

Capital Gains Incorporated

Form ADV, Part 2A, Firm Brochure, March 28, 2012



8060 W. Oakton Street, Suite 102
Niles, IL 60714

Telephone: (847) 318-9975

Facsimile: (847) 318-9958

www.capitalgainsinc.com

Form ADV, Part 2A
Brochure
March 28, 2012

This brochure provides information about the qualifications and business practices of Capital Gains Incorporated. If you have questions about the contents of this brochure, please contact us at (847) 318-9975. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority.

Additional information about Capital Gains Incorporated is available on the SEC's website at www.adviserinfo.sec.gov.

Please note that registration as an investment adviser with the SEC does not imply any certain level of skill, training or ability with respect to the provision of investment advisory services.

ITEM 2 - SUMMARY OF MATERIAL CHANGES

There are no material changes to this brochure. This brochure was updated on March 28, 2012, providing information that is designed to update information we provided to our clients and potential clients in our previous brochure, dated March 31, 2011.

TABLE OF CONTENTS

Item 1	Cover Page	1
Item 2	Summary of Material Changes	2
Item 3	Table of Contents	3
Item 4	Advisory Business	4
Item 5	Fees and Compensation	4
Item 6	Performance-Based Fees and Side-By Side Management	6
Item 7	Types of Clients	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	10
Item 12	Brokerage Practices	11
Item 13	Review of Accounts	15
Item 14	Client Referrals and Other Compensation	15
Item 15	Custody	16
Item 16	Investment Discretion	16
Item 17	Voting Client Securities	16
Item 18	Financial Information	18

ITEM 4 - ADVISORY BUSINESS

Capital Gains Incorporated (identified as “Capital Gains” in this brochure) is a registered investment adviser based in Niles, Illinois. It was incorporated as a subchapter “S” corporation in the State of Illinois in 1992. Gary Karshna is the President and principal owner of Capital Gains.

Capital Gains specializes in providing fixed income and equity portfolio management services primarily to municipal pension funds and municipalities themselves with regard to their corporate or reserve funds. However, Capital Gains may also provide investment advice to individuals, municipal districts, corporate pension plans, credit unions, banks, and other public and non-profit entities. In addition to its portfolio management services, Capital Gains may also be retained by pension funds on a non-discretionary basis to analyze their portfolio holdings, develop investment strategies and make recommendations regarding specific securities.

Capital Gains works with its clients to formulate a strategic investment plan based on each client’s investment objectives, time horizon, risk tolerance, asset and liability mix, retirement distribution obligations, and other individual or unique factors. The planning process involves understanding not only the client’s objectives but also the constraints and any restrictions to be imposed or investment parameters to guide the portfolio. For example, clients may restrict or prohibit transactions in certain types of securities or direct that transactions be effected through specific brokers or dealers. Specifically, Capital Gains works closely with municipal treasurers, finance officers and pension officials to evaluate and recommend appropriate and acceptable investments, with the goal of optimal performance within the selected investment strategy.

Wrap accounts are not typically used by Capital Gains for pension fund clients, however they may be cost beneficial (as opposed to paying commissions for each trade) for individuals and smaller institutional accounts. Wrap accounts may be used for pension fund clients in instances where a high volume of activity is expected (managed stock account, with an active investment strategy) and the use of a wrap account is expected to be cost beneficial to the client. Capital Gains does not receive commissions or fees from brokerage firms for trades or wrap accounts.

As of December 31, 2012, Capital Gains manages \$273,138,811 in client assets on a discretionary basis. Capital Gains currently does not manage client assets on a non-discretionary basis.

ITEM 5 - FEES AND COMPENSATION

Advisory fees are negotiable for both existing and prospective clients. Advisory fees, which may include assumption of custodial costs, range generally from 0.14 of 1.00% to 1.00% (annually) of each client’s assets under management. Fees are calculated and billed in arrears on a monthly or quarterly basis. For monthly billings, one twelfth of the annual fee is charged to the client each month and payable on or before the last day of the month. For quarterly billings, one-fourth

of the annual fee is charged to the client each quarter and payable on or before the last day of the quarterly period. If an account is opened at any time other than the beginning of a month or quarter (as applicable) or closed prior to the end of a month or a quarter (as applicable), the advisory fee will be prorated and charged only for the days during the period that the account was open.

Additional Fees and Expenses

As part of its investment advisory services, Capital Gains may invest, or recommend that a client invest, in mutual funds and exchange traded funds. The fees that a client pays to Capital Gains for investment advisory services are separate and distinct from the fees and expenses charged by mutual funds or exchange traded funds (described in each fund's prospectus) to their shareholders. These fees, which are part of a fund's or ETF's expense ratio, will generally include a management, custodial and transfer agent fee and other fund expenses.

Our fees are exclusive of brokerage commissions, custodial fees, transaction fees and other related costs and expenses. These charges and fees are typically imposed by the broker-dealer or custodian through which client account transactions are executed. Capital Gains does not share in any portion of these commissions, fees and costs. Please refer to "Item 12 - Brokerage Practices" for a description of the factors Capital Gains considers in selecting or recommending broker-dealers for client transactions and determining the reasonableness of their compensation.

Referral Fees

Capital Gains also may recommend that a portion of a client's account be managed by a third party investment adviser when it determines that a client's portfolio may benefit from an investment adviser with different expertise (and when investment in a mutual fund is not suitable). The selection of an investment adviser is not limited to any particular investment strategy. In all such cases, Capital Gains will not accept discretionary authority to determine which third party investment adviser is to be retained for a client's account. Clients will be required to enter into an advisory agreement with such investment adviser before the adviser may manage a portion of the client's account.

Capital Gains may charge an advisory fee, usually within the range of its customary fees, with respect to any portion of a client's account that is managed by a third party investment adviser for its work in identifying, analyzing the investment program of and conducting due diligence on the third-party adviser. However, in connection with a recommendation of such an adviser, Capital Gains will typically be paid a referral fee by the adviser in accordance with Rule 206(4)-3 under the Investment Advisers Act of 1940. In cases where a third party investment adviser compensates Capital Gains with a referral fee, Capital Gains will not assess an advisory fee for the portion of a client's assets that are managed by the third party investment adviser.

The referral fee will ordinarily consist of a percentage of the advisory fees in the range of 5% to 35% that the third party investment adviser receives from the client. The client's fees to the third party investment adviser will not increase as a result of the payment of the referral fee by the investment adviser to Capital Gains. Capital Gains will not receive any referral fees for any portion of a client's account invested in mutual funds.

ITEM 6 - PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT

Capital Gains does not charge performance based fees based on a share of capital appreciation in the account. Accordingly, it is not subject to potential conflicts of interest that arise from participation in side-by-side management of accounts with an asset based fee and accounts with a performance based fee.

ITEM 7 - TYPES OF CLIENTS

Currently, Capital Gains provides investment advisory services to municipal pension plans and municipalities themselves with regard to their corporate or reserve funds. In addition, Capital Gains may provide advisory services to individuals, municipal districts, corporate pension plans, credit unions, banks, and other public and non-profit entities. Although Capital Gains generally requires a minimum account size of \$1 million, it may waive this requirement in its discretion.

As a condition to its acceptance of a new account, Capital Gains requires the safekeeping of all account assets by a qualified custodian, which may be a bank or a registered broker-dealer. If a client does not have an existing custodial relationship, Capital Gains generally recommends a qualified custodian with whom it has a successful working relationship.

ITEM 8 - METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS.

Capital Gains uses a combination of technical and fundamental analysis to attempt to identify investment opportunities which have the greatest potential to enhance investment returns in a client's portfolio. This "flexible" investment strategy is designed to seek the optimum point on the "efficient frontier" based upon the risk reward parameters of each individual client. Capital Gains strives to achieve this objective by implementing "strategic diversification" over many asset classes; diversified fixed income securities plus a variety of equity investments, such as small-cap, mid-cap, large-cap, international, emerging markets, inflation hedges, value, growth, and fixed income investments.

Capital Gains' strategy is customized to match the investment parameters in each client's investment policy and risk profile. Capital Gains seeks to establish a strategic asset mix within the context of a client's risk tolerance level. The broad asset classes are adjusted based upon changes in the fundamentals of the asset class and changes in the macroeconomic environment.

Changes in the asset allocation of each portfolio are achieved by adjusting the weightings of various segments of the capital markets. Capital Gains does not engage in broad market timing strategies between cash, stocks or bonds. This reallocation may be implemented through the use of mutual funds or exchange traded funds (ETFs). Capital Gains cannot provide the client with an assurance that such strategies always will be profitable.

When Capital Gains determines that a client's portfolio may benefit from a referral to an investment adviser with expertise in other areas or from investments in certain mutual funds, Capital Gains utilizes research provided by Morningstar, Bond Edge, Albridge, Orion, Charles Schwab & Bloomberg to evaluate such investment advisers and mutual funds. Capital Gains selects investment advisers and mutual funds with consistent performance records.

Risk of Loss

Investing in securities involves risk of loss that clients should be prepared to bear. Capital Gains does not represent or guarantee that its services or methods of analysis can or will predict future results, successfully identify market tops or bottoms, or insulate clients from losses due to market corrections or declines. Capital Gains cannot offer any guarantees or promises that your financial goals and objectives will be met. Past performance is in no way an indication of future performance. Capital Gains sets forth below some of the material risks of investing as a client. You are invited to discuss any risks or other considerations that are particular to your individual situation.

- 1) *Debt and Other Income Securities.* Income securities are subject to interest rate, market and credit risk. Interest rate risk relates to changes in a security's value as a result of changes in interest rates generally. Even though such instruments are investments that may promise a stable stream of income, the prices of such securities are inversely affected by changes in interest rates and, therefore, are subject to the risk of market price fluctuations. In general, the values of fixed income securities increase when prevailing interest rates fall and decrease when interest rates rise. Market risk relates to the changes in the risk or perceived risk of an issuer, country or region. Credit risk relates to the ability of the issuer to make payments of principal and interest. A client could lose money if the issuer of a fixed income security is unable to pay interest or repay principal when due. Credit risk applies to most fixed income securities. The values of income securities may also be affected by changes in the credit rating or financial condition of the issuing entities.
- 2) *Equity and Equity-Related Instruments.* Stocks and other equity-related instruments may be subject to various types of risk, including market risk, liquidity risk, counterparty credit risk, legal risk and operations risk. In addition, equity-related instruments can involve significant economic leverage and may, in some cases, involve significant risk of loss. "Equity securities" may include common stocks, preferred stocks, interests in real estate investment trusts, convertible debt obligations, convertible preferred stocks, equity interests in trusts, partnerships, joint

ventures or limited liability companies and similar enterprises, warrants and stock purchase rights. Equity securities fluctuate in value and such fluctuations can be pronounced. In general, stock values fluctuate in response to the activities of individual companies and in response to general market and economic conditions. Accordingly, the value of the stocks and other securities and instruments that a client holds may decline over short or extended periods. The stock markets tend to be cyclical, with periods when stock prices generally rise and periods when stock prices generally decline.

- 3) *Derivatives.* Derivatives are financial instruments that derive their performance, at least in part, from the performance of an underlying asset, index or interest rate. Derivatives include, without limitation, futures, options, swaps, forward contracts, and derivative techniques such as synthetic short sales. The prices of derivatives can be highly volatile. Price movements of derivative instruments are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies. In addition, governments from time to time intervene, directly and by regulation, in certain markets, particularly those in currencies, financial futures and options. The use of certain derivatives may involve inherent indebtedness or economic leverage.]
- 4) *Non-U.S. Investments.* Investments in securities of non-U.S. issuers and the governments of non-U.S. countries involve special risks not usually associated with investing in securities of U.S. companies or the U.S. government, including political and economic considerations, such as greater risks of expropriation and nationalization, confiscatory taxation, the potential difficulty of repatriating funds, social, political and economic instability and adverse diplomatic developments; the possibility of the imposition of withholding or other taxes on dividends, interest, capital gain or other income; the small size of the securities markets in such countries and the low volume of trading, resulting in potential lack of liquidity and in price volatility; fluctuations in the rate of exchange between currencies and costs associated with currency conversion; and certain government policies that may restrict investment opportunities. In addition, there may be different types of, and lower quality, information available about a non-U.S. company than a U.S. company. There is also less regulation, generally, of the securities markets in many foreign countries than there is in the United States, and such markets may not provide the same protections available in the United States. With respect to certain countries there may be the possibility of political, economic or social instability, the imposition of trading controls, import duties or other protectionist measures, various laws enacted for the protection of creditors, greater risks of nationalization or diplomatic developments which could materially adversely affect investments in those countries. Investment in non-U.S. countries may also be subject to withholding or other taxes, which may be significant and may reduce the investment returns.

- 5) *Stock Market Risk.* There is a risk that stock prices overall will decline. Stock markets tend to move in cycles, with periods of rising prices and periods of falling prices.
- 6) *Inflation Risk.* When any type of inflation is present, a dollar today will not buy as much as a dollar next year, because purchasing power is eroding at the rate of inflation.
- 7) *Currency Risk.* Overseas investments are subject to fluctuations in the value of the dollar against the currency of the investment's originating country. This is also referred to as exchange rate risk.
- 8) *Reinvestment Risk.* When interest rates are low, issuers will often repay the obligation underlying a "callable security" earlier than expected, thereby affecting the investment's average life and perhaps its yield. There is a risk that future proceeds from investments may have to be reinvested at a potentially lower rate of return (i.e. interest rate). This risk primarily relates to fixed income securities.
- 9) *Business Risk.* These risks are associated with a particular industry or a particular company within an industry. For example, oil-drilling companies depend on finding oil and then refining it, a lengthy process, before they can generate a profit. They carry a higher risk of profitability than an electric company, which generates its income from a steady stream of customers who buy electricity no matter what the economic environment is like.
- 10) *Liquidity Risk.* Liquidity is the ability to readily convert an investment into cash. Generally, assets are more liquid if many traders are interested in a standardized product. For example, Treasury Bills are highly liquid, while real estate properties are not.
- 11) *Financial Risk.* Excessive borrowing to finance a business' operations increases the risk of profitability, because the company must meet the terms of its obligations in good times and bad. During periods of financial stress, the inability to meet loan obligations may result in bankruptcy.
- 12) *Dependence on Gary Karshna.* The performance of client accounts depends on the skill of Gary Karshna, the sole investment principal of Capital Gains. The success of any account depends on the ability of Mr. Karshna to develop and implement investment strategies that achieve a client's objectives. If Mr. Karshna becomes unavailable or is incapacitated, there may be interruption or delay in the management of the account.

- 13) *Recent Market Conditions.* Recent events in the U.S. and global economies have resulted, and may continue to result, in fixed income securities experiencing unusual liquidity issues, increased price volatility and, in some cases, credit downgrades and increased likelihood of default. Because such conditions can be unprecedented and widespread, it may be unusually difficult to identify risks and opportunities using past models or to predict the duration of market downturns.
- 14) *Repurchase Agreements and Reverse repurchase Agreements.* The Illinois Pension Code imposes limitations on the investments of public safety pension funds with respect to repurchase agreements. Although Capital Gains does not invest directly in repurchase agreements, some of the money market mutual funds used by Capital Gains clients may contain a small percentage of repurchase agreements.
- 15) *U.S. Government/Agency Risk.* There is a risk that the U.S. government will not provide financial support to U.S. government agencies, instrumentalities or sponsored enterprises if it is not obligated to do so by law. Not all U.S. government securities are backed or guaranteed by the U.S. government. Some government securities are supported only by the credit of the issuing agency, which depends entirely upon its own resources to repay the debt and are subject to the risk of default. Securities issued by the Federal National Mortgage Association (“Fannie Mae”), Federal Home Loan Mortgage Corporation (“Freddie Mac”) and Federal Home Loan Banks may be chartered or sponsored by acts of Congress, but their securities are neither issued nor guaranteed by the U.S. Treasury, and, therefore, are not backed by the full faith and credit of the United States. Because the maximum potential liability of these issuers may greatly exceed their current resources, including their legal right to support from the U.S. Treasury, it is possible that these issuers will not have the funds to meet their payment obligations in the future.
- 16) *Investment Limitations Under the Illinois Pension Code.* The Illinois Pension Code imposes limitations on the investments of public safety pension funds of varying sizes. Funds with assets over \$10 million have more latitude to invest in equity markets than smaller funds and can, therefore, diversify their portfolios to a greater degree. The differences in these investment limitations may result in disparate rates of return between certain public pension funds under Capital Gains’ management.

ITEM 9 - DISCIPLINARY INFORMATION

Neither Capital Gains nor any of its management persons have been involved in any legal or disciplinary events affecting its business, material or otherwise.

ITEM 10 - OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS

Referral Fees

As described in “Item 5 – Fees and Compensation,” Capital Gains may recommend that a portion of a client’s account be managed by a third party investment adviser, and Capital Gains may receive a referral fee by such adviser in accordance with Rule 206(4)-3 under the Investment Advisers Act of 1940. In cases where a third party investment adviser compensates Capital Gains with a referral fee, Capital Gains will not assess an advisory fee for the portion of a client’s assets that are managed by the third party investment adviser. The referral fee will ordinarily consist of a percentage of the advisory fees ranging from 5% to 35%, that the third party investment adviser receives from the client. The client’s fees to the third party investment adviser will not increase as a result of the payment of the referral fee by the investment adviser to Capital Gains. Capital Gains may have a conflict of interest between acting in the client’s best interest and securing referral fees from such investment advisers. Capital Gains addresses this potential conflict by ensuring that its recommendations are suitable for each client.

Financial Network Investment Corporation

Mr. Karshna's son, Neil Karshna, a former employee of Capital Gains, is a registered representative of Financial Network Investment Corporation (“Financial Network”), a full-service, independent broker-dealer which provides a broad range of investment services to its clients. From time to time, Capital Gains may seek bids and offers from Financial Network as a dealer or market-maker in certain fixed income investments. Capital Gains may select or recommend Financial Network as a broker or dealer to execute transactions for client accounts, including the purchase or sale of shares of common or preferred stock, mutual funds, variable annuities, exchange traded funds (ETF’s) and other securities.

Capital Gains may have a conflict of interest due to an incentive to provide business to Financial Network. Capital Gains addresses this potential conflict by seeking to obtain best execution in all circumstances. In addition, Capital Gains fully discloses to all clients (verbally and in writing, by distributing a copy of our SEC ADV form, Parts 1 and 2) that Neil Karshna is the son of Gary Karshna and will derive a monetary benefit from any business provided to Financial Network. Each client of Capital Gains must consent before any trades are transacted through Neil Karshna and/or Financial Network. If a client does not consent, Capital Gains will not transact any business for that particular client through Neil Karshna or Financial Network.

ITEM 11 - CODE OF ETHICS

Code of Ethics and Insider Trading Policies

Capital Gains has adopted a Code of Ethics, a copy of which is available to you upon request. Capital Gains strives to comply with applicable laws and regulations governing its practices.

Therefore, the Code of Ethics includes guidelines for professional standards of conduct for its firm's officers and employees ("firm personnel"). Provisions in the Code of Ethics relate to reporting of personal securities trading and conflicts of interest, among other things. In addition, Capital Gains also has adopted a firm policy that prohibits insider-trading. All firm personnel are expected to adhere strictly to these guidelines and must acknowledge their obligation to comply with the Code of Ethics annually. The Code of Ethics also requires that firm personnel submit reports of their personal account holdings and transactions to the President of Capital Gains who will review these reports for conflicts or potential conflicts with client transactions on a periodic basis. Currently, Mr. Karshna is the only employee of Capital Gains subject to the Code of Ethics, and as such, he is required to maintain records of his personal securities transactions, comply with all applicable federal securities laws, and certify that he has read and understood Capital Gains' Code of Ethics.

Personal Securities Transactions

Capital Gains and its employees may buy or sell securities, including individual stocks and shares of mutual funds and exchange-traded funds, for their own accounts that Capital Gains also recommends to clients in appropriate circumstances consistent with such clients' investment objectives. Personal securities transactions by an employee may raise a potential conflict of interest when an employee owns or trades in a security that is considered for purchase or sale by a client. As described above, Capital Gains has adopted a Code of Ethics that is designed to detect and prevent such conflicts of interest.

Clients may obtain a copy of Capital Gains' Code of Ethics at any time upon request.

ITEM 12 - BROKERAGE PRACTICES

Broker/Dealer Selection Process

For its discretionary clients, Capital Gains generally has authority to supervise and direct the investments of the client without prior consultation with the client. Pursuant to this discretionary authority, Capital Gains normally will determine which securities are bought and sold for the account, the total amount of such purchases and sales, the brokers or dealers through which transactions will be executed, and the commission rates paid to effect the transactions. Capital Gains' authority may be subject to conditions imposed by the client, for example, where the client restricts or prohibits transactions in certain types of securities or directs that transactions be effected through specific brokers or dealers.

For non-discretionary client accounts, Capital Gains suggests specific brokers or dealers for securities transactions. It may also negotiate the commission rates paid by its clients to effect portfolio transactions. Although Capital Gains makes recommendations as to the use of specific brokers or dealers based on the considerations described below, the decision as to which broker

or dealer to use is made by the client. Likewise, the decision to buy and sell securities recommended by Capital Gains is ultimately made by the client.

The adviser's selection or recommendation of a broker or dealer is limited by the client's investment objectives, the type of instruments (consisting mainly of U.S. government backed securities) employed for the account and any special needs or considerations indicated by the client. In selecting or recommending brokers or dealers, Capital Gains' overriding objective is to seek for the client the best combination of price and execution. The best net price, giving effect to brokerage commissions, if any, and other transaction costs are normally important factors, but a number of other judgmental factors may also be considered. These factors include the financial strength, stability and integrity of the broker, the size of the transaction and the broker's ability to affect a large transaction; the timing of transactions and the execution, settlement and clearance capabilities of the broker. Recognizing the value of these factors, Capital Gains may select or recommend a broker whose brokerage commissions may exceed that which another broker may be charging for the same transaction.

Soft Dollar Practices

Generally, in addition to a broker's ability to provide "best execution," Capital Gains may also consider the value of research or additional brokerage products and services a broker-dealer has provided or may be willing to provide. This is known as paying for those services or products with "soft dollars." Because many of the services or products could be considered to provide a benefit to Capital Gains, and because the "soft dollars" used to acquire them are client assets, Capital Gains could be considered to have a conflict of interest in allocating client brokerage business: Capital Gains could receive valuable benefits by selecting a particular broker or dealer to execute client transactions and the transaction compensation charged by that broker or dealer might not be the lowest compensation Capital Gains might otherwise be able to negotiate. In addition, Capital Gains could have an incentive to cause clients to engage in more securities transactions than would otherwise be optimal in order to generate brokerage compensation with which to acquire products and services.

Our use of soft dollars is intended to comply with the requirements of Section 28(e) of the Securities Exchange Act of 1934. Section 28(e) provides a "safe harbor" for investment managers who use commissions or transaction fees paid by their advisory accounts to obtain brokerage and research services in connection with agency transactions that provide lawful and appropriate assistance to the manager in performing investment decision-making responsibilities. Capital Gains does not use soft dollars to purchase products or services in connection with transactions in securities executed by a market-maker on a principal basis, which comprises a substantial portion of the fixed income transactions placed by Capital Gains for its clients.

As required by Section 28(e), Capital Gains will make a good faith determination that the amount of commission or other fee paid is reasonable in relation to the value of the brokerage and research services provided. That is, before placing orders with a particular broker, Capital

Gains generally determines, considering all the factors described below, that the compensation to be paid to a broker-dealer is reasonable in relation to the value of all the brokerage and research products and services provided by such broker-dealer. In making this determination, Capital Gains typically considers not only the particular transaction or transactions and the value of brokerage and research services and products to a particular client, but also the value of those services and products in the performance of its overall responsibilities to all of its clients. In some cases, the commissions or other transaction fees charged by a particular broker-dealer for a particular transaction or set of transactions may be greater than the amounts another broker-dealer who did not provide research services or products might charge. Capital Gains may, but generally does not, pay brokerage commissions higher than those obtainable from other brokers in return for research products or services provided by brokers.

Research products and services Capital Gains may receive from broker-dealers may include research products and other services such as on-line reports, statistical calculations (duration, alpha, beta, standard deviation, Sharpe ratio's, etc), financial publications, market reports, mutual fund recommendations, bond ratings updates and risk assessment analysis. In addition, Capital Gains has verbal agreements with several brokerage firms, whereby rate of return information and modern portfolio statistics (alpha, beta, duration, convexity, standard deviation, Sharpe ratio or average maturity) are provided to Capital Gains on a monthly basis or upon request.

To the extent that Capital Gains uses client transactions to obtain products or services that it could otherwise purchase for cash, Capital Gains may have an incentive to place a greater volume of transactions or pay higher commissions than would otherwise be the case. Capital Gains does not attempt to allocate the relative costs or benefits of such services to or among specific clients because it believes that the research as a whole assists it in its overall investment activities. Any research or statistical data received by Capital Gains may be used in servicing any or all of the firm's clients including those accounts which direct Capital Gains to a particular broker from whom Capital Gains receives no research services. Such services may not necessarily be used in conjunction with a particular account or the one affecting transactions through the broker or dealer providing the research or statistical data. Accounts which direct brokerage therefore may receive a disproportionate benefit over accounts which pay for such services through soft dollar transactions directed by Capital Gains.

Client Referrals

Capital Gains may receive client referrals from broker-dealers to whom Capital Gains directed brokerage executions or from whom it receives research. Capital Gains may have a conflict of interest between its duty to obtain a combination of best price and execution for its clients and an incentive to secure additional business from a particular broker or dealer. To address this conflict of interest, Capital Gains follows the best price and execution policy described above, and it does not consider, in selecting or recommending broker-dealers, whether it or a related person receives client referrals from a broker-dealer or third party.

Client-Directed Brokerage Arrangements

Capital Gains may accept direction from a client to effect portfolio transactions through a particular broker or dealer. These clients should know that Capital Gains' ability to negotiate commission rates for such clients is virtually eliminated nor is Capital Gains in a position to evaluate additional services that may be provided to such clients by those brokers or dealers.

A client who chooses to designate a particular broker or dealer should consider whether such a designation may result in certain costs or disadvantages to the client, either because the client may pay higher commissions on some transactions that might otherwise be attainable by Capital Gains, or may receive less favorable execution of some transactions, or both. In determining whether to direct its brokerage to a particular broker or dealer in recognition of custodial or other services, the client may wish to compare the possible costs or disadvantages of such an arrangement with the value of the custodial or other services provided.

A client who has restricted Capital Gains to a particular broker or dealer generally will be unable to participate in an aggregated order. Also, a client who has restricted Capital Gains from using a particular broker or dealer will be unable to participate in an aggregated order placed with that broker or dealer. In each of these situations, a client may pay higher brokerage commissions than paid through participating in an aggregated order.

Trade Aggregation

Capital Gains often serves as investment adviser for multiple accounts having the same or similar investment objectives and strategies and holding many of the same securities. Capital Gains may, but is not required to, aggregate for execution as a single transaction orders for the purchase or sale of a particular security for the accounts of several clients in order to seek a more advantageous net price or more efficient execution. Before placing an aggregated trade, Capital Gains generally establishes a target allocation of securities purchased or sold among the accounts of participating clients. If an aggregated order is filled only partially on a day, the securities purchased or sold are generally allocated through a pre-determined rotational system. Exceptions to that allocation may be made by Capital Gains if appropriate in light of participating clients' cash positions, other securities holdings, the cost to a client of multiple transactions and other relevant factors.

Exceptions to the pre-determined rotational system may be based upon the following relevant factors: (i) when only a small percentage of the order is executed, shares may be allocated to the account with the smallest order or the smallest position or to an account that is out of line with respect to security or sector weightings relative to other portfolios, with similar mandates; (ii) allocations may be given to one account when one account has limitations in its investment guidelines which prohibit it from purchasing other securities which are expected to produce similar investment results and can be purchased by other accounts; (iii) if an account reaches an

investment guideline limit and cannot participate in an allocation, shares may be reallocated to other accounts (this may be due to unforeseen changes in an account's assets after an order is placed); (iv) with respect to sale allocations, allocations may be given to accounts low in cash; (v) in cases when a pro rata allocation of a potential execution would result in a de minimis allocation in one or more accounts, Capital Gains may exclude the account(s) from the allocation; the transactions may be executed on a pro rata basis among the remaining accounts; or (vi) in case where a small proportion of an order is executed in all accounts, shares may be allocated to one or more accounts on a random basis.

Capital Gains may face conflicts of interest when allocating securities among clients. For instance, Capital Gains receives different advisory fees from different clients and the performance records of some clients may be more public than those of other clients. Although the investment strategies of many of the public safety clients are similar, they may experience similar but not identical returns. These differences could be due to factors that relate to price and timing differences in the execution of trades, the timing of cash deposits and withdrawals and limitations that prevent Capital Gains from purchasing certain securities for some clients.

ITEM 13 - REVIEW OF ACCOUNTS

Review of Accounts

Gary Karshna, President of Capital Gains, reviews all accounts, including accounts managed by a third party, on a monthly basis.

More frequent reviews may be prompted by changes in the macroeconomic environment, the capital markets, management and structure of mutual fund companies or separate account manager organizations in which client assets are invested, or the client's financial goals, objectives or financial situation. In addition, Clients may request more frequent reviews and may establish specific criteria that would cause a review to take place.

Reports to Clients

Clients will be provided with monthly account statements from their custodian reflecting account holdings and transactions. Clients receiving continuous supervisory management services will be provided quarterly reports from Capital Gains reflecting the performance of the clients account. Capital Gains also may provide additional performance reports upon a client's request. Capital Gains urges its clients to carefully review such reports and compare account statements received from the custodian with those prepared by Capital Gains for accuracy.

ITEM 14 - CLIENT REFERRALS AND OTHER COMPENSATION

Payments Received

As described in “Item 5 – Fees and Compensation,” Capital Gains may recommend that a portion of a client’s account be managed by a third party investment adviser. In connection with such recommendation, Capital Gains may be paid a referral fee by the adviser in accordance with Rule 206(4)-3 under the Investment Advisers Act of 1940. In cases where a third party investment adviser compensates Capital Gains with a referral fee, Capital Gains will not assess an advisory fee for the portion of a client's assets that are managed by the third party investment adviser. The referral fee will ordinarily consist of a percentage of the advisory fees that the third party investment adviser receives from the client. The client’s fees to the third party investment adviser will not increase as a result of the payment of the referral fee by the investment adviser to Capital Gains. Capital Gains may have a conflict of interest between acting in the client’s best interest and securing referral fees from such investment advisers. Capital Gains addresses this conflict of interest by ensuring that investments are suitable for each client and in compliance with applicable investment guidelines and objectives.

Payments to Others

Capital Gains currently does not pay referral fees to persons not affiliated with Capital Gains who introduce advisory business to the firm. However, Capital Gains may do so in the future in accordance with applicable law, including the solicitor’s rule, Rule 206(4)-3 under the Investment Advisers Act of 1940, and the “pay-to-play” rule, Rule 206(4)-5 under the Investment Advisers Act of 1940. Such fees will ordinarily consist of a percentage of the advisory fees paid to Capital Gains by the referred client. The client's fees to Capital Gains will not increase as a result of the payment by Capital Gains to the solicitor.

ITEM 15 - CUSTODY

Capital Gains does not maintain custody of client funds or securities. As a condition to its acceptance of a new account, Capital Gains requires the safekeeping of all account assets by a qualified custodian, which may be a bank or a registered broker-dealer. This qualified custodian sends a monthly statement detailing the client’s holdings, transactions and values for that period. Clients should carefully review those statements. Capital Gains urges its clients to compare the account statements they receive from the qualified custodian with those they receive from Capital Gains.

ITEM 16 - INVESTMENT DISCRETION

Clients typically grant Capital Gains authorization to manage the client’s account on a discretionary basis. The client will grant such authority to Capital Gains by execution of the client agreement and a brokerage account application. The client may terminate discretionary authorization at any time upon sending written notice to Capital Gains. Additionally, the client may set parameters with respect to when the account should be rebalanced, set trading restrictions or limitations and/or require that portfolio transactions be effected through a particular broker or dealer.

ITEM 17 - VOTING CLIENT SECURITIES

Voting of Proxies

For all public safety accounts and accounts which are subject to the Employee Retirement Income Security Act ("ERISA"), Capital Gains will vote all proxies for securities and exercise voting rights pertaining to investments in a client's account unless the client informs Capital Gains in writing (such as in the investment management agreement) that the client retains voting discretion for investments in the client's account.

For any client which is not a public safety client or subject to ERISA, Capital Gains will not vote any proxies for securities or exercise any voting rights pertaining to investments in client's account unless the client directs Capital Gains to do so in writing. Accordingly, it is the client's responsibility to vote any proxies for securities or exercise all voting rights pertaining to investments in its account. Ordinarily, the client's broker-dealer or custodian will forward proxies pertaining to investments in client's account to client. The client should contact its broker-dealer or custodian if it does not receive proxies or other mailings pertaining to investments in the account. At a client's request, Capital Gains will answer questions or provide advice about a particular solicitation.

Capital Gains is not responsible for voting proxies for client securities held in the portion of client's account managed by a third party investment adviser.

Voting Policies and Procedures

All proxies for client securities for which Capital Gains has authority to vote shall be voted in a manner considered to be in the best interests of Capital Gains' clients, without any regard to Capital Gains. Capital Gains shall examine each proposal and vote against the proposal, if, in its judgment, approval or adoption of the proposal would be expected to impact adversely the current or potential market value of the issuer's securities. In addition, Capital Gains shall examine each proposal and vote the securities held on behalf of a client against the proposal if, in its judgment, the proposal would be expected to affect adversely the best interest of the client.

More specifically, Capital Gains will normally vote as follows:

Capital Gains will examine each proposal and vote against such proposal if (a) the proposal would be expected to impact adversely the current or potential market value of the issuer's securities; or (b) the proposal would be expected to affect adversely the best interest of the client. References to the best interest of a client refer to the interest of the client in terms of the potential economic return on the client's investment. In determining the vote on any proposal, Capital Gains shall not consider any benefit to Capital Gains [any of its affiliates, any of its or its

affiliates' clients, or of its customers or service providers] other than benefits to the owner of the securities to be voted.

Capital Gains will usually vote for management unless the proposals relate to the following:

1. Proposals that give management the ability to alter the size of the board of directors without shareholder approval.
2. Proposals requiring a majority vote larger than 51% of outstanding shares to approve any proxy proposal.
3. Proposals which allow more than one vote per share in the election of directors.
4. Proposals intended largely to avoid acquisition prior to the occurrence of an actual event or to discourage acquisition by creating a cost constraint.
5. Proposals to change voting rights by type of Common stock or for long term holders versus new holders.
6. Proposals to eliminate the right of shareholders to act by written consent without a meeting.

Capital Gains may vary from the predetermined policy if it determines that voting on the proposal according to the predetermined policy would be expected to impact adversely the current or potential market value of the issuer's securities or to effect adversely the best interest of the client.

Based on the nature of the investments that Capital Gains makes for its client accounts, Capital Gains does not expect any material conflicts of interest to arise. However, our Chief Compliance Officer – Gary Karshna must determine whether any material conflict of interest is present with each proposal on which Capital Gains has discretion to vote. A conflict of interest may exist, for example, if Capital Gains has a business relationship with (or is actively soliciting business from) either the company soliciting the proxy or a third party that has a material interest in the outcome of a proxy vote or that is actively lobbying for a particular outcome of a proxy vote. [Any individual with knowledge of a personal conflict relating to a particular proposal must disclose that conflict to the Chief Compliance Officer and otherwise remove himself or herself from the proxy voting process. If a material conflict of interest arises, Capital Gains will (i) refer the matter to a third-party proxy voting service; or (ii) prepare a report that (A) describes the conflict of interest; (B) discusses procedures used to address such conflict of interest; (C) discloses any contacts from outside parties (other than routine communications from proxy solicitors) regarding the proposal; and (D) confirms that the recommendation was made solely on the investment merits and without regard to any other consideration. Capital Gains will retain a copy of such report with the proxy voting log.]

A client may contact Capital Gains for specific voting guidelines or information on how Capital Gains voted with respect to securities in its account.

ITEM 18 - FINANCIAL INFORMATION

Capital Gains is required in this item to provide clients with any information about its financial condition that is reasonably likely to impair its ability to meet its contractual commitments to clients. There is no such information, as Capital Gains has ample capital and resources to meet all of its obligations.