

## DISCLOSURE BROCHURE

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# Penn Davis McFarland, Inc.

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March 2012

This brochure provides information about the qualifications and business practices of Penn Davis McFarland, Inc. If you have any questions about the contents of this brochure, please contact us at 214-871-2772. 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 Penn Davis McFarland, Inc. also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **Item 2-Material Changes**

This revision reflects a new arrangement we have with a FIX electronic trading platform. See Item 12.

If you would like another copy of this Brochure, please download it from the SEC website ([www.advisorinfo.sec.gov](http://www.advisorinfo.sec.gov)), or you may contact our Chief Compliance Officer Sydney Sharp at 214-871-2771 (or e-mail [sydneys@pdavis.org](mailto:sydneys@pdavis.org)).

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## Item 4-Advisory Business

### Our History

Penn Davis McFarland, Inc. (PDM) was founded in 1977 by Fred M. Penn, John H. Davis, and John S. McFarland. We offer asset management services through separately managed accounts. Our typical account owners are individuals, retirement and pension plans, trusts, and limited partnerships.

PDM has full discretionary investment authority over the vast majority of its client accounts. See Item 16-Investment Discretion below.

PDM invests its client's assets primarily in publicly traded stocks and bonds; however, we may occasionally purchase and sell other assets for your account, including but not limited to those described below in Item 8-Methods of Analysis, Investment Strategies and Risk of Loss. We generally seek to make investments that provide a reasonable expected rate of return relative to the risk of loss. We use primarily fundamental analysis when assessing the merits of investment opportunities. As part of our due diligence process to vet potential investments we review regulatory filings, sell side research reports, newspapers and other trade journals, as well as rely on our own experiences and conversations with individuals engaged in the particular business we are evaluating. Once we have identified what we deem to be an attractive investment, we then consider each client's risk tolerances, cash needs, and any other criteria our clients have asked us to consider when determining whether or not that particular investment is appropriate for that specific client.

As of December 31, 2011, our discretionary assets under management were \$465,100,000. Our total discretionary and non-discretionary assets under management including non-discretionary infrequently priced assets some of our clients hold and we advise them on (such as investments in private partnerships) were \$475,362,000 as of December 31, 2011.

### Our Principals

**Fred M. Penn** is a native Dallasite with a life-long interest in finance and the stock market. Fred graduated from Southern Methodist University where he majored in Banking and Finance. After 17 years at the First National Bank in Dallas, he became one of the founders of Penn Davis McFarland, Inc. In addition to being a retired Commander in the U.S. Naval Reserve, Fred has been President of the Boys and Girls Club of Dallas, the Dallas Summer Musicals, the American Heart Association (Dallas Chapter), and participated in many other civic aspects of the community. Fred's primary focus is client relations.

**John H. Davis** graduated from Texas Christian University with a Bachelor of Arts and Sciences degree in Economics and English. He was subsequently employed by the First National Bank in Dallas, where he served as portfolio manager for a variety of trusts, as well as manager of two pooled equity funds. In 1973, John was a founder of Southland Trust Company and became Head of Investments. He left Southland Trust to form Penn Davis McFarland, Inc. in 1977. John's primary responsibility is portfolio management. He is a member of our Investment Committee.

**John S. McFarland** graduated from Southern Methodist University with a Bachelor of Arts and Business Administration degree. John became a Securities Broker with Goodbody & Co. From there he was a founder of Southland Trust Company and, later Penn Davis McFarland, Inc. John is a life-long Dallasite and has served on many civic boards, including Bryan's House, Dallas Mental Health Association, President of the Boys and Girls Clubs of Dallas and currently serves on the Board of Meadows School of the Arts at Southern Methodist University and is co-chairman of The SMU Meadows School Capital Campaign. John is a member of Saint Michael and All Angels Episcopal Church. John is President of Penn Davis McFarland, Inc. He focuses on client relations and manages all operational aspects of the firm.

**R. Van Ogden** has been with the firm since 1986 and became a partner in 1993. He is a CFA charterholder and holds a Masters in Business Administration from Southern Methodist University. Prior to joining the firm, Van served as a personal trust officer with a large Dallas Bank, now a part of Bank of America. While at the bank, he gained extensive experience in managing trust, real property, and financial assets, as well as estate and tax planning. Van's primary responsibilities are portfolio management and client relations. He is a member of our Investment Committee.

## **Our People**

**Jeffrey (Jeff) W. Helfrich** joined the firm in May 2010. He graduated magna cum laude from Harvard University with an A.B. in Economics and is a CFA charterholder. He has been an equity research analyst with the Janus Capital Group, and Independence Capital Asset Partners, LLC in Denver, Co. Prior to joining Penn Davis McFarland, Inc. he was a research analyst for Perot Investments, the private investment company for the Perot family in Dallas. Jeff's primary responsibility is investment research and portfolio management. He is a member of our Investment Committee.

**Sydney C. Sharp** joined the firm in 2006. She is a member of the State Bar of Texas and the Dallas Bar Association and holds degrees from Austin College, St. Mary's Law School and the Episcopal Seminary of the Southwest. Prior to joining PDM, she worked as a Senior Vice President of several Texas Trust Departments. Sydney is also a former licensed Texas Real Estate Broker and Exxon landman. Sydney's primary responsibilities are compliance and client relations and she is our Chief Compliance Officer.

**Kenni L. Hamilton** joined the firm in March of 2005. Prior to joining Penn Davis McFarland, Inc., Kenni was a portfolio administrator for a Dallas investment firm for 9 years. Her primary duties include the ongoing accounting for client portfolios.

**Frances (Fran) D. Jenkins** joined the firm in 2004. Fran is a native Dallasite. Prior to joining Penn Davis McFarland, Inc., she was a licensed Agency Trader for a brokerage firm for seventeen years. Fran's primary responsibilities include the ongoing accounting for client portfolios.

**Miriam M. Lee** joined the firm in December of 1996. Miriam graduated from Massey Business College with an Executive Secretarial/Accounting degree. Prior to joining the firm, Miriam had several years of experience in banking and held a management position in the health care

industry. Her primary responsibilities include administrative support for the principals and client relations.

**Stacy L. Wulf** joined the firm in February of 2007. Prior to joining Penn Davis McFarland, Inc., Stacy was the accountant for a family owned business and worked with special needs children in the Mesquite Independent School District. Stacy oversees the daily accounting needs of the firm's clients who utilize our "Family Office" services.

**N. Aliene McGee** joined the firm in 1979 and currently serves as Secretary and Treasurer. She has been active in many different aspects of the firm since its early days including supporting investments and accounting.

## Item 5-Fees and Compensation

### How We Are Paid

We are paid based on a percentage of our client's assets under management. Our fee is computed quarterly (the quarterly fee percentage is  $\frac{1}{4}$  of the annual fee percentage). The fee is calculated based on assets under management on the final day of the preceding quarter and is billed quarterly in advance. The fee is due upon receipt of our invoice. We deduct all fees from the subject accounts, except a few IRA fees which are deducted from the clients' taxable accounts. Clients do have the choice to pay their fees via some means other than a deduction from their account. If an account is terminated, the fee is prorated and the unearned portion is returned to the client.

### Annual Fee Schedule

One and one-quarter percent (1.25%) of the first \$1,000,000 of assets under management;

One percent (1.00%) of assets from \$1,000,000 to \$4,000,000;

Three quarters of one percent (0.75%) of assets from \$4,000,000 to \$10,000,000;

One-half of one percent (0.50%) on assets \$10,000,000 and above.

While fees are generally not negotiable, the firm has in some instances negotiated a fee with clients opening several accounts (e.g. a family). Your account may also be charged for custodian fees, brokerage fees, and other customary third party fees charged based on the assets we invest in (e.g. fees related to and/or charged by ADRs, ETFs, or mutual funds). You have the choice to keep your account at a bank or at a broker such as Charles Schwab & Co., Inc. (Charles Schwab). You will generally incur custodian fees if your account is held by a bank. These charges run from 0.08% to 0.50% of the market value of the account and are deducted by the custodian from your account.

Accounts held at brokers such as Charles Schwab are not charged a custodial fee, but because we usually trade these accounts through the custodian broker, higher brokerage fees for the purchase and sale of securities may be charged by the broker. We tend to recommend that clients use Schwab for their managed account with us when our clients have an existing account

there or when an account is less than \$500,000. The accounts held at Schwab are usually traded through Schwab, which currently charges a commission of \$12.95 for the first 1,000 shares plus \$0.015 per share thereafter per trade if the balance of accounts held at Schwab is less than \$1,000,000 and \$8.95 per trade if the balance of accounts held at Schwab is over \$1,000,000. Clients who choose E-Delivery for statements from Schwab receive commissions of \$8.95 per trade regardless of account size.

PDM typically uses third party brokerage firms for the purchase and sale of our investments and currently pays a commission of no more than five cents (\$0.05) per share of stock traded, except when trades are executed at a custodian broker such as Charles Schwab or JP Morgan Securities. See Item 12-Brokerage Practices for more information about our use of brokerage firms.

We prefer that clients hold their managed accounts at one of five institutions for trading efficiency and to take advantage of negotiated custody fees. Our preferred custodians are Bank of America, N.A., JP Morgan, Frost National Bank, Texas Capital Bank and Charles Schwab.

Neither PDM, nor any of our employees receive any compensation for the sale of securities or other investment products, other than the generation of soft dollars as discussed below under Item 12-Brokerage Practices.

### **Additional Compensation**

PDM performs some “family office services” for 10 of our clients. These services include bill paying and reporting, insurance placement, the payment of salaries/withholding and reporting for employees and other complementary business services. We bill for these services on a quarterly basis. Our fees for family office services are negotiated individually with clients and range from \$1,250 to \$12,500 a quarter depending on the amount of work performed.

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

PDM does not charge Performance Based Fees.

## **Item 7-Types of Clients**

### **Our Clients**

The majority of our clients are high net worth individuals. We also offer our services to pension plans, foundations, trusts, and partnerships.

### **Minimum Account Size**

PDM prefers a minimum account size of one million dollars, but has accepted smaller accounts under certain circumstances.



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

### **Our Investment Strategies**

Our primary investment strategy is to invest in common stocks, bonds, and cash and cash equivalents which in our estimation offer attractive return potential relative to the risk of permanent loss. We evaluate each investment on a case by case basis using primarily fundamental analysis.

Fundamental analysis is a type of analysis where one evaluates a range of quantitative and qualitative factors with respect to a business in order to ascribe a fair value to that business. In conducting such analysis we will frequently review regulatory filings such as annual reports (e.g. SEC form 10-K or 20-F), quarterly reports (e.g. SEC form 10-Q), proxy statements (e.g. SEC form DEF 14A), registration statements (e.g. SEC form S-1 or F-1), and current reports (e.g. Form 8-K). In addition we may refer to macroeconomic statistics from third party research providers and/or government agencies. We frequently read articles about a particular business or industry we are researching in newspapers and trade journals and/or magazines. We often read research reports on companies or macroeconomics provided by third parties such as brokers. We may try to contact people who have worked in a particular industry we are evaluating to draw on their experiences to better understand the practical realities of the specific business we are trying to evaluate. We quantitatively try to evaluate the historic and potential for future cash flow and earnings as well as the soundness of a specific company's balance sheet. We qualitatively try to evaluate the business in terms of its strengths, weaknesses, opportunities for growth, and threats to the existing business as well as many other qualitative factors dictated by the circumstances of the specific company we are evaluating. Once a value has been ascribed to a business as a whole, we can then evaluate the capital structure of the business and determine a fair value for the various securities that represent a claim on that business.

From time to time we may evaluate technical factors (e.g. review the stock chart, moving averages, historic trading volume) when considering whether the timing is favorable to enter or exit an investment.

If we find that a particular security is trading at a significant discount in the market to our estimate of fair value and the timing seems appropriate, we may choose to pursue it as an investment for clients who have the appropriate risk tolerance and who have surplus cash relative to their immediate needs. We generally take a long-term view (i.e. years not months) when evaluating potential investments. We sell our investments when we believe the likely returns no longer justify the potential for permanent loss of capital. We typically run a concentrated portfolio of investments as we believe truly good investments are difficult to find and, thus, when one is found it should represent a meaningful portion of one's assets. A typical investment position is 3-4% of a client's account. Most client accounts have 45 positions or less. Position sizes generally range from 0.5% of client assets up to 15% of client assets depending on the situation. Sometimes exceptions to these size ranges may occur, but we would expect it to be very rare. We may also invest in foreign securities, ADRs, ETFs, preferred stock, warrants, options, private placements, and other securities that we deem to offer attractive returns relative to the risk of permanent loss of capital. We have occasionally engaged in the short sale of

options (often covered calls) and common stocks. All of our investment strategies involve a substantial degree of risk and the potential for loss. Some securities, such as foreign securities involve special risks due to economic, political and legal developments, including favorable or unfavorable changes in currency exchange rates. Some strategies, such as the short sale of a common stock, can result in losses that are theoretically infinite and are appropriate only for investors that have the appropriate risk tolerance for such risky investments.

### **Cash Management**

Cash is generally invested in a taxable or tax-exempt money market fund offered by the custodian that the client has chosen.

### **Risk**

Investing in securities involves the risk of loss. While our ultimate goal is to provide attractive absolute returns over a long period of time (several years at a minimum), there can be no assurance we will achieve this goal. Clients' portfolios have historically and will almost certainly experience losses in the future over certain periods of time.

### **Item 9-Disciplinary Information**

None of the employees of PDM, or the firm, have been involved in any disciplinary proceedings since our inception.

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

PDM does not have any material relationships with other financial industry participants. We do not refer clients to other investment advisors and we do not receive any compensation from other financial industry participants, other than soft dollar credits. We receive soft dollar credits from one of the brokers we use, Jefferies & Company, Inc. (Jefferies), which are used to pay for investment research that benefits all of our clients including some of those who execute trades only through other brokers. This is discussed in more detail under Item 12-Brokerage Practices below.

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

#### **Code of Ethics**

We have a fiduciary responsibility to treat our clients fairly and avoid actual or potential conflicts of interest. Our employees have an obligation to act solely in the best interests of clients, and to make full and fair disclosure of all material facts, particularly where the clients' interests may conflict with the interests of the firm or our employees. A thorough knowledge and understanding of our Code of Ethics by all of our employees assists in promoting a "culture of compliance" that is crucial to fulfilling our fiduciary responsibility.

The fiduciary principles that govern personal investment activities of employees are, at a minimum, the following: (1) the duty at all times to place the interests of clients first; (2) the

requirement that all personal securities transactions be conducted in a manner that is consistent with Rule 204A-1 of the Advisers Act and in such a manner so as to avoid any actual or potential conflict of interest, or any abuse of an individual's position of trust and responsibility; and (3) the fundamental standard that personnel providing services to clients should not take inappropriate advantage of their positions. Our policy is that the interest and privacy of our clients always comes first and all employees will conduct themselves in accordance with the highest standards of integrity, honesty and fair dealing. Our Code of Ethics is available to anyone upon request.

Our principals and employees may invest in the same securities (or related securities e.g. warrants, options, or futures) that we recommend to our clients. This potentially creates a conflict of interest because we may be competing with our clients for investment opportunities. To address this potential conflict, our policy is to finish trading a security for our client accounts before we allow our principals or employees to trade in the security. We do not permit principal transactions with client accounts or agency cross transactions.

### **Personal Trading**

Employees of PDM frequently purchase the same stocks that are recommended for client accounts; however, employees are not to trade for themselves until all client accounts have completed their transactions. Employees are prohibited from trading on any insider (material non-public) information and PDM will not purchase any investments in which an employee has a material financial interest.

Employee security transactions are reported on a quarterly basis and reviewed by Sydney Sharp, the Chief Compliance Officer.

## **Item 12-Brokerage Practices**

### **In General**

Most of the brokers that we use to execute trades on behalf of our clients' accounts currently charge no more than five cents (\$0.05) per share of stock traded. In the case of low-priced stocks we sometimes negotiate this rate lower. PDM primarily uses brokers who provide us with access to their investment research and who also conscientiously trade with our clients' best interests in mind.

The accounts held at Schwab are usually traded through Schwab, which currently charges a commission of \$12.95 for the first 1,000 shares plus \$0.015 per share thereafter per trade if the balance of accounts held at Schwab is less than \$1,000,000 and \$8.95 per trade if the balance of accounts held at Schwab is over \$1,000,000. Clients who choose E-Delivery for statements from Schwab receive commissions of \$8.95 per trade regardless of account size.

Schwab does not charge a custody fee so we feel it is a financial benefit for some clients to custody at Schwab although those clients do not participate in the bulk executions through the other brokers we use such as Jefferies.

## **Research and Soft Dollar Benefits**

Jefferies offers PDM a soft dollar credit of \$1.00 for each \$1.50 in commissions for trades that PDM directs to their firm. PDM uses this soft dollar credit to purchase investment research tools for the firm. The soft dollar credit does provide a benefit to PDM, because otherwise PDM would be paying for the same services out of our own resources. This is a potential conflict with our clients because we may direct trades to Jefferies to generate soft dollars to purchase investment research despite the fact that Jefferies may charge our clients more in commission than they might be able to pay at some other broker offering comparable execution service, but not offering PDM soft dollar credits.

Most of the accounts at PDM use Jefferies for trading, although accounts held at other brokers per the clients request trade through those brokers. All of the accounts managed by PDM benefit from the tools purchased with soft dollars provided by trades routed to Jefferies, and we make no attempt to allocate soft dollar benefits to client accounts proportionately to the soft dollar credits the accounts generate.

PDM uses a Financial Information Exchange – a “FIX” connection to engage in electronic trading and allocation through NYFIX. We have FIX connection with Jefferies and Schwab for trading. With Schwab we also use FIX for allocating which reduces manual labor in our back office. PDM does not benefit financially from this association but it does make our operations smoother. PDM still pays a full fee to NYFIX for use of their services. However NYFIX charges additional fees to each connection to a broker. Schwab and Jefferies pay for the FIX connection with PDM, a cost we would otherwise bear. As a result of our FIX connection we may be more likely to conduct business with Schwab and Jefferies.

The services obtained with soft dollar credit in the last year are: BCA Research, Daily Graphs, New York Stock Exchange pricing, Option Price Reporting, R.W. Mansfield Co., Inc. graphs, Standard & Poors’ Capital IQ, Townsend Analytics, Value Line Publishing, payments to Burnham Securities Inc. and Sterne, Agee & Leach, Inc. for investment recommendations and research, Grants Interest Rate, Morningstar, NYFIX software, Telemet America for pricing and Western International Securities for small cap research.

We are authorized to pay higher prices for the purchase of securities from or accept lower prices for the sale of securities to brokerage firms that provide us with investment and research information or to pay higher commissions to such firms if we determine those prices or commissions are reasonable in relation to the overall services provided. Accordingly, we may be deemed to be paying for research and other services with "soft" or commission dollars. Such investment and research information may be internally generated by the brokerage firms we use or obtained from third parties by the brokerage firms. Research services furnished by brokers may include written information and analyses concerning specific securities, companies or sectors; market, financial and economic studies and forecasts; statistics and pricing or appraisal services; discussions with research personnel; and invitations to attend conferences or meetings with management or industry consultants. We are not required to weigh any of these factors equally. Since commission rates in the United States are negotiable, selecting brokers on the basis of considerations which are not limited to applicable commission rates may at times result in higher transaction costs than would otherwise be obtainable.

Section 28(e) of the Securities Exchange Act of 1940, as amended, provides a "safe harbor" to investment managers who use commission dollars generated by their advised accounts to obtain investment research and brokerage services that provide lawful and appropriate assistance to the manager in the performance of investment decision-making responsibilities. Conduct outside of the safe harbor afforded by Section 28(e) is subject to the traditional standards of fiduciary duty under state and U.S. federal law. Notwithstanding a good faith determination that the amount of commissions paid is reasonable in relation to the value of brokerage research services provided, to the extent that we determine to use commission dollars to pay for products and services that provide administrative or other non-research assistance, such payments may not fall within the safe harbor of Section 28(e). However, we intend to use commission dollars generated by our clients' brokerage accounts to obtain only such investment research and brokerage services or products as permitted under the safe harbor afforded by Section 28(e) and will not utilize commission dollars to pay for expenses relating to subscriptions, research related travel, reports or other expenses that would otherwise be expenses of PDM.

### **Brokerage for Client Referrals**

We do not direct brokerage business to brokers in exchange for client referrals.

### **Directed Brokerage**

We allow clients to choose their custodian and brokers at the beginning of our relationship, however, we may offer them some guidance on what we expect to be the most cost effective configuration for the client. Most of our clients choose to defer to us regarding brokerage and custody decisions, in which case we generally recommend setting up custody at a bank, which allows us to use brokers to execute transactions that are not affiliated with the custodian. Some clients, however, choose custodians like Schwab that waive their custodial fee in exchange for brokerage business and in order to get this waiver the clients direct us to conduct all trades through that broker. Others clients direct us to trade through a specific brokerage account with a broker they have chosen. However, clients who direct us to use a specific broker may not get best execution because we may not be able to aggregate orders to reduce transaction costs and they may receive less favorable prices. See Order Aggregation below.

We sometimes pay higher commissions to full service brokers for research or, in the case of Jefferies, soft dollars we can use to purchase research and research-related services. In addition we cannot be sure we are directing the trade to the broker that will get the best execution. Therefore, clients who defer to us regarding brokerage decisions may end up paying more in commission than other clients.

### **Order Aggregation**

Our preferred practice is to aggregate orders, which we believe results in best execution. Our practice is to execute bulk orders on behalf of clients who defer to us regarding brokerage decisions first and then to proceed to execute transactions on behalf of our clients who direct us to use a specific broker as we want to avoid having our clients bid against each other in the marketplace. It should be noted that clients sometimes get different executions as a result of this practice and, indeed, clients not participating in aggregate orders may get a worse (or

better) execution depending on market fluctuations during the time between when aggregate and other orders are executed.

In the event of partial fills for aggregate orders, our practice is to allocate trades to the least invested accounts first in the case of a buy and the most invested accounts first in the case of sells. If several accounts are similarly invested we may then choose to allocate by custodian for the sake of convenience.

### **Item 13-Review of Accounts**

Accounts are monitored on a daily basis by the members of our investment committee (John H. Davis, R. Van Ogden and Jeffrey W. Helfrich) for market and economic factors that might dictate a change or redirection of assets. The entire investment committee meets at least once a month (via telephone or in person) and often more frequently than that as the committee meets at any time it is deemed necessary. Large withdrawals or additions of cash may prompt an adjustment of the portfolio holdings.

Monthly statements are mailed to clients from PDM and at least quarterly statements are mailed from all Custodians. See Item 15-Custody below.

We seek to meet with our clients on a quarterly basis to review their portfolios, performance, risk tolerance, investment goals, and cash needs. We meet with some clients more frequently than quarterly and some less frequently as the client so chooses.

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

We do not pay for client referrals.

### **Item 15-Custody**

PDM uses qualified third party custodians and clients will receive a statement from their custodian at least quarterly. Clients will also receive a monthly statement from PDM. All statements should be carefully reviewed and the two separate statements compared for accuracy. For tax and other purposes, the PDM statement is the official record of your account and transactions.

### **Item 16-Investment Discretion**

The Discretionary Investment Management Agreement executed between a client and PDM contains a Power of Attorney which grants PDM full discretion with respect to the investment and management of a client's portfolio. The Power of Attorney also appoints PDM as the client's Attorney in Fact for the purpose of placing all brokerage orders for the account.

PDM will maintain full discretion over all assets in a client's portfolio unless otherwise directed by the client. Clients may impose restrictions on the type of securities we buy for their account.



## **Item 17-Voting Client Securities**

Proxies for securities held in clients' discretionary management accounts are forwarded to PDM by the custodian banks or brokers holding the securities. PDM votes all proxies in a prudent and timely manner in accordance with our Proxy Voting Procedures outlined in our Compliance Manual unless the client has requested either to vote the proxy personally or to have it voted in a specific manner. A copy of our Compliance Manual and Proxy Voting Procedures is available to any client or prospective client upon request. Information on how votes were cast is also available to any client upon request.

PDM will generally vote FOR:

1. Election of directors nominated by the current directors, where no corporate governance issues are in question;
2. Selection of independent auditors recommended by management;
3. Increases in authorization for the issuance of or reclassification of common stock;
4. Management recommendations adding or amending indemnification provision in charter or by-laws;
5. Changes in board of directors recommended by management;
6. Outside director compensation recommended by management;
7. Proposals that maintain or strengthen shared interests of shareholders and management;
8. Proposals that maintain or increase shareholders' influence over issuer's board of directors and management;
9. Proposals that maintain or increase rights of shareholders;
10. Management proposals for merger or reorganization if the transaction appears to offer fair value.

PDM will generally vote AGAINST:

1. Shareholder resolutions that consider non-financial impacts of mergers;
2. Anti-greenmail provisions.

All proxies will be voted in a prudent and timely manner and only after a careful evaluation of the issues presented on the ballot. PDM will provide adequate disclosure to clients if any substantive aspect of foreseeable result of the subject matter to be voted upon raises an actual or potential conflict of interest between PDM and its clients. Details concerning the possible conflict will be provided and the client will be asked to either vote the proxy personally or to indicate a voting response.

Any client may obtain information as to when and how a vote is cast for their account by making an oral or written request for such information.

## **Item 18-Financial Information**

PDM has custody of the checking accounts which we use for our “family office” payment of bills. The checks are generated by one PDM employee and signed by two others. We have a monthly reconciliation prepared by a fourth employee and signed off by the original two check signors. The monthly reconciliation is also mailed to the client and to their CPA if requested. All funds are held in a separate checking account for each client. Because PDM supplies this service, we are subject to an annual surprise audit by our CPA who reviews our transactions.

Any unforeseen impairment in PDM’s financial condition would not impair any of these accounts as they are held as individual accounts owned by each client and are subject to the annual audit. PDM has always been financially solvent.

Clients with accounts held at Schwab can authorize PDM to direct the distribution of money from their account to the client; however, a separate authorization must be signed by the client for PDM to direct a distribution from the account to a third party. Some of the custodial banks allow PDM to direct payments from their custody accounts to third parties, often for the payment of legal or accounting fees, without a separate agreement from the client. In all cases, the client receives a statement from the custodian and from PDM to review all transactions and holdings on a regular basis.

John McFarland and Fred Penn act in their individual capacity as Trustees for four trusts which are also clients of PDM. In their roles as Trustees, they have discretionary control over the trust assets. The beneficiaries of the trusts all receive dual statements for the accounts.



## ***Brochure Supplement***

### **Item 1-CoverPage**

This brochure supplement provides information about our supervised persons who either (i) formulate investment advice for our clients and have direct client contact or (ii) have discretionary authority over a client's assets, even if the supervised person has no direct client contact. These persons include:

- **Fred M. Penn**
- **John H. Davis**
- **John S. McFarland**
- **R. Van Ogden**
- **Jeffrey (Jeff) W. Helfrich**
- **Sydney C. Sharp**

For the business address and telephone number of each of our supervised persons, please see the cover page of our brochure.

### **Item2-Educational Background and Business Experience**

Please see Item 4-Advisory Business of our brochure and additional required information below:

Fred M. Penn – 76. Fred has worked for PDM for each the prior five years.

John H. Davis – 70. John has worked for PDM for each of the prior five years.

John S. McFarland – 75. John has worked for PDM for each of the prior five years.

R. Van Ogden – 55. Van has worked for PDM for each of the prior five years.

Jeffrey (Jeff) W. Helfrich – 31. Jeff has worked for PDM since May 2010. From October 2008-May 2010 Jeff worked for Perot Investments in Plano, TX as a research analyst. From April 2008-September 2008 Jeff worked for Mirador Funds, L.P. in Dallas, TX as Research Director. From August 2005-March 2008 Jeff worked as a research analyst for

Independence Capital Asset Partners, LLC in Denver, CO. From June 2003-August 2005 Jeff worked as a research analyst for Janus Capital Group in Denver, CO.

Sydney C. Sharp – 51. Sydney has worked for PDM since October 2006. From October 1990 to July 2006, Sydney was a Senior Vice President and Private Trust Officer at Frost National Bank in Austin, TX.

About the CFA charter: The CFA charter is a designation awarded by the CFA Institute. To become a CFA Charterholder one must pass three six hour exams, have at least four years of qualified investment work experience, and pledge to adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct.

### **Item 3-Disciplinary Information**

Please see Item 9-Disciplinary Information of our brochure.

### **Item 4-Other Business Activities**

None of our supervised persons are engaged in any investment-related or other business or occupation, other than activities for PDM.

### **Item 5-Additional Compensation**

None of our supervised persons receives any additional compensation or economic benefit for providing advisory services, other than their regular salary and other compensation from PDM.

### **Item 6-Supervision**

Jeff Helfrich and Sydney Sharp are supervised by John McFarland, President of Penn Davis McFarland, Inc. (214-871-2772). Mr. McFarland speaks with Jeff and Sydney daily (except on days he is out of the office) about any contact they have with clients in order to stay informed regarding the quality of advice they are providing. As principals of the firm, Fred Penn, John Davis, John McFarland, and Van Ogden report to each other with respect to the advice clients receive.