

## **Part 2A of Form ADV: *Firm Brochure***

### **DCI, LLC**

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This brochure provides information about the qualifications and business practices of DCI, LLC which will do business in California as DCI Investment Management LLC ("DCI" or the "Company"). If you have any questions about the contents of this brochure, please contact us at 415-764-1906 or [kwheadon@dcicom](mailto:kwheadon@dcicom). 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 DCI also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). You can search this site by a unique identifying number, known as a CRD number. Our firm's CRD number is 134018.

## **Item 2     Material Changes**

The SEC adopted "Amendments to Form ADV" in July, 2010. This Firm Brochure, dated 12/31/2010, is our new disclosure document prepared according to the SEC's new requirements and rules. As you will see, this document is a narrative that is substantially different in form and content, and includes some new information that we were not previously required to disclose.

After our initial filing of this Brochure, this Item will be used to provide our clients with a summary of new and/or updated information. We will inform you of the revision(s) based on the nature of the updated information.

Consistent with the new rules, we will ensure that you receive a summary of any material changes to this and subsequent Brochures within 120 days of the close of our business' fiscal year. Furthermore, we will provide you with other interim disclosures about material changes as necessary.

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## **Item 4     Advisory Business**

DCI is a SEC-registered investment adviser with its principal place of business located in California. DCI began conducting business in 2004.

Listed below are the firm's principal shareholders (i.e., those individuals and/or entities controlling 25% or more of this company).

- Stephen Kealhofer and Janet Ann Luck 1999 Family Trust. Stephen Kealhofer is Managing Principal of DCI.

There are no publicly held subsidiaries that indirectly own 25% or more of our firm:

DCI offers the following advisory services to our clients:

### **INVESTMENT SUPERVISORY SERVICES ("ISS")**

#### **PORTFOLIO MANAGEMENT**

DCI organizes and serves as the discretionary investment adviser to collective investment funds ("funds"), which may be organized inside or outside of the US as limited partnerships, trusts, companies or other entities and single client separate accounts ("separate accounts"). Each fund and separate account's investment objective is to seek to produce investment returns from credit risk. DCI uses proprietary technology to produce model-driven portfolios.

Our investment recommendations are not limited to any specific product or service offered by a broker-dealer or insurance company and will generally include advice regarding the following securities:

- Corporate debt securities (other than commercial paper)
- United States government securities
- Futures contracts on intangibles
- Interest Rate Swaps
- Credit Default Swaps

Because some types of investments involve certain additional degrees of risk, they will only be implemented/recommended when consistent with the investment objectives agreed with the separate account's or fund's investment objectives. Each fund's prospectus or offering memorandum contains additional information about the fund, including a discussion of certain significant risks of investing in the funds.

To ensure that our initial determination of an appropriate portfolio remains suitable and that the separate account or fund continues to be managed in a manner consistent with the agreed investment objectives, we will:

1. Conduct an ongoing and continuous review of each account to ensure consistency with the strategy's objectives.
2. Be reasonably available to consult with the client; and

3. Provide at least monthly reports including, but not limited to, the performance of the accounts and other risk measures.

### **AMOUNT OF MANAGED ASSETS**

As of 12/31/2010, we were actively managing approximately \$3,500,000,000 of clients' assets on a discretionary basis. We do not at this time manage any non-discretionary accounts.

## **Item 5 Fees and Compensation**

### **INVESTMENT SUPERVISORY SERVICES ("ISS")**

#### **PORTFOLIO MANAGEMENT FEES**

On a case-by-case basis, DCI determines an appropriate fee structure based on the size, complexity and investment objectives of the fund or separate account. Fee arrangements may include a combination of a management fee and incentive fee, or may be solely limited to a management fee. The terms and conditions of the fee structure are mutually agreed upon prior to entering into an advisory agreement. Fees for funds are typically deducted from the assets of the fund by the Administrator. Fees for separate accounts are invoiced to the client.

**Account Management Fees:** DCI typically charges a fee for account management that is calculated and paid as a percentage of the assets under management. The Account Management Fee is calculated at an annual rate not to exceed 3%. Fees are calculated on a monthly or quarterly basis, and are payable in arrears based on the value of the account at the end of each billing period. The Account Management Fee is prorated for periods less than a full billing cycle and adjusted to cover any additional contributions made during that period.

**Account Incentive Fees:** Certain separate accounts and funds pay DCI performance-based compensation ("Incentive Fees"). The Incentive Fee is calculated based on a percentage of the net profits of the account(s) on a frequency mutually agreed upon with the client.

DCI's incentive fee is typically 10-20% of the net profits above the account's previous "high water mark". To the extent that the amount of account appreciation is less than the high water mark, there is a loss carry forward allocation that must be recouped before DCI is entitled to a performance-based fee.

Clients who elect to terminate their contracts will be charged a performance-based fee based on the performance of the account for the measuring period going back from the termination date and pro-rated from the date on which the performance-based fee was last assessed, or as otherwise specifically agreed with the client.

In measuring a separate account's or fund's assets for the calculation of performance-

based fees, for securities for which market quotations are readily available, DCI includes the unrealized appreciation as well as unrealized gains in the client's account.

The client should understand the performance-based fee method of compensation and its risks prior to entering into a management contract with us.

PERFORMANCE-BASED FEES WILL ONLY BE CHARGED IN ACCORDANCE WITH THE PROVISIONS OF REG. 205-3 OF THE INVESTMENT ADVISERS ACT OF 1940 AND/OR APPLICABLE STATE REGULATIONS. THE FEES WILL NOT BE OFFERED TO ANY CLIENT RESIDING IN A STATE IN WHICH SUCH FEES ARE PROHIBITED.

**Limited Negotiability of Advisory Fees:** Although DCI has established the aforementioned fee schedule(s), we retain the discretion to negotiate alternative fees on a client-by-client basis. Client facts, circumstances and needs are considered in determining the fee schedule. These include the complexity of the client, assets to be placed under management, anticipated future additional assets; related accounts; portfolio style, account composition, reports, among other factors. The specific annual fee schedule is identified in the contract between the adviser and each client.

## GENERAL INFORMATION

**Termination of the Advisory Relationship:** A client agreement may be canceled at any time, by either party, for any reason upon receipt of 30 days written notice, or as otherwise explicitly agreed with the client.

**Advisory Fees in General:** Clients should note that similar advisory services may be available from other registered (or unregistered) investment advisers for similar or lower fees.

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

### PERFORMANCE-BASED FEES

As we disclosed in Item 5 of this Brochure, our firm may charge a performance-based fee to certain separate accounts and funds. Such a performance-based fee is calculated based on a share of the realized and unrealized capital gains on capital appreciation of the assets of the client. To qualify for a performance-based fee arrangement, a client (or fund investor, as applicable) must either demonstrate a net worth of at least \$1,500,000.

Clients should be aware that a performance-based fee arrangement may create an incentive for us to recommend investments which may be riskier or more speculative than those which would be recommended under a different fee arrangement.

Furthermore, as we also have clients who do not pay performance-based fees, we have an incentive to favor accounts that do pay such fees because compensation we receive from these clients is more directly tied to the performance of their accounts.

## **Item 7    Types of Clients**

DCI provides advisory services to the following types of clients:

- Other pooled investment vehicles
- Institutional clients
- Sovereign Wealth Funds

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

### **METHODS OF ANALYSIS**

We use the following methods of analysis in formulating our investment advice and/or managing client assets:

**Fundamental Analysis.** DCI targets superior risk adjusted returns from portfolios of corporate credit assets and derivatives through active diversification and selection of good return/risk positions. The principal driver of DCI's strategies is a default probability model that incorporates fundamental balance sheet information, real time information embedded in equity and options markets, and a database of historical defaults. DCI uses its technology to produce timely risk measures for investments which are monitored in "real-time", providing early warning capabilities and a large investment universe from which to create portfolios.

In the long portfolios, the model selects relatively low default probability, high return-to-risk positions that are expected to outperform the market. DCI actively diversifies the portfolio in an attempt to mitigate idiosyncratic risk. In portfolios that use long and short exposures, the model selects undervalued and overvalued credits to go long and short, respectively.

**Risks for all forms of analysis.** Our securities analysis methods rely on the assumption that the companies whose securities we purchase and sell, the rating agencies that review these securities, and other publicly-available sources of information about these securities, are providing accurate and unbiased data. While we are alert to indications that data may be incorrect, there is always a risk that our analysis may be compromised by inaccurate or misleading information.

### **INVESTMENT STRATEGIES**

The underlying strategy for all DCI accounts is to achieve risk adjusted returns from portfolios of corporate credit assets and derivatives through active diversification and selection of good return/risk assets. There are a number of risks inherent in the methods by which DCI deploys its strategy, including:

#### **Interest Rates**

The values of some or all of a fund's investments may change in response to movements in interest rates. If rates rise, the values of debt securities generally fall.

The longer the average duration of a fund's or separate account's investment portfolio, the greater the change in value. Duration is a measure of the expected life of a fixed income security that was developed as a more precise alternative to the concept of "term to maturity."

### **Credit Risk**

Credit risk is the risk that the issuer of a debt security will not be able to pay principal and interest when due. Rating agencies assign credit ratings to certain debt securities to indicate their credit risk but these ratings are not a guarantee of any specific level of credit risk. The price of a debt security will generally fall if the issuer defaults on its obligation to pay principal or interest, the rating agencies downgrade the issuer's credit rating or other news affects the market's perception of the issuer's credit risk.

### **Swap Agreements**

DCI's strategies involve entering into interest rate swaps and credit default swaps ("swap agreements"). Swap agreements are two-party contracts entered into primarily by institutional investors for periods ranging from a day to many years. In a standard swap transaction, two parties agree to exchange the returns earned on specific assets, such as the return on, or increase in value of, a particular dollar amount invested at a particular interest rate, in a particular foreign currency, or in a "basket" of securities representing a particular index. A swap contract may not be assigned without the consent of the counter-party, and may result in losses in the event of a default or bankruptcy of the counterparty. Swap agreements are traded in the over-the-counter market and may be considered to be illiquid.

The funds or separate accounts will enter into swap agreements only if the claims-paying ability of the other party or its guarantor is considered to be investment grade by the DCI and where an ISDA Agreement and Collateral Support Annex is in place between the fund or separate account and the counterparty. In an effort to reduce counterparty risk, we will only transact Swap Agreements on a collateralized basis.

### **Interest Rate Swaps**

Interest rate swap agreements are a specialized form of a swap agreement, used to obtain or preserve a desired return or spread at a lower cost than through a direct investment in an instrument that yields the desired return or spread. In a standard interest rate swap transaction, two parties agree to exchange their respective commitments to pay fixed or floating rates on a predetermined notional amount. The swap agreement notional amount is the predetermined basis for calculating the obligations that the swap counterparties have agreed to exchange. Under most interest rate swap agreements, the obligations of the parties are exchanged on a net basis. The two payment streams are netted out, with each party receiving or paying, as the case may be, only the net amount of the two payments.

### **Credit Default Swaps**

Certain funds and separate accounts may enter into credit default swap agreements. The "buyer" in a credit default contract is obligated to pay the "seller" a periodic stream of payments over the term of the contract provided no event of default has occurred. In the event of default, the seller must pay the buyer the "par value" (full notional value) of the reference obligation in exchange for the reference obligation. Alternatively, the seller may 'cash settle' the contract by paying an amount equal to the difference between the 'par value' of an issuer's debt securities and the market value of such securities as



determined via an ISDA sanctioned auction. The fund or separate account may be either the buyer or seller in the transaction. If the fund or separate account is a buyer and no event of default occurs, the fund or separate account loses its investment and recovers nothing. However, if an event of default occurs, the buyer receives the full notional value for a reference obligation that may have little or no value. As a seller, the fund or separate account receives a fixed rate of income throughout the term of the contract, provided there is no default event. If an event of default occurs, the seller may pay the notional value of the reference obligation (or 'cash settle' the contract as described above). The value of the reference obligation received by the seller, coupled with the periodic payments previously received may be less than the amount it pays to the buyer, resulting in a loss of value to the fund or separate account.

#### **Leverage Risk**

Leverage may result from certain transactions, including the use of derivatives, borrowing and reverse repurchase agreements. Leverage may exaggerate the effect of a change in the value of a fund's or separate account's portfolio securities, causing a fund or separate account to be more volatile than if leverage was not used. The fund or separate account may, but is not required to, reduce leverage risk by either segregating an equal amount of liquid assets or "covering" the transactions that introduce such risk.

**Risk of Loss.** Securities investments are not guaranteed and you may lose money on your investments. We ask that you work with us to help us understand your tolerance for risk.

Investors in the funds should refer to the detailed risk disclosures in the fund's offering documents.

## **Item 9      Disciplinary Information**

We are required to disclose any legal or disciplinary events that are material to a client's or prospective client's evaluation of our advisory business or the integrity of our management.

Our firm and our management personnel have no reportable disciplinary events to disclose.

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

### ***Other pooled investment vehicle(s):***

Management personnel of DCI may also be managing members of limited liability companies (LLCs) and/or general partners to limited partnerships (LPs) formed for investment purposes and/or serve on the Board of Directors of Funds which DCI acts as the Investment Manager. As appropriate, our advisory clients may be solicited to invest in such LLCs, LPs and/or funds. These related persons of our firm do not directly receive investment advisory compensation in relation to these investments, but do have a conflict of interest in soliciting client investments because they may benefit economically through their ownership in DCI.

Additionally, we have a wholly owned subsidiary, DCI Asset Management (Ireland) Ltd. (DCIAM) that was established to provide management services to funds that are part of unit trusts in Ireland. DCI and DCIAM have investment management agreements in place with two funds that are domiciled in Ireland. Management personnel of DCI serve on the Board of DCIAM but receive no compensation for their service.

Because investment in these types of entities may involve certain additional degrees of risk, they will only be recommended when consistent with the client's stated investment objectives, tolerance for risk, liquidity and suitability.

A list of these affiliated entities is specifically disclosed on Schedule D of Form ADV, Part 1 at Item 7.B. Part 1 of our Form ADV can be accessed by following the directions provided on the Cover Page of this Firm Brochure.

Clients interested in investing in a specific partnership/company/fund should refer to the partnership's/ company's/fund's private placement memorandum or other disclosure document for more information specific to the investment.

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

Our firm has adopted a Code of Ethics which sets forth high ethical standards of business conduct that we require of our employees, including compliance with applicable federal securities laws.

DCI and our personnel owe a duty of loyalty, fairness and good faith towards our clients, and have an obligation to adhere not only to the specific provisions of the Code of Ethics but to the general principles that guide the Code.

Our Code of Ethics includes policies and procedures for the review of quarterly securities transactions reports as well as initial and annual securities holdings reports that must be submitted by DCI's access persons. Among other things, our Code of Ethics also requires the prior approval of any acquisition of securities in a limited offering (e.g., private placement) or an initial public offering. Our code also provides for oversight, enforcement and recordkeeping provisions.

DCI's Code of Ethics further includes the firm's policy prohibiting the use of material non-public information. While we do not believe that we have any particular access to non-public information, all employees are reminded that such information may not be used in a personal or professional capacity.

A copy of our Code of Ethics is available to our advisory clients and prospective clients. You may request a copy by email sent to [kwheadon@dcicom.com](mailto:kwheadon@dcicom.com), or by calling us at 415-764-1906.

Our Code of Ethics is designed to assure that the personal securities transactions, activities and interests of our employees will not interfere with (i) making decisions in the best interest of advisory clients and (ii) implementing such decisions while, at the same time, allowing employees to invest for their own accounts.

Our firm and/or individuals associated with our firm may not buy or sell for their personal accounts credit default swaps or corporate bonds.

## **Item 12 Brokerage Practices**

DCI does not have any explicit third party soft-dollar arrangements. DCI may receive research from broker-dealers but this is not by pre-arrangement and not afforded any weight in brokerage determinations.

DCI requires that clients provide us with written authority to determine the broker-dealer to use and the commission costs that will be charged to our clients for these transactions.

Clients must include any limitations on this discretionary authority in this written authority statement. Clients may change/amend these limitations as required. Such amendments must be provided to us in writing.

DCI's allocation procedures have been designed to ensure that buy and sell opportunities are allocated fairly among clients and that, over time, all clients are treated equitably. Investment decisions for each client are made independently from those of other clients and are made with specific reference to each client's needs, objectives and investment guidelines. At times, it will be desirable to acquire or dispose of the same securities for more than one client at the same time. In this circumstance, it occasionally may not be possible to acquire or dispose of a sufficiently large portion of the security, or we may have to accept a less advantageous price or obtain a lower yield. In such situations, we will use its allocation procedures.

Importantly, since fixed income securities trade on a relative value (i.e., "spread") basis, the quality of execution cannot be judged merely by reference to the buy/sell price. Under some market conditions, a purchase at a higher price than initially quoted might actually represent a better execution for all participating accounts for example, after a rally in Treasury bond prices.

DCI's allocation procedures are designed to provide sufficient flexibility to accommodate a range of client mandates and a variety of specific client restrictions. To this end, our allocation procedures include screening portfolios for minimum permissible security quality, average portfolio quality, other quality restrictions as well as a variety of weighting and risk restrictions and preferences. Portfolios that do not allow the quality or quantity of the security being purchased are eliminated from the allocation process. Emphasis is given to portfolios that are the most underweight relative to our target portfolio weighting in the relative sector. Position size also becomes a factor in this process as available cash and other considerations might prohibit allocation to certain accounts.

Given the nature and supply of certain fixed income securities, often a portfolio can (or must) be allocated a comparable security to that received by other accounts. Often, DCI cannot obtain sufficient quantities of the bond due to market conditions, but may obtain more bonds later in the trading period. In these situations, DCI will allocate based on the factors described above and settle the initial trades. New allocations will occur if

additional bonds become available later in the day, using the same criteria outlined above. We do not give preference to portfolios based upon size, fees, performance, or any other criteria other than those outlined above. Any private pooled investment vehicle with substantial ownership by DCI and its personnel will be treated the same as other clients for allocation purposes. Finally, because DCI offers a set of different investment strategies to its various clients, it is conceivable that different decisions can be made concerning the timing to purchase or sell a particular bond for clients within any particular strategy.

Limitations placed on securities or sectors eligible for investing (for example, “do not invest in companies engaged in a particular type of business or industry” or “do not invest in companies conducting business in various countries”) may reduce DCI’s opportunity to aggregate trades for other clients as effectively as might otherwise be the case – whether those restrictions were imposed by any DCI client, or by any applicable statute, rule or regulation.

### **Item 13    Review of Accounts**

While the underlying securities within the accounts DCI manages are continually monitored, accounts are also reviewed at least monthly. The overall performance of the separate accounts and funds is reviewed in the context of the investment objectives and guidelines of each portfolio as well as any investment restrictions provided by the client. DCI Operations monitors all separate account and fund investment restrictions on a daily basis, using our proprietary in-house application. Investment restrictions issues are brought to the attention of the DCI Risk Committee. More frequent reviews may be triggered by material changes in variables such as the client's individual circumstances, or the market, political or economic environment.

These accounts are reviewed by: DCI Operations staff, DCI Portfolio Managers, DCI Risk Committee.

REPORTS: In addition to the monthly statements and confirmations of transactions that clients receive from their administrator or custodian, we provide monthly reports summarizing account performance and net assets.

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

It is DCI's policy not to engage solicitors or to pay related or non-related persons for referring potential clients to our firm.

It is DCI's policy not to accept or allow our related persons to accept any form of compensation, including cash, sales awards or other prizes, from a non-client in conjunction with the advisory services we provide to our clients.

### **Item 15    Custody**

In addition to the periodic statements that clients receive directly from their custodians,

we also send performance statements directly to our clients on a monthly basis.  
Our firm does not have actual or constructive custody of client accounts.

## **Item 16 Investment Discretion**

Clients hire us to provide discretionary asset management services, in which case we place trades in a client's account without contacting the client prior to each trade to obtain the client's permission.

Our discretionary authority includes the ability to do the following without contacting the client:

- determine the security or derivative position to buy or sell; and/or
- determine the amount of the security to buy or sell

Clients give us discretionary authority when they sign a discretionary agreement with our firm, and may limit this authority by giving us written instructions. Clients may also change/amend such limitations by once again providing us with written instructions.

DCI requires that it be provided with written authority to determine which securities and the amounts of securities that are bought or sold in a client's account.

Clients give us discretionary investment authority when they sign a discretionary agreement with our firm, and may limit this authority by giving us written instructions. Clients may also change/amend such limitations by once again providing us with written instructions.

## **Item 17 Voting Client Securities**

As a matter of firm policy, we may vote proxies on behalf of clients. However given that DCI currently does not invest in equity securities, there are seldom proxy votes required.

## **Item 18 Financial Information**

Under no circumstances do we require or solicit payment of fees in advance of services rendered. Therefore, we are not required to include a financial statement.

As an advisory firm that **maintains discretionary authority for client accounts**, we are also required to disclose any financial condition that is reasonable likely to impair our ability to meet our contractual obligations. DCI has no additional financial circumstances to report.

DCI has not been the subject of a bankruptcy petition at any time during the past ten years.