

# FIRM BROCHURE

## *(PART 2A OF FORM ADV)*

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This brochure provides information about the qualifications and business practices of Cape Ann Capital, Inc. If you have any questions about the contents of this brochure, please contact us at: (978) 526-7541, or by email at: [DaveU@CapeAnnCapital.com](mailto:DaveU@CapeAnnCapital.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. Registration with the SEC or a state securities authority does not imply a certain level of skill or training.

Additional information about Cape Ann Capital, Inc. also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)

## ITEM 2: MATERIAL CHANGES

### *Material Changes since the Last Annual Update*

This summary includes the material changes made since last year's brochure. It is not a list of all of the changes we have made. We last updated our brochure on March 31, 2011.

- David Umstead now owns 60% of Cape Ann Capital. James Jasinski owns 40%. As of our last annual update, David Umstead owned 85% and Jim Jasinski owned 15%.
  - Cape Ann Capital now has \$90 million in discretionary assets under management. This is up from \$77 million as of the last update.
  - Cape Ann Capital is now managing 129 client portfolios. This is up from 108 portfolios as of the last update.
  - Cape Ann Capital has partnered with three independent service providers to deliver an open architecture 401(k) Plan to a corporate sponsor in Massachusetts. The Plan replaces a captive plan, for which all services were provided by a single mutual fund company. An open architecture plan removes conflicts of interest in the selection of investments offered to participants and makes costs much more transparent. Cape Ann Capital is the independent advisor. The assets are custodied on TD Ameritrade's Trust platform. Kenneth D. Anderson, Inc. is the Third Party Administrator and does the census work, the 5500 filing and the compliance testing. Professional Capital Services is the record keeper and provides the website that gives participants access to their accounts. Each participant selects one of six Cape Ann Capital managed portfolios. The portfolios are constructed from our normal Buy list and cover a wide range of risk levels from a very conservative asset allocation to a very aggressive allocation. Cape Ann Capital is committed to this type of open architecture 401(k) solution and is willing to work with a wide variety of independent partners.
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## ITEM 4: ADVISORY BUSINESS

### ***Firm Description***

Cape Ann Capital was founded in April of 1999 to provide investment advisory services to individuals and institutions. The firm manages 129 client portfolios with an aggregate market value of \$90 million.

### ***Principal Owners***

David Umstead owns 60% of the firm and James Jasinski owns 40%.

### ***Types of Advisory Services***

Cape Ann Capital manages portfolios of actively managed mutual funds and exchange traded index funds for individuals, qualified plans, trusts, corporations and charities. Each client portfolio is tailored to a long-term asset allocation target determined by the client. Cape Ann Capital assists in finding an asset allocation target that will meet each client's long-term return objectives without exceeding his or her tolerance for risk. Most clients are targeting exposures to all of the following asset classes: U.S. cash, U.S. bonds, U.S. equities, European equities, Asian equities, emerging markets equities and commodities. Allocations across these seven categories vary considerably from client to client.

### ***Wrap Fee Programs***

Cape Ann Capital does not participate in any wrap fee programs.

### ***Assets Under Discretionary Management***

Cape Ann Capital has assets under discretionary management of \$90 million.

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## ITEM 5: FEES AND COMPENSATION

### ***Description***

Cape Ann Capital is a fee-only adviser. Fees are based on the market value of the assets being managed and are calculated according to the following fee schedule.

#### **Fee Schedule**

<u>Assets</u>	<u>Annual Fee Rate</u>
First \$1 million	0.65% of assets
Next \$1 million	0.35% of assets
Over \$2 million	0.20% of assets

Fees are negotiable.

***Fee Billing***

Fees are collected monthly (at one-twelfth the annual rate) in arrears based on month-end valuations. Fees are pro-rated from the date of inception for the first monthly invoice. Cape Ann Capital submits fee invoices to TD Ameritrade. TD Ameritrade debits our monthly fee directly from client accounts.

***Other Expenses***

Cape Ann Capital uses TD Ameritrade for custody and discount brokerage. Clients will incur brokerage and other transaction costs. Further information on brokerage is provided at Item 12 in this brochure.

All mutual funds and exchanged traded index funds have internal operating expenses, which are debited from the fund and therefore paid by the client. These fees are in addition to the fees charged by Cape Ann Capital.

Some mutual funds can be bought or sold commission free and some carry a \$24 commission. Most of the funds on our Buy List offer both options. Commission-free share classes typically have higher internal expenses. Cape Ann Capital uses the share class that will likely lead to the lowest long-run cost for the client. Small portfolios with monthly or quarterly contribution flows are much better off owning the shares classes with slightly higher expense ratios to avoid all the \$24 ticket charges. All of the exchange traded index funds we use are commission-free.

***Participation or Interest in Client Transaction***

Cape Ann Capital receives no compensation for the sale of securities or other investment products and therefore has no incentive to select one investment over another.

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**ITEM 6: PERFORMANCE-BASED FEES**

Cape Ann Capital does not accept performance-based fees, flat fees or hourly fees.

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**ITEM 7: TYPES OF CLIENTS**

Cape Ann Capital provides investment advisory services to:

- high net worth individuals,
- individuals,
- qualified plans,
- trusts,

- corporations, and
- charities.

Generally, Cape Ann Capital does not require a minimum account size.

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## ITEM 8: METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

### ***Methods of Analysis and Investment Strategies***

In most cases, Cape Ann Capital invests exclusively in actively managed mutual funds and exchange traded index funds.

Cape Ann Capital regularly evaluates every mutual fund in the country to identify those that have outperformed their benchmarks over the long term with a consistency that is very unlikely to have been achieved by chance. Cape Ann Capital employs various research tools to conduct ongoing analyses of these funds. Cape Ann Capital typically draws on its proprietary research to select a diversified mixture of actively managed mutual funds and then adds exchange traded index funds, if necessary, to provide exposure to sectors not covered by the actively managed funds. The active and indexed proportions within the portfolio depend on Cape Ann Capital's ability to identify actively managed funds with convincing evidence of skill in delivering returns above what can be achieved with index funds.

Cape Ann Capital uses a multi-factor risk model to measure the effective asset allocation history of each mutual fund and to calculate a unique reference benchmark that is appropriate for each manager. This allows measuring a value manager against a value index, a bond manager against a bond index, a small cap manager against a small cap index, etc. Cape Ann Capital then calculates each manager's average excess return, the consistency of the excess return and a t-statistic that reflects the probability the result could have occurred by chance.

Cape Ann Capital looks at additional factors such as investment process, corporate culture, management tenure, expense ratios, portfolio turnover and load structure to arrive at a final Buy List. Cape Ann Capital reviews its Buy List periodically to ensure that it always reflects the most skillful managers available.

**Constructing Portfolios:** Every Cape Ann Capital client commits to a long-term asset allocation target. Cape Ann Capital seeks to create a portfolio from the Buy List that meets this target. Cape Ann Capital uses an optimizer and a multi-factor risk model to identify the portfolio that minimizes risk relative to each client's benchmark. The

optimizer tells us which mutual funds to select from the Buy List and what the target weight for each fund should be.

Cape Ann Capital's software identifies the target weights that come closest to aligning the asset allocation of the client's portfolio with the asset allocation of the client's benchmark. The analysis takes account of the risk of each asset and the correlations among the assets. Cape Ann Capital sets lower and upper bounds on the calculation.

If the optimal portfolio is not within tolerance, Cape Ann Capital adds exchange traded index funds to bring the portfolio in line. We use a statistic called tracking error to monitor each portfolio's risk relative to its benchmark. Cape Ann Capital strives to keep tracking error under 2%. A portfolio with a tracking error of 2% has a high likelihood of performing within plus or minus 2 percentage points of its benchmark on an annual basis.

**Why Mutual Funds:** There are many investment vehicles available to investors. Cape Ann Capital prefers mutual funds for the following reasons:

**Transparency:** Mutual funds provide a transparent investment vehicle with a publically available track record. Net asset value is reported daily. The SEC carries out regular audits of mutual fund operations, independent directors oversee fund activities, independent auditors scrutinize fund financial statements and fund assets are held by independent custodians. These characteristics allow us to evaluate all mutual fund managers on a consistent basis. In our view it is very difficult to compare hedge funds or separately managed accounts as these vehicles are less regulated, performance is often not readily available and not all are registered with the SEC.

**Professional Management:** If a skillful management team can achieve a higher return, net-of-expenses than the return of the asset classes in which they invest, this benefit accrues to the shareholders of the fund. Investors do not have to pay more for the services of a skilled manager vs. an unskilled manager. Investors would certainly be willing to pay a premium for skilled management, but because mutual funds exchange shares at net asset value the services of a skilled manager costs no more than the services of an unskilled manager. Cape Ann Capital seeks to identify mutual fund managers with more than enough skill to overcome the expenses of their fund and the expenses of Cape Ann Capital.

**Diversification:** A single share of a mutual fund provides an investment in many individual securities.

**Lower Trading Commissions:** Because mutual funds trade in large volume, they can negotiate much lower commissions when buying and selling securities.



**Liquidity:** Mutual fund shares are redeemable on a daily basis.

**Load vs. No Load:** Mutual funds come in two types; load funds and no-load funds. A load is a commission that goes to the salesperson who markets the fund. Cape Ann Capital's fund selection is driven by our fiduciary responsibility as a registered investment adviser. In that regard, we never buy load funds. Since no-load mutual funds do not have a sales force marketing their shares, they must rely primarily on performance to compete. Since expenses detract from performance, no-load funds tend to have lower expense ratios than load funds.

### ***Risk of Loss***

An investment in a mutual fund or an exchange traded fund involves a risk of loss which a client should be prepared to bear.

Client portfolios are generally invested in ten to twenty mutual funds depending on the asset allocation being targeted. For most clients we are able to achieve our target tracking error without using any exchange traded index funds. For very small portfolios and some unusual asset allocation targets we are forced to use exchange traded index funds.

Our mutual funds and exchange traded index funds invest in stocks and bonds as well as various derivative contracts such as foreign currency contracts, futures contracts, options contracts and swap agreements. Investing in mutual funds and exchange traded index funds is risky because the underlying securities and derivative contracts fluctuate in value. These fluctuations may be due to political, economic or general market circumstances. Some of these factors may affect a single company or industry and others may impact the broader market. Because the values of mutual funds and exchange traded index funds fluctuate, portfolios managed by Cape Ann Capital may decline in value.

Investments in derivative instruments carry exposure to various risks such as, but not limited to, interest rate and foreign currency risk. Interest rate risk is the risk that a fixed income security will decline in value because of changes in interest rates. Foreign currency risk is the risk that a foreign currency or a security that is denominated in a foreign currency will decline in value. Derivative contracts also carry counter party risk; i.e. the risk that the entity on the other side of the contract will default.

All of these risks are mitigated by the fact that Cape Ann Capital portfolios typically hold numerous funds and each fund holds hundreds or even thousands of securities. Through all of this diversification Cape Ann Capital believes it is able to eliminate most of the idiosyncratic risk in client portfolios. Systematic risk can be controlled, but not eliminated. Each client commits to a long-term asset allocation target and commits to

the systematic risks associated with that target. One of the largest risks born by Cape Ann Capital clients is the risk that they will capitulate on an aggressive asset allocation after suffering an extended period of market value declines and thereby convert an unrealized loss to a realized loss.

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## **ITEM 9: DISCIPLINARY INFORMATION**

Cape Ann Capital has never been involved in any kind of disciplinary proceeding in any court or with the SEC or with any other federal, state or foreign regulatory authority.

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## **ITEM 10: OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

### ***Broker-Dealer Registration***

We do not have a registration or an application pending to register as a broker-dealer or a registered representative of a broker-dealer.

### ***Futures, Commodity Pool Operator, Commodity Trading Adviser***

We do not have a registration or an application pending to register as a futures commission merchant, commodity pool operator, a commodity trading adviser, or an associated person of the foregoing entities.

### ***Related Person Arrangements***

Neither we nor any of our management persons have any relationship or arrangement that is material to our advisory business or to our clients that we have not otherwise disclosed.

### ***Arrangements With Other Investment Advisers***

We do not recommend or select other investment advisers for our clients nor do we have other business relationships with those advisers that create a material conflict of interest.

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## **ITEM 11: CODE OF ETHICS**

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

Cape Ann Capital has a Code of Ethics that provides the standard of conduct for all employees. The Code requires that all employees conduct themselves in accordance with high ethical standards premised on the concepts of integrity, honesty and trust. Every employee is held to a strict fiduciary standard. Every employee must always act in the best interest of the client and to treat all clients fairly. A copy of the Code is available upon request. The following is a summary of certain provisions of the Code of Ethics:

**Confidential Information:** As an investment adviser, we have a fiduciary duty to our clients not to divulge or misuse information obtained in connection with our services as an adviser. Therefore, all information, whether of a personal or business nature, that an employee obtains about a client's affairs in the course of employment with us should be treated as confidential and used only to provide services to the benefit of the client. Such information may sometimes include information about non-clients, and that information should likewise be held in confidence. Even the fact that Cape Ann Capital advises a particular client should ordinarily be treated as confidential. Cape Ann Capital's Code of Ethics sets forth steps employees should take to help preserve confidential information.

**Material Inside Information:** The Code of Ethics advises employees that purchasing or selling securities on the basis of material nonpublic information for their own or a client's account or "tipping" is a crime.

**Fiduciary Duty and Conflicts of Interest:** Cape Ann Capital and its employees have a fiduciary duty to always act for the benefit of clients and to take action on the clients' behalf before taking action to benefit themselves or the firm. The manner in which any employee discharges his or her fiduciary duty and addresses a conflict of interest depends on the circumstances.

**Unfair Treatment of Certain Clients vis-à-vis Others:** The Code prohibits employees from favoring one client over another.

**Personal Trading Policy:** Cape Ann Capital's Code is unusual in that it requires **all employees to have all of their personal investments managed by the company.** Employees are not allowed to own or otherwise have a beneficial interest in any securities held in an account not managed by the company. **Employees are not allowed any personal trading and their portfolios receive no preferential treatment over client portfolios.**

Each new employee must submit an initial holdings report disclosing to the Cape Ann Capital Chief Compliance Officer the identities, amounts, and locations of all securities owned in all accounts in which he or she has a "beneficial ownership interest." The management of these securities must be immediately turned over to Cape Ann Capital. The employee portfolio will be managed via the same process used for all client portfolios. The employee portfolio will be subject to all the reviews and reporting listed under Item 13.

Employee portfolios look just like client portfolios. Each employee signs a management agreement and selects a long-term asset allocation target. We run our optimizer to select the portfolio from our Buy List that comes closest to the employee's long-run asset allocation target.

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## **ITEM 12: BROKERAGE PRACTICES**

### ***Selecting Brokerage Firms***

Cape Ann Capital recommends TD Ameritrade for all client brokerage transactions. Cape Ann Capital reviewed other brokers' fees and services and believes that TD Ameritrade offers excellent service and a wide array of investment options at reasonable, competitive rates. Currently, TD Ameritrade offers about 14,000 mutual funds, about 3,500 of which can be purchased or sold with no transaction fee. Transactions in the remaining mutual funds are \$24 each way. TD Ameritrade assesses a \$49.99 redemption penalty for no-transaction-fee funds sold within 90 days of purchase. TD Ameritrade also offers 100 commission-free exchange traded index funds. Transactions in the remaining exchange traded funds are \$9.99 each way. As noted earlier, Cape Ann Capital generally invests only in no-load mutual funds and commission-free exchange traded index funds for its clients.

### ***Research and Other Soft Dollar Benefits***

Cape Ann Capital accepts no research or soft dollar benefits from any broker.

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

We do not consider whether we receive client referrals from a broker in selecting or recommending broker-dealers.

### ***Directed Brokerage***

We routinely recommend to our clients that they use TD Ameritrade for custody and for the execution of all mutual fund and exchange traded index fund transactions because of the reasons set out under the sub-heading "Selecting Brokerage Firms". Not all investment advisers recommend particular brokers to their clients. We have no affiliation or other economic relationship with TD Ameritrade. It is possible that another broker might offer lower fees for certain mutual fund and/or exchange trades index fund purchases. Accordingly, there is the potential that we are unable to achieve the lowest price on client transactions when we use TD Ameritrade and the use of TD Ameritrade may cost our clients more money than the use of another broker. However, we believe that TD Ameritrade offers competitive pricing and service for mutual fund and exchange traded index fund transactions.

### ***Aggregation of Client Accounts***

Mutual funds exchange shares at the market close. All clients buying or selling that day receive the same price. Accordingly, we do not aggregate trades as we do not have to be concerned with one client getting a better price than another.

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## **ITEM 13: REVIEW OF ACCOUNTS**

### ***Periodic Reviews***

Cape Ann Capital reviews each client portfolio at least monthly. If the asset allocation of the portfolio is off target, we take steps to correct it. If any individual mutual fund is off target we take steps to correct that as well.

Cape Ann Capital periodically reviews every mutual fund in the country. If we identify a fund that has demonstrated a higher skill level than a fund on the Buy List and the fund passes our due diligence check list we make the substitution on our Buy List and adjust client portfolios accordingly.

### ***Review Triggers***

Cape Ann Capital monitors every mutual fund on the Buy List on a daily basis. If a fund displays a pattern of out-of-the-ordinary underperformance, we drop it from the Buy List and from client portfolios.

### ***Regular Reports***

Cape Ann Capital provides a written Portfolio Review to every client every month. The Portfolio Review contains commentary on the markets, month-end holdings, portfolio performance for three intervals (since inception, year-to-date and latest month), performance of each individual holding for the latest month and all transactions for the month. TD Ameritrade sends monthly statements to clients as well. After year-end, TD Ameritrade sends 1099s to clients and Cape Ann Capital sends realized gains reports.

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## **ITEM 14: CLIENT REFERRALS AND OTHER COMPENSATION**

### ***Incoming Referrals***

Cape Ann Capital does not pay anyone for referral business.

### ***Referrals Out***

Cape Ann Capital does not receive any income for referring business to anyone.

### ***Other Compensation***

Cape Ann Capital's only compensation is the monthly fee referred to in Item 5 of this brochure, which TD Ameritrade debits from client accounts. Cape Ann Capital does not have any arrangements under which we receive any economic benefit, including sales awards or prizes.

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## **ITEM 15: CUSTODY**

Cape Ann Capital does not have custody of client assets. All Cape Ann Capital clients use TD Ameritrade as their primary custodian. A few clients have additional assets that we manage that are custodied at other custodians: TIAA-CREF, Fidelity, J.P. Morgan Retirement Plan Services and Principal Financial Group.

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## **ITEM 16: INVESTMENT DISCRETION**

Cape Ann Capital has investment discretion over all client accounts. All clients have given Cape Ann Capital limited power of attorney to execute trades on their behalf. In spite of having discretionary authority, we are more than willing to discuss pending transactions in advance if desired by the client. Once each client gives us a long-term asset target, they can be as involved or uninvolved as they wish in our investment process. Typically if a transaction will generate meaningful taxable income we will ask for client approval before making the trade.

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## **ITEM 17: VOTING CLIENT SECURITIES**

If a client so desires, Cape Ann Capital will accept the authority to vote proxies on their behalf.

### ***Proxy Votes***

Cape Ann Capital's written Proxy Voting Policy is available upon request. As Cape Ann Capital's clients generally invest in mutual funds and exchange traded index funds rather than directly in securities, this issue is not of the same importance that it otherwise would be. Our objective in voting proxies is to support proposals and director nominees that maximize the expected long-term value of client investments. Proxy proposals are varied and complex. As such, Cape Ann Capital's Proxy Voting Policy guidelines can only provide a framework for assessing each proposal. The Policy stresses Cape Ann Capital's role as a fiduciary with responsibility for evaluating each proposal on its merits, based on particular facts and circumstances as presented. Cape Ann Capital gives substantial weight to the recommendations of the company's board, absent other specific facts that would support a vote against management.

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## **ITEM 18: FINANCIAL INFORMATION**

Since Cape Ann Capital invoices its fees in arrears, it is not required to include a balance sheet for its most recent fiscal year.

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## **ITEM 19: REQUIREMENTS FOR STATE-REGISTERED ADVISERS**

Cape Ann Capital is an SEC registered adviser and not a state-registered adviser.

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