

# **F-Squared Investments, Inc.**

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## **Form ADV, Part 2A Brochure**

July 31, 2011

This brochure provides information about the qualifications and business practices of F-Squared Investment Inc., (hereinafter "F-Squared Investment Inc."). If you have any questions about the contents of this brochure, please contact us at 866-288-7657 or [info@f2inv.com](mailto:info@f2inv.com). 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.

Any reference to or use of the terms "registered investment adviser" or "registered," does not imply that F-Squared Investment Inc. or any person associated with F-Squared Investment Inc. has achieved a certain level of skill or training.

Additional information about F-Squared Investment Inc. 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. The CRD number for F-Squared Investments, Inc. is 146673

## **Item 2: Summary of Material Changes**

**Revised July 31, 2011**

There are no material changes to disclose as a result of creating the new Firm Brochure ADV Part 2 for 2011. F-Squared Investment Inc. maintains its management style, investment strategies, client relations, industry standards, fee structure, and educational programs.

The last annual update of ADV Part II was on 12/17/2010.

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## Item 4: Advisory Business

### ***Description of our Firm:***

Founded in 2006, F-Squared Investment Inc. is an index manager and SEC registered investment management firm located in Wellesley, Massachusetts, that provides investment advisory and portfolio management services for a wide range of clients.

F-Squared Investment Inc. is a wholly owned subsidiary of F-Squared Investment Management, LLC. F-Squared Investment Management is a privately owned company with no individual shareholder owning more than 25% of the company.

### ***Types of Advisory Services We Offer:***

F-Squared Investment Inc. provides active index solutions and offers investment management services to a wide range of clients. We offer two primary suites of investment solutions:

- **AlphaSector™ Strategies:** Investment portfolios designed to create long-term value by avoiding losses. These portfolios track our family of AlphaSector Indexes, and are actively offered to Advisors, Brokers, Wealth Managers, Family Offices, Trust Companies, and Institutional Investors. Individual investors can access the strategies through one of our sub-advised mutual funds or our many distribution partners. Investment portfolios are delivered in multiple formats and through many operational means to meet the needs of our clients.
- **Custom Replication Solutions:** Investment solutions derived from our proprietary PoRT™ technology that allows F-Squared to accurately clone most actively managed equity mutual funds. This investment solution is targeted to solving significant business challenges such as hedging active manager basis risk of variable annuities or enabling construction of low cost custom portfolios of active managers. While this suite of investment solutions is typically targeted to Institutional Investors, investment portfolios tracking our suite of AlphaCycle™ Indexes are actively offered to Advisors, Brokers, Wealth Managers, Family Offices, Trust Companies, Consultants, and Institutional investors.

### **Separately Managed Accounts, Model Portfolios, and Institutional Separate Accounts**

F-Squared creates multiple investment strategies eligible for sale as Separately Managed Accounts (SMAs), Institutional Separate Accounts, or Model Portfolios. These strategies typically track one of our AlphaSector or AlphaCycle Indexes.

### **Sub-Advisory Services**

F-Squared currently sub-advises several mutual funds that are readily available to individual investors. In addition, F-Squared creates multiple investment strategies eligible for sale as sub-advisory solutions to mutual funds, exchange traded funds (ETFs) and variable annuities (VAs). The fees charged by F-Squared for sub-advisory solutions for use within commingled vehicles are negotiated.

The minimum for these services is \$25 million.

## Custom Replication Solutions

F-Squared creates multiple investment strategies eligible for sale to Institutional Investors through our Custom Replication Solutions services. In most cases, F-Squared delivers the investment solutions as model portfolios for execution on the client's investment platform, or to the trading and custodial provider of their choice.

Our Custom Replication suite builds off of F-Squared's proprietary technology engine, Portfolio Replication Technology (PoRT™). PoRT allows F-Squared to replicate, through the use of public information, most equity-based mutual funds, closed end funds, or variable trust funds in the United States. F-Squared does not replicate individual funds, but instead replicates select, custom portfolios of funds ("Target Portfolio"). The basket of funds that make s up the Target Portfolio is either 1) selected by the Institutional Investor or Consultant (alpha generation objective), 2) determined by an existing investment portfolio that the client wishes to see replicated (e.g. existing executive deferred compensation plan), or 3) one of our 18 AlphaCycle Indexes of actively managed mutual funds (alpha generation objective).

F-Squared's proprietary Customized Replication Solutions provide Consultants and Institutional Investors:

- Access to the performance of world class managers at below market minimums
  - Fully integrated, multi-manager portfolios
  - Open architecture platform
  - Selection of a portfolio of any publicly listed domestic equity mutual fund (including funds closed to new investments)
    - Selection can be based on manager preference or portfolio characteristics
  - Optimal diversification of process and managers
- No restrictions on buy discipline or sell discipline
  - Board approval of concept rather than individual managers improves timeliness of manager changes
- Superior compliance and risk controls
  - Transparency of holdings
  - Internal control of operations including compliance, custody, trading and valuation
- Fees are well below industry averages; elimination of traditional mutual fund fees; no layering of fees

Applications for Custom Replication Solutions address critical needs of Institutional Investors, including needs that might have been previously unmet. Examples include:

- Alpha generation for public or private pension plans, endowments, foundations, and fund of fund structures
- Hedging of active manager basis risk for variable annuity (VA) providers
- Replication of Company-Owned or Business-Owned Life Insurance and Executive Deferred Compensation plans, allowing sponsor firms to recapture the expense ratio and associated working capital

## ***Tailored Advisory Services:***

F-Squared Investment Inc. is an index provider and model manager, offering investment strategies that track our AlphaSector and AlphaCycle Indexes. Although our primary business is that of index provider

and model manager, F-Squared Investment Inc. may offer custom advisory services to Institutional Investors. As the majority of our investment services involve model management, we generally do not allow clients to impose restrictions on investing in certain securities or types of securities.

***Wrap Fee Programs:***

F-Squared Investment Inc. does not currently participate in any wrap fee programs by providing portfolio management services.

***Assets under Advisement:***

As of 7/30/2011, the total assets under advisement for F-Squared Investment Inc. are as follows:

<b><i>Discretionary:</i></b>	\$565,828,525
<b><i>Non-Discretionary:</i></b>	<u>\$1,111,769,078</u>
<b><i>Total:</i></b>	\$1,677,597,603

## Item 5: Fees and Compensation

***Fee Schedule:***

F-Squared receives an investment management fee for its advisory services based on the market value of the assets under advisement. The most typical pricing options for providing SMAs or Model Portfolios, excluding operational costs, are as follows:

<u>ASSET LEVEL</u>	<u>ALPHACYCLE STRATEGIES</u>
Asset levels up to \$100 million:	35bp (0.35%)
Asset levels > \$100 million and < \$500 million:	25bp (0.25%)
Asset levels > \$500 million:	20bp (0.20%)

<u>ASSET LEVEL</u>	<u>ALPHASECTOR STRATEGIES (MONTHLY)</u>
Firm asset levels up to \$25 million:	40bp (0.40%)
Firm asset levels > \$25 million and < \$100 million:	35bp (0.35%)
Firm asset levels > \$100 million:	30bp (0.30%)

<u>ASSET LEVEL</u>	<u>ALPHASECTOR PREMIUM STRATEGIES (WEEKLY)</u>
Firm asset levels invested in premium strategies up to \$100 million:	60bp (0.60%)
Firm asset levels invested in premium strategies > \$100 million:	55bp (0.55%)

The most typical fees charged by F-Squared for our Custom Replication Solutions are as follows, although these fees may be subject to negotiation:

<u>ASSET LEVEL</u>	<u>CUSTOM REPLICATION</u>
Asset levels up to \$100 million:	25bp (0.25%)
Asset levels > \$100 million and < \$250 million	22.5bp (0.225%)
Asset levels > \$250 million and < \$1 billion	20bp (0.20%)

***How Fees are Paid:***

Generally, firms are billed at the end of each quarter on any assets under management that utilize our investment strategies. Firms that utilize our investment strategies may choose different billing methods for applying fees to the underlying investors.

***Other Types of Fees or Expenses:***

Costs of trading and operations for the SMA and Model Portfolio are determined by the SMA platform sponsor or trading platform. Fee collection schedules are typically assigned by the platform sponsor. These fees may be negotiable based on operational support and expected future asset growth.

All fees paid to F-Squared Investment Advisors are for investment advisory services and are separate and distinct from the fees and expenses charged by the underlying Exchange Traded Funds used in our models. Mutual Fund expenses are described in each fund's prospectus. Accordingly, clients should review both the fees charged by the ETF's and the fees charged by F-Squared Investment Inc. to fully understand the total amount of fees to be paid and evaluate the advisory services being provided.

In addition to the advisory fees charged by F-Squared Investment Inc., clients may also incur fees and expenses charged by custodians and imposed by broker dealers, including but not limited to any transaction charges imposed by a broker dealer with which an independent investment manager effects transactions for the client's account(s). See item 12 which describes our brokerage practices and details the process for reviewing and recommending a broker dealer for clients' transactions in applicable situations.

Although F-Squared Investments bills its clients in arrears, some SMA Platforms or investment advisors that utilize our investment strategies may choose to bill the underlying investor in advance. Investors should refer to their investment advisor or SMA Platform provider for information on billing practices, and where applicable, their policy on refunds for "fees in advance" payment structures.

The fees charged by F-Squared for sub-advisory solutions for use within commingled vehicles are negotiated.

Neither F-Squared Investment Inc., or any of its supervised employees receive additional compensation for the sale of securities or other investment products to our clients.

**Item 6: Performance-Based Fees**

F-Squared Investment Inc., does not charge performance-based fees.

**Item 7: Types of Clients**

F-Squared Investment Inc. provides investment advisory services to a number of clients including wealth management and investment advisory firms, investment companies, pensions, endowments, trusts, and individuals.

There are minimums for accounts, varying by account type.

The minimums for the SMAs are typically determined by the SMA platform sponsor or operational provider, and can range from \$50,000 to \$250,000 for individual accounts. Institutional accounts typically have a minimum of \$10,000,000. Costs of trading and operations for the SMA and Model Portfolio are determined by the SMA platform sponsor or trading platform. Fee collection schedules are typically determined by the platform sponsor. These fees may be negotiable based on operational support and expected future asset growth.

F-Squared creates multiple investment strategies eligible for sale as sub-advisory solutions to mutual funds, exchange traded funds (ETFs) and variable annuities (VAs). The fees charged by F-Squared for sub-advisory solutions for use within commingled vehicles are negotiated. The minimums for these services are \$25 million.

F-Squared Investment Inc. may waive any and all minimum account requirements at their sole discretion.

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

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

***The AlphaSector Strategies*** use a purely technical analysis model that is designed to modestly outperform its assigned benchmark in growth markets and significantly outperform its benchmark during bear markets. Our model is based on three primary components:

- Historical Price Return
- Volatility
- Changing Levels of Volatility

Our model analyzes past market movements and applies that analysis to the present in an attempt to recognize recurring patterns of investor behavior and potentially forecast performance of a particular sector relative to cash returns. This results in a binary decision that determines whether a sector is either included or removed from the portfolio.

***The AlphaCycle Strategies*** are based primarily on a quantitative analysis model driven by F-Squared's proprietary technology engine, Portfolio Replication Technology (PoRT™). PoRT allows F-Squared to replicate, through the use of public information, most equity-based mutual funds, closed end funds, or variable trust funds in the United States. F-Squared does not replicate individual funds, but instead replicates select, custom portfolios of funds ("Target Portfolio"). The basket of funds that make s up the Target Portfolio are either 1) selected by the Institutional Investor or Consultant (alpha generation objective), 2) determined by an existing investment portfolio that the client wishes to see replicated (e.g. existing executive deferred compensation plan), or 3) one of our 18 AlphaCycle Indexes of actively managed mutual funds (alpha generation objective).

F-Squared uses a variety of public information as inputs into our PoRT engine. We access the information through a variety of commercially available data services including Morningstar, Standard &



Poors, Lipper, and others. We also access certain data from public websites. All information used in our approach is publicly available information. Specific sources of information as input to PoRT includes:

- Daily values of the Target Portfolios or the AlphaCycle Indexes as published by the New York Stock Exchange;
- Daily Net Asset Values (NAVs) of the underlying mutual funds in the indexes;
- Total performance returns for all stocks in the investable universe for each Index;
- Publicly disclosed data representing complete or partial historical holdings data for all funds within each Index (mutual funds periodically publish historical holdings data to the SEC, with the most common frequency quarterly with a 30 - 45 day lag).

F-Squared also receives data input into the process from outside investment firms, data providers, or consultant firms for either our AlphaSector Indexes or AlphaCycle Indexes. These firms include Morningstar, Standard & Poors, New Found Research, and Active Index Solutions.

### ***Investment Strategies:***

F-Squared primarily offers two suites of products: Custom Replication Solutions and AlphaSector strategies.

**AlphaSector** Indexes are a suite of investments that are designed to meet the REAL needs of investors: relative outperformance in rising markets, and significant risk controls in declining markets. Avoiding losses has been proven to both improve wealth creation and increase the success rate of systematic withdrawal programs for either individual or Institutional Investors.

All of the AlphaSector Indexes (currently eleven) invest in exchange traded funds (ETFs) with all security decisions made with the intent of avoiding losses, in particular significant market declines. In periods of extreme market distress, a partial or complete allocation to short-term bonds (a “cash equivalent” investment) is allowed. Cash is viewed as the only safe haven in times of significant bear markets.

This approach to investing is taken for two reasons. First, losses have an exponentially negative impact on long-term returns (a 50% loss requires a subsequent 100% gain to return to breakeven). Second, when comparing the frequency and extent of extreme losses versus extreme gains of most equity asset classes, the extreme losses are both much more frequent and cumulatively greater than the extreme gains. Focusing all decisions on avoiding losses creates an “odds-in-your-favor” approach to investing.

The investment models, portfolio design, and ETFs within the portfolio for our flagship US equity versions of the Indexes have been used to manage actual clients assets back to April, 2001 (primarily in the form of SMAs), and are therefore stress-tested across two bear markets and a bull market. The core philosophy and methodology behind our AlphaSector strategies and Indexes were designed to meet the REAL needs of individual and wealth investors. This means that our AlphaSector suite of Indexes and strategies is designed to modestly outperform their benchmarks in normal bull markets, but dramatically outperform in significant down markets or bear markets.

AlphaSector strategies provide superior downside risk management, especially in weak markets. They represent a powerful but simple story, and use NO derivatives, leverage, or shorting.

This dual approach - perform as relative performers in up markets but act more like absolute return investments in down markets - is specifically designed to increase an investor's likelihood of meeting

their investment goals over a full market cycle, whether their targeted investment goal is wealth creation or wealth distribution.

There is a growing amount of research that points to significant losses as dramatically impairing an investor's ability to create sustainable growth of their assets over time. A simple example of this is the devastating Bear Market of 2008 and 2009. During this market collapse, the S&P 500 reached a low in early March, 2009, and at its bottom, the decline had wiped out six years of prior returns of the S&P 500. In just ten months from mid-May 2008 to early March 2009 the S&P 500 declined -51%. For the S&P 500 to recover the losses for that ten month span, it would take 6.5 years of compounding market growth based on the longer term returns of the S&P 500.<sup>1</sup>

Additionally, there is a large volume of research that points out that the single biggest threat to systematic withdrawal (institutional) or retirement income (individual) objectives is significant market losses. Therefore, the singular focus of AlphaSector on avoiding losses ideally positions this suite of strategies for retirees and endowments, foundations, and plan sponsors looking to reliably meet their annual funding commitments.

<sup>1</sup>Sources: Morningstar Direct, Financial Research Corporation, Dover Research, and F-Squared Investments

## Portfolio Construction and Design

The domestic equity strategies (AlphaSector Rotation and Premium) invest in exchange traded funds (ETFs) representing the 9 sectors of the S&P 500 or short-term Treasuries. The implementation of the strategy is exclusively through ETFs, which are low cost, highly liquid index-linked vehicles tracking the performance of each respective sector. The ETFs most often used are published by State Street Global Advisors, and include the Select Sector SPDRs and an ETF tracking short term Treasury securities as the proxy for cash. As such, there are a maximum number of 9 securities in the portfolio at any one time, resulting in operational ease and lower transaction costs.

AlphaSector Global and International include ETFs that represent MSCI EAFE (EFA) and Emerging Markets (EEM).

AlphaSector Allocator is a fully diversified portfolio adding in ETFs tracking traditional fixed income asset classes and “alternative” asset classes such as gold and REITs.

All monthly AlphaSector Index portfolios are rebalanced monthly. All Premium Indexes are reviewed weekly for reconstitution and rebalancing.

Default “position” within each Index is to have all available ETFs (other than cash) invested and equally weighted within that index or sleeve. Decisions to remove a sector or asset class from the portfolio at any time are based on a probabilistic determination that that sector or asset class is viewed as likely to lose money on a forward looking basis.

For example, the flagship US Equity AlphaSector Indexes determine when to “turn off a sector” through analysis from a proprietary analytical engine that evaluates “true” sector trends while adjusting for market “noise” and for changing levels of volatility within each sector. ETFs are included in the portfolio based on a binary model: A positive signal results in inclusion in the portfolio, and a negative signal results in complete removal from the portfolio. All sectors, or asset classes included in an index or sleeve of the Global and Allocator indexes, are equal weighted. The maximum allocation to any one sector within the domestic equity indexes is capped at 25% of the portfolio.

When our models signal a Bear Market (defined as having 6 or more of the 9 US sector ETFs removed due to the expectation of future losses) AlphaSector will begin to build a position in short-term Treasuries, which can include up to 100% of the portfolio. This ability to automatically shift to a defensive position in times of broader market weakness is critical to the portfolio's ability to manage downside risk exposures and protect client returns.

For more information about the philosophy, methodology and construction of any individual AlphaSector Index, please see our website at [www.f-squaredinvestments.com](http://www.f-squaredinvestments.com).

**Custom Replication** - AlphaCycle Indexes are select portfolios of best-in-class actively managed mutual funds that have been selected by third-party institutional consultants. By using disciplined means of determining when to add funds to the portfolio and when to remove them, AlphaCycle attempts to capture excess return from the managers for the period of time during which they outperform the market. There are 18 discrete AlphaCycle strategies covering most domestic equity asset classes. All AlphaCycle products are designed to consistently outperform their benchmarks and peer groups with modestly reduced risk.

F-Squared generates its custom replication investment solutions through a two-step process:

1. Construction of custom portfolios of actively managed mutual funds. This can be done to achieve consistent outperformance (alpha generation) or to reflect an existing investment portfolio where conversion to individual securities offers investment or financial benefits.
2. Creation of Tracking Portfolios of individual stocks (delivered as Model Portfolios).

#### **Creation of Alpha through the construction of portfolios of actively managed mutual funds**

Typically, Institutional Investors will select the portfolio of mutual funds themselves based on the objectives of either alpha generation or replication of an existing portfolio of funds. F-Squared also offers an "off the shelf" version available for sale through our Replication services - AlphaCycle Indexes.

A subsidiary of F-Squared, Active Index Solutions creates and publishes a series of specialty indexes (AlphaCycle Indexes and AlphaSector Indexes) covering a wide range of investment strategies and asset classes. As of January 2011, F-Squared, had 26 such indexes, 19 of which are published daily by either the New York Stock Exchange or NASDAQ OMX.

Each AlphaCycle Index is constructed utilizing the principles of AlphaCycle investing and consists of a select portfolio of 'best in breed' mutual funds, with the funds selected annually by third party institutional consultants. The Net Asset Value and the Gross of Fee values of each AlphaCycle Index are published daily by the New York Stock Exchange. Complete performance information for all AlphaCycle Indexes can be found at [www.activeindexsolutions.com](http://www.activeindexsolutions.com).

The construction process of the Indexes can be seen in detail at [www.activeindexsolutions.com](http://www.activeindexsolutions.com), but the core principles of AlphaCycle Investing include:

1. Professional selection of "best of breed" mutual funds;
2. Multi-manager implementation, creating diversification at the process level (typical Index has 10 underlying mutual funds);
3. Strict sell discipline and embedded manager rotation - An annual reconstitution of the index constituent funds occurs February 15 of every year, and is designed to ensure that the Index maintains a current version of "best in class" actively managed mutual funds at all times.

### **Creation of Tracking Portfolios of individual stocks**

F-Squared Investments builds portfolios of investible securities (Tracking Portfolios or investment models) which are designed to track, as closely as possible, the performance of portfolios of actively managed mutual funds ("Target Portfolios"). Target Portfolios can include the AlphaCycle Indexes. These portfolios are delivered as Model Portfolios for SMAs and IMAs, and Institutional Separate Accounts for institutional and sub-advisory mandates. *F-Squared **DOES NOT GUARANTEE** that the performance of the tracking models will replicate the performance of the target AlphaCycle Index.*

Using sophisticated replication technology, our proprietary Portfolio Replication Technology (PoRT™), F-Squared is able to build tracking portfolios of individual securities for each Target Portfolio. Only public information is used by PoRT.

PoRT™ is the result of development, testing, and usage dating back to the late 1990's. This technology allows us to create an investment solution (a portfolio of individual stocks) that avoids a direct investment into the Target Portfolio's underlying basket of mutual funds. In fact, there are no costs to the investor from either investing in the underlying funds (they are never purchased) or for any licensing fee to the underlying funds, and therefore there is no layering of fees. This approach allows F-Squared to reduce the total fees charged to levels that are 50% or more below those of traditional investment management fees\*. \*(Sources: Morningstar Direct, Financial Research Corporation, Dover Research, and F-Squared Investments)

*For the sake of clarity, F-Squared Investment Inc.'s investment solutions do not include the direct investment into any mutual fund. All investments are into portfolios of individual stocks that are generated by PoRT. This approach allows us to capture the alpha from the Target Portfolios without the layering of fees, operational restrictions, and potential illiquidity that occurs from investing in underlying mutual funds.*

The only inputs into PoRT are publicly available information, which includes the daily performance result of the Target Portfolio and the underlying funds, historical fund holdings as periodically reported to the SEC, and other data deemed useful by F-Squared. PoRT then uses a dynamic regression engine on top of a massive scale optimizer to generate the Tracking Portfolios or Model Portfolios.

F-Squared Investments was designed from its inception to optimally leverage its replication technology. This allows us to both implement our Custom Replication solutions while also significantly reducing costs. F-Squared does not employ expensive portfolio managers or investment analysts for this effort, nor does it have the additional day to day costs associated with traditional investment professionals. This allows us to be the industry's low cost leader for delivering active management. We are also not tied to proprietary investment teams, and can therefore fully deliver the open architecture platform required for AlphaCycle Investing.

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

All investments in securities include a risk of loss that clients should be prepared to bear. This includes the risk of capital (invested amount) and any profits that have not been realized. Stock and bond markets may fluctuate substantially over time, and performance of any investment is not guaranteed.

Our investment strategies may not achieve their objectives, and they are not intended to be a complete investment program.

The principal risks of our strategies are :

- **Market Risk:** The risk that the value of the securities in which the strategies invest may drop in reaction to tangible and intangible events and conditions, independent of a security's particular underlying circumstances. For example, political, economic, and social conditions may cause a change in the value of the securities. Price changes may be temporary or may last for extended periods.
- **Equity Securities Risk:** The risk that events or circumstances at a particular industry, or a particular company within an industry will impact the value of the stocks and ETF's held by the strategy and thus, the value of your investment over short or extended periods.
- **Interest-Rate Risk:** The risk that fluctuations in interest rates may cause investment prices to fluctuate and impact the value of Fixed Income securities or ETF's held by the strategy. For example, when interest rates rise, yields on existing bonds become less attractive causing their market values to decline.
- **Exchange-Traded Funds (ETFs) Risk:** The risk that the value of an ETF that the strategies invest in will be more volatile than the underlying portfolio of securities the ETF is designed to track, or that the costs to the fund of owning shares of the ETF will exceed those the fund would incur by investing in such securities directly.
- **Sector Concentration Risk:** The risk that events negatively affecting an industry or market sector in which the strategy invests will cause the overall value of the strategy to decline. To the extent that some of our investment strategies invest significant portions of their strategy in ETF's representing particular markets or sectors (such as Energy, Healthcare, Real Estate, etc.) or in an ETF representing U.S. Treasuries, the strategy is more vulnerable to conditions that negatively affect such sectors as compared to investment strategy that is not significantly invested in such sectors.
- **Turnover Risk:** The risk that frequent trading will result in increased brokerage and other transaction-related costs, as well as less favorable tax treatment of short-term capital gains that can negatively impact your overall investment as compared to investments in strategies with low turnover. Some of our investment strategies may involve frequent trading and/or turnover and investors should carefully consider the impact of taxes and brokerage costs on their investment portfolio.
- **U.S. Government Securities Risk:** The risk that U.S. Government securities in the strategy will be subject to price fluctuations, or that an agency or instrumentality will default on an obligation not backed by the full faith and credit of the United States.
- **Quantitative Risk:** The risk that the effectiveness of the quantitative model used for the strategy can dissipate over time as similar strategies are adopted and as the market becomes more efficiently priced.

## **Item 9: Disciplinary Information**

F-Squared Investment Inc. has no 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.

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

### ***Broker-Dealer Affiliations***

F-Squared Investment Inc., nor any of its management persons are registered, or have an application pending to register, as a broker-dealer or a registered representative of a broker-dealer.

### ***Futures/Commodities Affiliations***

F-Squared Investment Inc., nor any of its management persons are registered, or have an application pending to register, as a futures commission merchant, commodity pool operator, commodity trading advisor, or an associated person of the foregoing entities.

### ***Investment Company Affiliations***

F-Squared Investment Inc. maintains a relationship with Virtus Investment Partners of Hartford, Connecticut and serves as sub-adviser for one open-end mutual funds registered under the Investment Company Act of 1940. The mutual fund is the AlphaSector Rotation Fund.

### ***Investment Adviser Affiliations***

F-Squared Investment Inc., is a subsidiary of F-Squared Investment Management, LLC. Other subsidiaries of F-Squared Investment Management, LLC include F-Squared Institutional Advisors, LLC, F-Squared Retirement Solutions, LLC, F-Squared Alternative Investments, LLC, and F-Squared Institutional Solutions, LLC.

The relationships or arrangements described above do not create a material conflict of interests with any of our clients.

F-Squared does not recommend or select other investment advisers for our clients and receive compensation directly or indirectly from those clients.

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

Pursuant to SEC Rule 204A-1, F-Squared Investment Inc. has adopted a Code of Ethics which sets forth high ethical standards of business conduct for our employees and governs a number of potential conflicts of interest that we may encounter when providing investment advisory services. This Code is based on the principle that F-Squared Investment Inc. owes a fiduciary duty to the investors for which we serve as an adviser. In adherence with this Code, F-Squared and its employees must avoid activities, interests and relationships that might interfere or appear to interfere with making decisions in the best

interests of our Advisory Clients. The Code seeks to place the interests of F-Squared Investment Inc. Clients over the interests of the firm and any of its employees, and to comply with the applicable Federal Securities Laws and other applicable law.

We distribute the code to each employee at the time of hire and annually thereafter. Each employee is required to sign the Code acknowledging that they have read, understand, and will abide by the Code and its requirements. Our compliance department conducts training and monitors employee activity to ensure compliance with the Code.

F-Squared Investment Inc. will provide a copy of our Code of Ethics to any client or prospective client upon request.

Our Code includes, but is not limited to the following:

- Requirements on fiduciary duty
- Prohibitions on the acceptance of gifts and entertainment that exceed our policy standards
- Prohibitions on insider trading and communication of material non-public information
- Requirements on the handling of confidential information
- Requirements for pre-clearance of employee transactions
- Identification and pre-clearance requirements on accounts where employees have beneficial interest
- Requirements for reporting all personal securities transactions

#### ***Personal Securities Transactions Requirements***

An Access Person, defined as an employee with access to confidential information related to the firm's investment strategies, must not engage, and must not permit any other person or entity to engage, in any purchase or sale of a Covered Security in which such Access Person has, or by reason of the transaction will acquire any direct or indirect Beneficial Ownership, unless (i) the transaction is an Exempt Transaction (as set forth below) or (ii) he/she has have complied with the provisions set forth below.

#### ***Pre-clearance***

Access Persons must seek to obtain pre-clearance trading approval from the Compliance Committee to purchase or sell any Covered Security for which the person has or will have by reason of the trade a Beneficial Ownership and that the Adviser actively engages in trading, advisory services or performs research on such Covered Security.

Finally, Access Persons must seek to obtain pre-clearance trading approval from the Adviser before directly or indirectly acquiring Beneficial Ownership in any Security in an Initial Public Offering or in a Limited Offering.

#### ***Beneficial Ownership***

To determine whether a person has "Beneficial Ownership," Access Persons are considered to have Beneficial Ownership of Securities if such Access Person, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise have or share a direct or indirect "pecuniary interest" in such Securities.

An Access Person has a pecuniary interest in the Securities if such Access Person has the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the Securities.

The following are examples of an indirect pecuniary interest in Securities:

Securities held by members of an Access Person's Immediate Family sharing the same household; however, this presumption may be rebutted by convincing evidence that profits derived from transactions in these Securities will not provide such Access Person with any economic benefit where "Immediate Family" means any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, and includes any adoptive relationship.

An Access Person's proportionate interest as a general partner in portfolio Securities held by a general or limited partnership.

An Access Person's interest as a manager-member in the Securities held by a limited liability company.

Access Persons do not have an indirect pecuniary interest in the portfolio Securities held by a corporation or similar entity in which he/she owns securities if such Access Person is not a controlling shareholder of the entity and does not have or share investment control over the entity's portfolio.

The following circumstances constitute Beneficial Ownership of Securities held by a trust by an Access Person:

If an Access Person is a trustee of the trust and has a pecuniary interest in any holding or transaction in the issuer's Securities held by the trust as well as if an Access Person is trustee and members of such Access Person's Immediate Family receive certain performance fees or a member of such Access Person's Immediate Family is a beneficiary to the trust.

If an Access Person is a beneficiary to a trust and such Access Person (a) shares investment control with the trustee with respect to a trust transaction, the transaction shall be attributed to such Access Person as well as the trust, (b) has investment control with respect to a trust transaction without consultation with the trustee, the transaction shall be attributed to such Access Person and (c) such Access Person shall be deemed to have pecuniary interest in the issuer's securities held by a trust to the extent of such Access Person's pro rata interest in the trust where the trustee does not exercise exclusive control. For instance, an Access Person who holds securities as a beneficiary of a trust over which he has investment discretion, such as a 401(k) or other participant-directed employee benefit plan, would be considered beneficial owner of Securities in the plan.

If you are a settlor of a trust and reserve the right to revoke the trust without the consent of another person, the trust holdings and transactions shall be attributed to you; provided, however, if the settlor does not exercise or share investment control over the issuer's securities held by the trust, the trust holdings and transactions shall be attributed to the Trust instead of you as settlor.

### ***Exempt Securities***

Access Persons are required to report all transactions in Covered Securities. The following are not considered Covered Securities:

- Direct obligations of the Government of the United States;



- Bankers' acceptances, bank certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements;
- Shares issued by money market Funds;
- Shares issued by open-end Funds except Reportable Funds.

### ***Initial Public Offerings***

Access Persons must obtain prior written approval of the Chief Compliance Officer to acquire direct or indirect Beneficial Ownership of any Security in an Initial Public Offering.

### ***Limited Offerings***

Access Persons must obtain prior written approval of a majority of the Compliance Committee to acquire direct or indirect Beneficial Ownership of any Security in a Limited Offerings. Approval will not be given unless a determination is made that the investment opportunity has not been offered to you by virtue of your position.

Upon receiving pre-clearance, if you have acquired Beneficial Ownership in Securities in a Limited Offering, you must disclose your investment when you play a part in any consideration of an investment by an Advisory Client in the issuer of the Securities.

## **Item 12: Brokerage Practices**

As a model manager, any selection or recommendation of broker-dealers for client transaction is generally made by the SMA manager and not F-Squared Investment Inc..

For institutional accounts, F-Squared may from time to time recommend a broker-dealer to execute the trading of underlying securities. In those circumstances, F-Squared will use best efforts to select and recommend a broker dealer that will provide the best services at the lowest commission rates. When reviewing a brokerage firm and the services they provide, our assessment includes, but is not limited to the following:

- Reputation/Stability of brokerage firm
- Ability to execute trades in a timely and efficient manner
- Ability to interface with client's custodian bank
- Competitive Commission Rates

As a model manager, practices surrounding Research and Other Soft Dollar Benefits are not applicable. F-Squared Investment Inc. does not receive research or other products or services from a broker-dealer or a third party in connection with client securities transactions.

As a model manager, practices surrounding aggregation of purchase or sale of securities for client accounts are not applicable. Any aggregation of orders would be done by the SMA Platform Manager.

## **Item 13: Review of Accounts**

As a model manager, F-Squared Investment Inc. generally does not have access to client accounts. In limited circumstances, F-Squared will manage a limited number of accounts for friends and family or

institutional clients. These accounts are reviewed quarterly to ensure that all transactions are in accordance with model instructions and that any tracking error to the index is within a reasonably acceptable threshold. All institutional accounts are also reviewed post any trading activity to ensure proper trade execution and settlement. These accounts receive confirmation of activity reports post any trading activity and on receive account statements on a quarterly and annual basis. These reports are provided by the custodian or SMA Platform provider that administers the account.

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

### ***Other Compensation***

F-Squared Investment Inc. does not have any compensation agreements where we receive cash or other economic benefit from someone who is not a client of ours in connection with providing services to our clients.

### ***Client Referrals***

F-Squared Investment Inc. does not directly or indirectly compensate any person who is not a supervised person of the firm for client referrals.

## **Item 15: Custody**

It is our policy not to take custody of clients' securities. As such, F-Squared Investment Inc. is not granted access to our clients' accounts and does not have permission to withdraw, transfer, or otherwise move funds or cash from any client account (other than limited access to a small number of "friends and family" and institutional accounts as described below). Custodians are typically selected by the investment advisor, institutional client, or SMA Platform Manager.

F-Squared Investment Inc. maintains a small number of "friends and family" accounts through Folio Advisors, an SMA Platform Manager for which it has limited access to view balances and execute trades consistent with our models.

F-Squared Investment Inc. does not send out any statements to clients.

## **Item 16: Investment Discretion**

F-Squared Investment Inc. serves as a model manager and as policy we do not accept discretion over individual clients' accounts. F-Squared Investment Inc. does have limited investment discretion over the mutual fund assets that it sub-advises. This discretion is limited to advising on the trade allocations within the fund to match our investment models as outlined in the sub-advisory agreement with the investment company.

F-Squared Investment Inc. also maintains limited discretion over a small number of "friends and family" accounts through Folio Advisors, an SMA Platform Manager. The discretion for these accounts involves limited access to balance inquiries and execution of trades in accordance to the models for which the clients have subscribed.

F-Squared Investment Inc. also maintains limited discretion over a small number of institutional accounts. The discretion for these accounts involves limited access to balance inquiries and execution of trades in accordance to the models for which the clients have subscribed.

## **Item 17: Voting Client Securities**

F-Squared Investment Inc. serves as a model manager and as a matter of firm policy and practice, does not accept authority to vote proxies on behalf of clients. Clients may receive a copy of our proxy voting policy and procedure upon request.

As a model manager, underlying securities are held in the name of the client and under this structure they will retain the responsibility for receiving and voting proxies for any and all securities maintained in client portfolios. Generally, proxies or other solicitations will be received by the client directly from the custodian or transfer agent. Clients are encouraged to contact their SMA Platform Manager or Investment Adviser or Custodian with questions related to proxies and solicitations. If clients need further assistance with this process, they may contact F-Squared Investment Inc. at 866-288-7657 with any questions related.

## **Item 18: Financial Information**

F-Squared Investment Inc. does not require or solicit payment of fees in advance of services rendered and as such, we have not included a balance sheet.

As described in section 16 above, F-Squared Investment Inc. maintains limited discretionary authority as a sub-adviser on one mutual fund, a few institutional accounts and on a small number of “friends and family” accounts. In both circumstances described in item 16, F-Squared does not take custody of client assets and only directs trades in accordance with our models. F-Squared does not have any financial conditions that would be reasonably likely to impair our ability to meet contractual commitments to clients.

F-Squared Investment Inc. has never been the subject of a bankruptcy petition.