM Program clients. Our fees are calculated by the adviser and paid to us monthly in arrears. Fees are calculated as a percentage of the total assets managed by SFE under

the program and vary depending upon the amount of assets. Our minimum client account size for third party separate account programs is \$100,000.

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

### ***Client Assets***

SFE manages \$296,312,767 on a discretionary basis and \$30,783,623 on a non-discretionary basis. Total assets under management are \$327,096,390 as of September 30, 2019.

## **Item 5 – Fees and Compensation**

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

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

<b><u>Account Assets</u></b>	<b><u>Annualized Rate</u></b>
<b>First \$250,000</b>	<b>2.00%</b>
<b>Next \$1 million</b>	<b>1.75%</b>
<b>Next \$2 million</b>	<b>1.50%</b>
<b>Next \$5 million</b>	<b>1.25%</b>
<b>Next \$10 million</b>	<b>1.00%</b>

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

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

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

### ***Billing Practices***

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

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

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

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

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

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

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

Our firm and representatives do not receive commissions for securities transactions.



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

SFE does not accept performance-based fees and has no side-by-side management conflicts of interest.

## **Item 7 – Types of Clients and Account Requirements**

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

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

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

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

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

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

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

Fixed income securities are selected for portfolios based upon the client's investment objective and risk tolerance. We review and assess the tax aspects, credit quality, maturity, interest rate, liquidity and diversification of the securities to make sure they are

appropriate for an account. The economic cycles and current market interest rates are also considered in our fixed income decisions.

### ***Investment Strategies***

SFE's investment philosophy is founded upon our belief that asset allocation is the single most important determinant of portfolio performance. Accordingly, we adjust equities, fixed income, and cash positions in response to market and economic conditions to fulfill client objectives. Through our disciplined investment approach, we seek to produce equity returns that consistently outperform the S&P 500 Index while taking less-than-market risk. We strive to preserve capital and achieve long term appreciation by employing an opportunistic, total return approach to managing client accounts.

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

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

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

## ***Risk of Loss***

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

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

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

## ***Market Risk***

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

## ***Interest-Rate Risk***

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

## ***Inflation Risk***

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

## ***Credit Risk***

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

## ***Other Risks***

Stocks and bonds may decline significantly in value due to economic and political events, both domestically and globally. In addition, international investments involve such risks

as fluctuating currency values (currency risk) as well as the potential for social, political, and economic upheavals that may affect a country's markets.

## **Item 9 – Disciplinary Information**

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

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

We act as the adviser and manager for two private placement investments, SFE Alternative Investment Fund I LLC and SFE Alternative Investment Fund II LLC. Our duties include (1) advisory tasks such as carrying out due diligence on underlying funds, verifying the qualifications of prospects and recommending allocations to funds on the part of investors; and (2) administrative tasks such as responding to capital calls, allocating distributions from the underlying investments, preparing reports and billing as well as answering investor questions.

A representative of our firm holds an insurance license. Any customary fees received as a result of insurance sales present a conflict of interest as such sales create an incentive to recommend products based on the compensation. To mitigate this potential conflict, our firm will specifically review that any insurance product sales for suitability.

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

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

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

1. Compliance with Laws and Regulations
2. Conflicts of Interest
3. Insider Trading
4. Personal Securities Transactions
5. Gifts and Entertainment

## 6. Confidentiality

## 7. Other Outside Activities

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

### ***Personal Trading***

SFE employees may own some of the same securities that we recommend to clients. These securities are usually widely-held stocks or exchange-traded funds. Our personal trades are immaterial in size and therefore do not impact the trading volume or price of such securities. These securities may have been purchased either before or after the same stock is purchased for a client. We recognize that the personal investment transactions of members of our firm demand the application of a high Code of Ethics and require that all such transactions be carried out in a way that does not endanger the interest of any client. At the same time, we believe that if investment goals are similar for clients and for members of our firm, it is logical and even desirable that there be common ownership of some securities. We feel common ownership aligns our interest with that of our clients' and does not present a conflict.

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

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

## **Item 12 – Brokerage Practices**

### ***Selecting a Brokerage Firm***

We seek to recommend a custodian/broker who will hold your assets and execute transactions on terms that are overall most advantageous when compared to other available providers and their services. We consider a wide range of factors, including, among others, the following:

- Ability to maintain the confidentiality of trading intentions
- Timeliness of execution
- Timeliness and accuracy of trade confirmations
- Liquidity of the securities traded
- Willingness to commit capital
- Ability to place trades in difficult market environments
- Research services provided
- Ability to provide investment ideas
- Execution facilitation services provided
- Record keeping services provided
- Custody services provided
- Frequency and correction of trading errors
- Ability to access a variety of market venues
- Expertise as it relates to specific securities
- Financial condition
- Business reputation

With the aforementioned in consideration, we utilize the services of Charles Schwab & Co., Inc. (“Schwab”) a FINRA-registered broker-dealer, member SIPC, as a qualified custodian. We are independently owned and operated and not affiliated with Schwab. Schwab offers services to independent investment advisers which include custody of securities, trade execution, clearance and settlement of transactions.

### **Products and Services Available to Us from Schwab**

Schwab services independent investment advisory firms like SFE through their Schwab Advisor division. They provide us and our clients with access to their institutional brokerage platform which offers trading, custody, reporting and related services – many features of which are not typically available to Schwab retail customers. Schwab also makes available various support services. Some of those services help us manage or administer our client accounts while others help us manage and grow our business. Here is a more detailed description of Schwab’s support services:

### Services that Directly Benefit You

Schwab's institutional brokerage services include access to a broad range of investment products, execution of securities transactions, and custody of client assets. The investment products available through Schwab include some that might not otherwise be available to us or that would require a significantly higher minimum initial investment by our clients. Schwab's services described in this paragraph generally benefit you and your account.

### Services that May Indirectly Benefit You

Schwab also makes available to us other products and services that benefit us but may not directly benefit you or your account. These products and services assist us in managing and administering our client accounts. They include investment research, both Schwab's own and that of third parties. We may use this research to service all or some substantial number of our client accounts, including accounts not maintained at Schwab. In addition to investment research, Schwab also makes available software and other technology that:

- provide access to client account data (such as duplicate trade confirmations and account statements);
- facilitate trade execution and allocate aggregated trade orders for multiple client accounts;
- provide pricing and other market data;
- facilitate payment of our fees from our clients' accounts; and
- assist with back-office functions, recordkeeping and client reporting.

### Services that Generally Benefit Our Firm

Schwab also offers other services intended to help us manage and further develop our business enterprise. These services include:

- educational conferences and events;
- technology, compliance, legal, and business consulting;
- publications and conferences on practice management and business succession; and
- access to employee benefit providers, human capital consultants and insurance providers.

Schwab may provide some of these services itself. In other cases, it will arrange for third-party vendors to provide the services to us. Schwab may also discount or waive its fees for some of these services or pay all or a part of a third party's fees. Schwab may also provide us with other benefits such as occasional business entertainment of our personnel.

We do not receive or direct client brokerage commissions to obtain research or other products or services. The aforementioned research and brokerage services are used by our firm to manage accounts for which we have investment discretion. Without this

arrangement, our firm might be compelled to purchase the same or similar services at our own expense.

As a result of receiving these services, we may have an incentive to continue to use or expand the use of Schwab services. Our firm examined this potential conflict of interest when we chose to enter into the relationship with Schwab and we have determined that the relationship is in the best interest of our firm's clients and satisfies our fiduciary obligations, including our duty to seek best execution.

Schwab charges brokerage commissions and transaction fees for effecting certain securities transactions (i.e., transaction fees are charged for certain no-load mutual funds, commissions are charged for individual equity and debt securities transactions). Schwab enables us to obtain many no-load mutual funds without transaction charges and other no-load funds at nominal transaction charges. Schwab commission rates are generally discounted from customary retail commission rates. However, the commission and transaction fees charged by Schwab may be higher or lower than those charged by other custodians and broker-dealers.

Our clients may pay a commission or transaction fee to Schwab that is higher than another qualified broker-dealer might charge to effect the same transaction where we determine in good faith that the commission 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 we will seek competitive rates, to the benefit of all clients, we may not necessarily obtain the lowest possible commission rates for specific client account transactions.

### ***Soft Dollars***

Our firm does not receive soft dollars in excess of what is allowed by Section 28(e) of the Securities Exchange Act of 1934. The safe harbor research products and services obtained by our firm will generally be used to service all of our clients but not necessarily all at any one particular time.

### ***Brokerage for Client Referrals***

Our firm does not receive brokerage for client referrals.

### ***Directed Brokerage***

Neither we nor any of our firm's related persons have discretionary authority in making the determination of the brokers with whom orders for the purchase or sale of securities are placed for execution, nor the commission rates at which such securities transactions are effected. We routinely recommend that a client directs us to execute through a



specified broker-dealer. Our firm recommends the use of Schwab. Each client will be required to establish their account(s) with Schwab if not already done. Please note that not all advisers have this requirement.

### ***Permissibility of Client-Directed Brokerage***

We allow clients to direct brokerage outside our recommendation. However, we may be unable to achieve the most favorable execution of client transactions. Client directed brokerage may result in higher fees for the client. For example, in a directed brokerage account, you may pay higher brokerage commissions because we may not be able to aggregate orders to reduce transaction costs, or you may receive less favorable prices than can be achieved through our institutional relationship with Schwab.

### ***Aggregation of Purchase or Sale***

We perform investment management services for various clients. There are occasions on which portfolio transactions may be executed as part of concurrent authorizations to purchase or sell the same security for numerous accounts served by our firm, which involve accounts with similar investment objectives. Although such concurrent authorizations potentially could be either advantageous or disadvantageous to any one or more particular accounts, they are executed only when we believe that to do so will be in the best interest of the effected accounts.

## **Item 13 – Review of Accounts**

Advisory accounts are continuously monitored by the individual client's primary investment counselor. In addition, each account is typically reviewed twice each quarter by the portfolio management team and client manager. Weekly Investment Committee meetings are held to review client portfolio transactions from the prior week. The Investment Committee is comprised of the following: Jon M. Kmett (President), Charles E. Bohlen, Jr. (Vice President and Chief Investment Officer), Teri M. McCasland (Vice President and Chief Compliance Officer), David J. Thomsen (Vice President/Business Development), James T. Moylan (Vice President/Portfolio Management & Research) and Oliver Cornelius Nihan (Analyst).

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

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

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

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

We receive an economic benefit from Schwab in the form of the support products and services it makes available to us and other independent investment advisors that manage client accounts at Schwab. These products and services, how they benefit us, and the related conflicts of interest are described above (*see Item 12 – Brokerage Practices*). The availability to us of Schwab's products and services is not based on us providing particular investment advice, such as buying particular securities for our clients.

#### **Item 15 – Custody**

Because certain clients are investors in SFE Alternative Fund II which is under common control as SFEIC, it should be noted that the fund financials are independently audited by a CPA registered with the Public Company Accounting Oversight Board and delivered annually to each investor.

#### **Item 16 – Investment Discretion**

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

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

SFE shall only vote client securities when the firm has the authority to vote proxies in respect of securities in client accounts ("Client Securities") over which the Company has voting discretion. In such cases, the Company will cast proxy votes in a manner that is

consistent with the best interests of the Company's clients. These policies and procedures are designed to deal with the complexities which may arise in cases where the Company's interests' conflict or appear to conflict with the interests of its clients and to communicate to clients the methods and rationale whereby the Company exercises proxy authority. This document is available to any client upon request. SFE will also make available the record of the Company's votes promptly upon request.

Unless contractually obligated to vote in a certain manner, the Company will reach its voting decisions independently, after appropriate investigation. It does not generally intend to delegate its decision making or to rely on the recommendations of any third party, although it may take such recommendations into consideration. Where the Company deviates from the guidelines listed below or depends upon a third party to make the decision, the reasons shall be documented. SFE may consult with such other experts, such as CPA's, investment bankers, attorneys, etc., as it regards necessary to help it reach informed decisions.

SFE generally will monitor proposed corporate actions and proxy issues regarding client securities and may take any of the following actions based on the best interests of our clients: (i) determine how to vote the proxies, (ii) abstain, or (iii) follow the recommendations of an independent proxy voting service in voting the proxies.

In general, the Company will determine how to vote proxies based on our reasonable judgment of the vote most likely to produce favorable financial results for our clients. Proxy votes generally will be cast in favor of proposals that maintain or strengthen the shared interests of shareholders and management, increase shareholder value, maintain or increase shareholder influence over the issuer's board of directors and management and maintain or increase the rights of shareholders. Proxy votes generally will be cast against proposals having the opposite effect. However, the Company will consider both sides of each proxy issue.

## **Item 18 – Financial Information**

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

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

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