

# **Baughman Wealth Advisors Inc.**

## **DBA Baughman Financial Group**

**2226 Westlake Drive, #6**

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**3/25/2011**

This Brochure provides information about the qualifications and business practices of Baughman Wealth Advisors. If you have any questions about the contents of this Brochure, please contact us at (408) 354-4840 or via email at [kbaughman@baughmanfinancial.com](mailto:kbaughman@baughmanfinancial.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.

Baughman Wealth Advisors is a Registered Investment Adviser. Registration of an Investment Adviser does not imply any level of skill or training. The oral and written communications of an Adviser provide you with information that you may use to determine whether to hire or retain them. Additional information about Baughman Wealth Advisors is also available on the SEC's web site at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## Material Changes

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There were no material changes to our business in 2010.

On July 28, 2010, the United State Securities and Exchange Commission published “Amendments to Form ADV” which amends the disclosure document describing our business practices and qualifications that we provide to our clients per SEC Rules. This Brochure, dated 3/25/2011 is a new document that has been prepared according to the SEC’s new requirements and rules. This Brochure is materially different in structure and requires certain new information that our previous brochure did not provide.

In the future, this section of the brochure will discuss only the specific material changes that were made to the Brochure, provide you with a summary of all material changes that have occurred since the last filing of this Brochure and identify the date of our last annual brochure update.

In the past we have offered or delivered information about our qualifications and business practices to our clients on at least an annual basis. Pursuant to new SEC 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 which is December 31st. We will provide other ongoing disclosure information about material changes as necessary. We will also provide you with a new Brochure, as necessary, based on changes or new information. Currently, our Brochure may be requested at any time, without charge, by contacting J. Kurt Baughman at (408) 354-4840.

Additional information about Baughman Wealth Advisors is also available via the SEC’s web site [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). You can search this site by using a unique identifying number, known as a CRD number. The CRD number for Baughman Wealth Advisors is 148649. The SEC’s web site also provides information about any persons affiliated with Baughman Wealth Advisors who are registered, or are required to be registered, as investment adviser representatives of Baughman Wealth Advisors.

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## Advisory Business Introduction

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Baughman Wealth Advisors Inc. DBA Baughman Financial Group (“Baughman”) is a Registered Investment Adviser (“Adviser”) which offers portfolio management services, consulting services, financial planning, insurance planning, retirement planning and estate planning. We use stocks, bonds, mutual funds and ETFs to create your customized portfolio. We are registered through the United States Securities and Exchange Commission (“SEC”) and are regulated by the United States Securities and Exchange Commission (“SEC”), the Texas State Securities Board and the California Securities Regulation Division.

We provide investment advice through investment adviser representatives (“advisor”) associated with us. These individuals are appropriately licensed, qualified, and authorized to provide advisory services on our behalf. In addition, all advisors are required to have a college degree or four years of equivalent investment related experience, have displayed a high degree of integrity in previous business undertakings, have high moral and ethical standards and be committed to providing quality investment advice.

Baughman Wealth Advisors Inc. DBA Baughman Financial Group was founded in 2008 by Kurt Baughman, who serves as President and Chief Compliance Officer. We provide investment management services primarily to high net worth individuals and their families, trusts, estates and foundations; we may also provide services to corporate pension and profit-sharing plans, charitable organizations, endowments, corporations, and small businesses. We are committed to the precept that by placing the client’s interests first, we will add value to the asset management process and earn the client’s trust and respect. We value long term relationships among our clients whom we regard as strategic partners in our business.

## Services

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We provide various asset management and planning services, with an emphasis on individuals, their families, trusts, foundations and business owners. Our focus is on helping you develop and execute plans that are designed to build, manage and preserve your wealth.

As of 12/31/2010, we provided asset management services for 132 accounts with total assets under management of \$39,462,407.00.

This amount is managed on a discretionary basis which means, you have given us the authority to determine the following without your consent:

- Securities to be bought or sold for your account
- Amount of securities to be bought or sold for your account

- Broker- dealer to be used for a purchase or sale of securities for your account
- Commission rates to be paid to a broker or dealer for your securities transaction

While we may have trading discretion on your account (i.e., placing trades in your account without your approval), trading activity is generally limited to help minimize your trading costs. Trading may be required to meet initial allocation targets, after substantial cash deposits that require investment allocation, and/or after a request for a withdrawal that requires liquidation of a position. Additionally, your account may be rebalanced or reallocated periodically in order to reestablish the targeted percentages of your initial asset allocation. You will be responsible for any and all tax consequences resulting from any rebalancing or reallocation of the account. We are not tax professionals and do not give tax advice. However, we will work with your tax professionals to assist you with tax planning. You will have the opportunity to meet with us periodically to review the assets in your account.

## **1. Financial Planning**

We can provide analysis and recommendations for retirement, estate planning, income tax planning, life and disability insurance, investments, and college education planning. You can have us create a full financial plan or select any of the individual modules. Fee based financial planning is a comprehensive relationship which incorporates many different aspects of your financial position into an overall plan that is designed to meet your goals and objectives. The financial planning relationship consists of face to face meetings and ad hoc meetings with your other advisors (attorneys, accountants, etc.) as necessary.

Financial planning, including planning for retirement, as well as other financial goals such as education funding, planning for acquisition or startup of a business, or for acquiring real estate or other assets involves allocating pools of money to be invested for each goal, time horizon identified, asset allocation policy established and risk tolerance levels defined.

In performing financial planning services we typically examine and analyze your overall financial situation, which may include any of the following wealth management issues: Investments, insurance, liabilities, qualified plans and IRA distributions, stock options, business succession planning, durable power of attorney at incapacity, gifting to children/descendants, charitable gifting during life, titling of assets, selection of executor/trustee, distribution plan at death to spouse/descendants, and charitable inclinations at death. Our services may focus on any or all of these issues depending on the scope of our engagement with you.

You must agree to provide the information and documentation we request regarding your income, investments, taxes, insurance, estate plan, etc. You also must agree to discuss your investment objectives, needs and goals, and to keep us informed of any changes. We will work with you to create a plan that will serve as the roadmap to guide your wealth management program. We can also work with you to implement the plan and provide ongoing monitoring and updates.

We obtain information from a wide variety of publicly available sources to help us create your plan. We do not have any inside private information about any investments that are recommended. All

recommendations developed by us are based upon our professional judgment and we cannot guarantee the results of any of our recommendations. You must decide what advice to follow.

If you engage us to perform these services, you will receive a written agreement detailing the services, fees, terms and conditions of the relationship. You will also receive this Brochure. You are under no obligation to implement recommendations through us. You may implement your plan through any financial organization or professional of your choice.

## **2. Asset Management**

With an Asset Management Account, you engage us to assist you in developing a personalized asset allocation program and custom-tailored portfolio designed to meet your unique investment objectives. Asset management is the professional management of securities (stocks, bonds and other securities) and assets (e.g., real estate) in order to meet your specified investment goals. The investments in the portfolio account may include mutual funds, ETFs, stocks, bonds, municipal securities, equity options, alternative investments, etc. The minimum initial investment in a managed account is \$500,000 however; this may be negotiable depending upon other factors.

We offer several options for managing your assets. We offer third party management services, such as, Lockwood Advisors and management services by our advisor, Kurt Baughman. We will recommend the level of service that we believe fits your unique financial circumstances. To determine what will be most appropriate for you, we will meet with you to discuss your financial circumstances, investment goals and objectives, and to determine your risk tolerance. We will ask you to provide statements summarizing current investments, income and other earnings, recent tax returns, retirement plan information, other assets and liabilities, wills and trusts, insurance policies, and other pertinent information. Based on the information you share with us, we will analyze your situation and recommend an appropriate asset allocation and investment strategy. You will be provided with a strategic allocation of assets by class, as well as investment advice. Our advice and ongoing management is based upon your investment goals and objectives, risk tolerance, and the investment portfolio you have selected. We will monitor the account, trade as necessary, and communicate regularly with you. Your circumstances shall be monitored in quarterly and annual account reviews. These reviews will be conducted in person, by telephone conference, and/or via a written inquiry/questionnaire. We will work with you on an ongoing basis to evaluate your asset allocation as well as rebalance your portfolio to keep it in line with your goals as necessary. We will be reasonably available to help you with questions about your account. You will also receive our Advisory Agreement which describes what services you will receive and what fees you will be charged.

We will:

- Review your present financial situation
- Monitor and track assets under management
- Provide portfolio statements, periodic rate of return reports and asset allocation statements
- Advise on asset selection

- Determine market divisions through asset allocation models
- Provide research and information on performance and fund management changes
- Build a risk management profile for you
- Assist you in setting and monitoring goals and objectives
- Provide personal consultations as necessary upon your request or as needed

You must notify us promptly when your financial situation, goals, objectives, or needs change.

You shall have the ability to impose reasonable restrictions on the management of your account, including the ability to instruct us not to purchase certain mutual funds, stocks or other securities. These restrictions may be a specific company security, industry sector, asset class, or any other restriction you request within reason.

Under certain conditions, securities from outside accounts may be transferred into your advisory account. However, we may recommend that you sell any security if we believe that it is not suitable for the current recommended investment strategy. You are responsible for any taxable events in these instances. Your account can be managed in a tax efficient manner; however, we do not provide tax advice or tax management services.

Certain assumptions may be made with respect to interest and inflation rates and the use of past trends and performance of the market and economy. Past performance is not an indication of future performance.

If you decide to implement our recommendations, we will help you open a custodial account(s). The funds in your account will generally be held in a separate account, in your name, at an independent custodian, not with us. The identity of your custodian will be communicated to you before the account is opened. You will enter into a separate custodial agreement with the custodian. This agreement, among other things, authorizes the custodian to take instructions from us regarding all investment decisions for your account. We will select the securities bought and sold and the amount to be bought and sold, within the parameters of the objectives and risk tolerance of your account. The custodian will effect transactions, deliver securities, make payments and do what we instruct. You are notified of any purchases or sales through trade confirmations and monthly statements that are provided by the Custodian. You will at all times maintain full and complete ownership rights to all assets held in your account, including the right to withdraw securities or cash, proxy voting and receiving transaction confirmations.

You will receive, at least quarterly, a statement containing a description of all the activity in your account from the custodian. This statement lists the total value at the start of the month, itemizes all transaction activity during the month, and lists the types, amounts, and total value of securities held as of the end of the month. Your statement may be in either printed or electronic form based upon your preferences.



We will also provide you with a quarterly performance statement. These statements give you additional feedback regarding performance, educate you about our long-term investment philosophy, and describe any changes in current strategy and allocation along with the reasons for making these changes.

We are available during normal business hours either by telephone, fax, email, or in person by appointment to answer your questions.

### **3. Third Party Asset Management Providers**

We may determine that opening an account with a professional third party asset manager provider is in your best interests. We have contracts with several of these providers which provide access to third party money managers and other asset management programs. We will help you determine which asset management programs and managers most appropriately fit your needs.

These programs allow you to obtain portfolio management services that typically require higher minimum account sizes outside of the program. The money managers selected under these programs will have discretion to determine the securities they buy and sell within the account, subject to reasonable restrictions imposed by you. We will not manage, or obtain discretionary authority over the assets in the accounts participating in these programs.

Due to the nature of these programs, each of the independent money managers is obligated to provide you with a separate disclosure document. You should carefully review this document for important and specific program details, including pricing.

Under these programs, we may:

- Assist in the identification of investment objectives
- Recommend specific investment style and asset allocation strategies
- Assist in the selection of appropriate money managers and review performance and progress
- Recommend reallocation among managers or styles within the program
- Recommend the hiring and firing of money managers utilized by you

### **Lockwood**

If you elect to use Lockwood, you will sign the Client Agreement that lists both Baughman Financial Group and Lockwood. We will assist you in opening a brokerage account with the broker-dealer that is designated in the Client Agreement. Depending upon the Program selected, your account may be custodied at Lockwood's affiliate, Pershing or at a custodian not affiliated at Lockwood. The custodian for your account is detailed in your Client Agreement.

The following is a description of the specific programs offered through Lockwood:

#### ***The SMA Program***

Through the SMA Program, you have access to an array of investment managers that have met the SMA Program's research standards and are available to manage designated client investment accounts. Lockwood has contracted with these investment managers to participate in the SMA Program with

negotiated fees and account minimums for clients. SMA Program fees, and other information relating to your account(s), are defined in Schedule A of your Client Agreement.

Each Investment Manager will manage the Assets allocated to it in accordance with the investment style you determined with your advisor. Lockwood's and Baughman's sole authority in connection with the SMA Program is to carry out your direction and delegate responsibility to a money manager of your choosing.

### ***Professional Fund Select Program***

The Fund Select Program is a mutual fund and exchange traded fund ("ETF") wrap program. This Program enables you to pursue your investment objectives through the purchase and sale of mutual fund shares and, in some cases, ETFs, all in one consolidated brokerage account.

If you select the PFS Program, Lockwood will invest and reinvest Assets in the Program in no-load and load-waived mutual fund shares in accordance with the PFS investment strategy you select on Schedule C of your Client Agreement.

You will grant Lockwood complete and unlimited discretionary trading authorization as your discretionary investment manager with respect to the Assets in your accounts. Baughman's sole authority in connection with these accounts is to carry out your direction and not to make any investment decisions on your behalf.

## **4. Other Services**

Our advisors may recommend and sell life, annuity, disability, health, and long-term care insurance. We will receive the usual and customary commissions associated with these sales from the insurance company. Your advisory fee will not be reduced by any payments we receive from these sales.

We can provide research and advice concerning any legal and legitimate investment for which public information is readily available.

## **Fees and Compensation**

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We provide asset management and financial planning services for a fee. Our Advisory Agreement or Financial Planning Agreement defines what fees are charged, their frequency and the services you are entitled to receive. The fees we receive for financial planning services do not include any of the costs to implement the plan.

The fees we receive for asset management services do not include brokerage commissions, transaction fees, and other related costs and expenses. You may incur certain charges imposed by custodians, third party investment companies and other third parties. These include fees charged by managers, custodial fees, deferred sales charges, odd-lot differentials, transfer taxes, wire transfer and electronic fund fees, and other fees and taxes on brokerage accounts and securities transactions. Mutual funds, money

market funds and exchange traded funds also charge internal management and operating fees, which are disclosed in the fund's prospectus. These fees may include, but are not limited to, a management fee, upfront sales charges, 12b-1 fees and other fund expenses. All of these fees are in addition to the asset management fee you pay us. You should review all fees charged to fully understand the total amount of fees you will pay. Services similar to those offered by us may be available elsewhere for more or less than the amounts we charge.

You could invest in a mutual fund directly, without our services. However, you would not receive the services provided by us which are designed, among other things, to assist you in determining which mutual fund or funds are most appropriate to your financial condition and objectives.

You may terminate the initial agreement at any time by providing written notice to us within five (5) business days of signing the agreement. You will incur charges for advisory or consulting services rendered up to the point of termination and such fees will be due and payable by you within five business days of being billed. Refunds will be given on a pro-rata basis within five business days of cancellation. However, if the relevant disclosure statement(s) were not provided to you at least forty-eight (48) hours in advance of entering into any written or oral advisory contract with us, you may cancel within five (5) business days without penalty. Once an account is established, either party may terminate the relationship with a 30 day written notice. Upon termination of any account, any prepaid fees that are in excess of the management services performed, will be promptly refunded to you. Any fees that are due, but have not been paid, will be billed to you and are due immediately. Accounts opened during a calendar quarter will be charged a prorated fee.

## **1. Financial Planning/Consulting Fees**

You may want us to create a financial plan and/or provide financial consulting to help you meet your long-term goals and objectives. We will work with you to develop a plan that will serve as your roadmap to the future. We will write a letter of engagement which outlines the planning services to be provided to you; the complexity of your plan will dictate the amount of time necessary to complete the planning process.

The usual fee for us to create your plan is \$300 per hour; an initial deposit of \$1,500 is due from you on the effective date of your Financial Planning agreement. We will bill you in stages, as the work progresses. The Financial Planning Agreement will show the fee you will pay and the frequency of payments. Fees are negotiable. The Financial Planning Agreement will terminate once you receive the final plan.

Based upon your needs, we may also provide consultations throughout the year to advise and counsel you about other financial issues. We can help you with transition planning, major transaction analysis coordinated with cash flow needs, retirement needs, estate planning needs, income tax planning, life and disability insurance needs, investment needs, and college education planning. We charge \$300 per hour for these services.

If the plan is implemented through us, our advisors may receive compensation from the sale of insurance or alternative investment products or services recommended in the financial plan. This compensation would be in addition to the financial planning fee you pay. The fees and expenses you pay for the purchase of these products may be more or less than the expenses you would pay should you decide to implement our recommendations through another investment advisory firm or broker-dealer and are typically determined by the broker-dealer or investment company sponsoring the product.

## **2. Asset Management Fee Schedule**

Our minimum account opening balance is \$500,000; however, fees and account sizes may be negotiable depending upon a number of factors including, but not limited to the amount of assets under management as well as the number and frequency of supplemental advisor and client related services. The fee charged is based upon your invested assets. You will pay fees quarterly, in advance. Payments are due within the first five days of the respective quarterly period and will be assessed on the first day of each quarter, based upon the balance of the account under management at the beginning of the following quarter as calculated by the custodian. We assess an annual fee of 1%. You will be billed one quarter of this amount on a quarterly basis. No increase in the annual fee shall be effective without prior written notification to you. Accounts opened mid-quarter will be assessed at a pro-rated management fee based upon the number of calendar days in the calendar quarter that your agreement goes into effect. Management fees are prorated for each contribution and withdrawal made during the applicable calendar quarter (with the exception of small inconsequential contributions and withdrawals). We believe our advisory fee is reasonable considering the fees charged by other investment advisers offering similar services/programs.

You may also pay additional advisory fees to a third party money manager depending upon which manager you select. Our fees will not be based upon a share of capital gains or capital appreciation of the funds or any portion of your funds. In no event shall we charge advisory fees that are both in excess of six hundred dollars and more than six months in advance of advisory services rendered.

Certain strategies offered by us involve investment in mutual funds. Load and no load mutual funds may pay annual distribution charges, sometimes referred to as “12(b) (1) fees”. These 12(b) (1) fees come from fund assets, and thus indirectly clients’ assets. We do receive compensation from these fees from our broker-dealer, First Allied Securities. The 12(b) (1) fee, deferred sales charges and other fee arrangements will be disclosed upon your request and are typically described in the applicable fund’s prospectus.

Your account at the custodian may also be charged for certain additional assets managed for you by us but not held by the Custodian (i.e. variable annuities, mutual funds, 401(k) s).

The fees we charge can be deducted directly from your account at the custodian. We will instruct the Custodian to deduct the fees from your account at the beginning of the calendar quarter. This fee will show up as a deduction on your following month's account statement from the Custodian.

### 3. Third Party Asset Management Providers

The fees assessed to you by third party asset management providers and programs will vary in amount and frequency according to the provider that you choose. Please see each provider's Form ADV Part 2 and your Advisory Agreement for detailed explanations of charges and fees.

The total fee you pay includes the fee negotiated with us and the Third Party Programs. There are no separate commissions or transaction costs charged to you.

#### **Lockwood**

The fee will you pay does not include any fees imposed by the Securities and Exchange Commission, wire transfer fees, fees or commissions for securities transactions (including without limitation dealer mark-ups or mark-downs) through any broker-dealer, costs associated with temporary investment of Client funds in a money market account or special requests by Client. In addition to the advisory fee, the Custodian may charge you additional miscellaneous fees (e.g., ACAT fees, IRA maintenance fees). If your assets are invested in any mutual funds or pooled investment vehicles, in addition to the Program Fee, you will incur the internal management and operating fees and expenses, which may include 12b-1 fees, mutual fund management fees, early termination fees (which include fees on whole or partial liquidations of your account(s)) and other fees and expenses that may be assessed by the investment vehicle's sponsor, custodian, transfer agent, adviser, shareholder service provider or other service providers. Such fees are not included in the advisory fee. Further information regarding charges and fees assessed may be found in the appropriate prospectus, and/or annual report and/or custodial agreement. You may be able to pay lower expenses by investing directly in those investment vehicles.

Lockwood will, for related clients, "household" or combine account assets for purposes of calculating the advisory fee. .

#### ***The SMA Program Fees***

The fee is based upon the amount of money you have invested and is calculated as follows:

<b>Lockwood Platform Fee / Baughman Fee:</b> Total Market Value of Client Account(s)	Annual Fee
Up to \$ 1,000,000	1.300%
Next \$ 1,000,000	1.250%
Next \$ 3,000,000	1.225%
Next \$ 10,000,000	1.200%
Next \$ 15,000,000	1.150%
Assets Over \$ 30,000,000	1.000%

### ***Lockwood Professional Fund Select Program***

You will pay one fee for the combined advisory, brokerage, custody and processing services of all the parties. The fee is a percentage of assets under management and will vary depending upon the services provided to you. The fee is based on the total assets under advisement, including any portion of the account maintained in cash or in short-term vehicles including, but not limited to, money market funds. The fees normally charged are explained more fully in the applicable Form ADV Part 2. The Program Fee will be debited and paid in advance on a quarterly basis.

You will pay an initial fee after the date that the Custodian receives the initial assets for your account(s) or for any additional net contributions greater than \$25,000. You will pay for that portion of the ongoing quarterly advisory fee that relates to the number of days remaining in the calendar quarter as of the date that your account(s) become subject to this Agreement. This fee will be based on the total market value of the Assets in your account(s) on that date. No adjustment or refund will be made with respect to net partial withdrawals you may make during any calendar quarter.

After the initial billing period, your quarterly fee will be paid to Lockwood, Baughman, and any other named parties, as applicable, at the end of each calendar quarter for the following quarter. This fee will be based on the total market value of the assets in your account(s) on the last business day of the prior calendar quarter.

If your Agreement is terminated for any reason, that portion of the fee that relates to the amount of days remaining in the quarter after the date of termination will be refunded to you.

By signing our Agreement, you authorize the payment of the fee directly from your account(s) held by the Custodian in accordance with Custodian's policies, practices and procedures. The fee withdrawals will occur no less frequently than quarterly from your account(s). Custodian will send to you a statement, at least quarterly, indicating all amounts disbursed from your account(s), including the amount of the fee.

## **4. Other Fees**

Our advisors may recommend and sell life, annuity, disability, health, and long-term care insurance. We will receive the usual and customary commissions associated with these sales from the insurance company. Your advisory fee is in addition to any commissions we may receive from these sales.

We can provide research and advice concerning any legal and legitimate investment for which public information is readily available. We will charge an hourly fee of \$300 or fixed project cost. We can also provide an-in depth analysis of your financial situation or other defined projects as requested on a fee only basis.

## Performance Based Fee and Side by Side Management

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We do not charge any performance-based fees. These are fees based on a share of capital gains on or capital appreciation of the assets of a client.

## Types of Client(s)

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We provide investment management services primarily to high net worth individuals and their families, trusts, estates and foundations; we may also provide services to corporate pension and profit-sharing plans, charitable organizations, endowments, corporations, and small businesses.

## Methods of Analysis, Investment Strategies and Risk of Loss

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The third party asset management provider uses a variety of analysis methods to provide you portfolio and investment management services based on the portfolio selected to implement your asset management plan. One of the main methods of analysis and sources of information is the proprietary due diligence conducted by the third party asset management providers. This due diligence may include, but not be limited to:

- on-site visits to certain Portfolio Managers
- interviews with investment, trading and operations personnel and senior management
- analysis of client accounts

In addition, third party asset management providers may review regulatory filings, as well as analysis and statistics written or compiled by government agencies, trade groups or professional associations. They may engage a third-party firm to assist in their due diligence efforts.

We review the third party asset management providers analysis during our due diligence process to determine whether to include them in your portfolio. We will look at the reports and information that they provide, as well as the following, for our due diligence efforts:

- Financial newspapers and magazines (e.g. Wall Street Journal, Forbes, etc.)
- Annual reports, prospectuses, filings with the Securities and Exchange Commission
- Research materials prepared by others
- Company press releases
- Corporate rating services
- Company websites
- Inspections of corporate activities

The investment strategies we use to implement any investment advice given to you include, but are not limited to:

- Long term purchases -securities held at least a year
- Short term purchases - securities sold within a year
- Trading -securities sold within 30 days
- Short Sales
- Margin Transactions
- The purchase of options and option writing, including covered, uncovered and spread strategies

## **1. Fundamental Analysis**

We may use the fundamental method of investment analysis for the selection of mutual funds. The process filters the potential number of mutual fund managers for their respective investment style.

Fundamental analysis serves to answer questions, such as:

- What is the size of the fund?
- Is the money manager or management team consistent in their investment style?
- Is the manager's performance consistent when compared to his peers?
- What is that manager's tenure with the fund?
- Are the internal costs competitive relative to other manager's in that style?

One of the primary objectives of fundamental analysis is to provide current analysis of funds, whether for selection or de-selection. We may use a combination of qualitative and quantitative factors to try and find funds that will perform well in their investment style. We look at both investment performance (relative to the peer group and the market) and modern portfolio statistics (like beta and standard deviation) to analyze the level of risk a manager takes to achieve those returns. When we examine a fund, we may look at the fund's annual turnover, sector weightings and many other quantitative factors.

The end goal of performing fundamental analysis is to produce a short list of funds, with the aim of figuring out what sort of position to take with those funds.

We may utilize these analyses individually or in combination depending upon your investment objectives.

## **2. Modern Portfolio Theory**

We may also use Modern Portfolio Theory to help us select the funds to include in your portfolio. Modern Portfolio Theory was created by some of the world's leading academic economists. They conducted extensive research, demonstrating that asset class selection (such as small-cap vs. large-cap, value vs. growth and U.S. vs. international)-not stock selection or market timing-is the most important determinant of portfolio performance.



Modern portfolio theory tries to understand the market as a whole, rather than looking for what makes each investment opportunity unique. Investments are described statistically, in terms of their expected long-term return rate and their expected short-term volatility. The volatility is equated with "risk", measuring how much worse than average an investment's bad years are likely to be. The end goal is to identify your acceptable level of risk tolerance, and then to find a portfolio with the maximum expected return for that level of risk.

### **3. Technical Analysis**

Technical Analysis is a technique that attempts to determine a security's value by developing models and trading rules based upon price and volume transformation. Technical analysis assumes that a market's price reflects all relevant information so the analysis focuses on the history of a security's trading behavior rather than external drivers such as economic, fundamental and news events. The practice of technical analysis incorporates the importance of understanding how market participants perceive and act upon relevant information rather than focusing on the information itself. Ultimately, technical analysts develop trading models and rules by evaluating factors such as market trends, market participant behaviors, supply and demand and pricing patterns and correlations.

In order to perform technical analysis, we may use the following techniques:

- Calculate moving averages
- Stochastic oscillators, which incorporate support and resistance levels to determine momentum.
- Charting and chart patterns
- Supply and demand indicators
- Investor behavior and psychology

As with other types of analysis, the predictive nature of technical analysis can vary greatly; models and rules are often modified and updated as new patterns and behaviors develop. Past performance is not an indicator of future return.

### **4. Cyclical Analysis**

While we do not attempt to time the market, we may use cyclical analysis in conjunction with other strategies to help determine if shifts are required in your investment strategies depending upon long and short-term trends in financial markets and the performance of the overall national and global economy.

### **5. Risks**

We cannot guarantee our analysis methods will yield a return. In fact, a loss of principle is always a risk. Investing in securities involves a risk of loss that you should be prepared to handle. You need to understand that investment decisions made for your account by us are subject to various market, currency, economics, political and business risks. The investment decisions we make for you will not always be profitable nor can we guarantee any level of performance. For a more comprehensive description of all the risks associated with the strategies, methodology, and products please refer to the glossary under Risks.

## Disciplinary Information

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Registered Investment Advisers are required to disclose all material facts regarding any legal or disciplinary events that would be material to your evaluation of us or the integrity of our management. We have no information to disclose here about the firm.

Kurt Baughman has one disclosure on his securities industry record. The event consisted of a customer complaint brought by the beneficiaries of a trust who questioned the suitability of a product. The case that was settled, pre-arbitration, by Kurt's former employer to avoid the potential cost of future litigation. Kurt denied any wrongdoing and no evidence of wrongdoing was found. We adhere to high ethical standards for all advisors and associates. We strive to do what's in your best interests.

## Other Financial Industry Activities and Affiliations

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Kurt Baughman, the President and Chief Compliance Officer of Baughman Financial Group is licensed as an insurance agent and may provide you with an analysis and recommendations that can include the purchase and/or sale of fixed insurance products.

Kurt is also a registered representative offering securities through First Allied Securities, Inc. ("FASI"). He may provide advice to you regarding brokerage products. If you implement this advice through Kurt, he may receive additional compensation in the form of brokerage commissions from FASI; commissions would be received in his separate capacity as a registered representative of FASI.

Since our advisors may sell insurance and securities products through FASI or the product sponsor, they may receive compensation in the form of commissions for these sales. Therefore, a conflict of interest may exist between our interests and your interests since we may recommend particular products based upon the potential compensation rather than your needs. This potential conflict is addressed in our Code of Ethics.

We act in a fiduciary capacity. If a conflict of interest arises between us and you, we shall make every effort to resolve the conflict in your favor. Conflicts of interest may also arise in the allocation of investment opportunities among the accounts that we advise. We will seek to allocate investment opportunities according to what we believe is appropriate for each account. We strive to do what is equitable and in the best interest of all the accounts we advise.

# Code of Ethics

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## 1. General Information

We have adopted a Code of Ethics for all supervised persons of the firm describing its high standards of business conduct, and fiduciary duty to you, our client. The Code of Ethics includes provisions relating to the confidentiality of client information, a prohibition on insider trading, a prohibition of rumor mongering, restrictions on the acceptance of significant gifts, the reporting of certain gifts and business entertainment items, and personal securities trading procedures. All of our supervised persons must acknowledge the terms of the Code of Ethics annually, or as amended.

We may recommend securities to you that we have purchased for our own accounts. We may trade securities in our account that we have recommended to you as long as we place our orders after your orders. This policy is meant to prevent us from benefiting as a result of transactions placed on behalf of advisory accounts.

We have established the following restrictions in order to ensure our fiduciary responsibilities to you are met:

- We shall not buy or sell securities for our personal portfolio(s) where this decision is substantially derived, in whole or in part, from our role as an Investment Advisory Representative of Baughman unless the information is also available to the investing public on reasonable inquiry. In no case, shall we put our own interests ahead of yours.
- We emphasize your unrestricted right to decline to implement any advice rendered.

However, some securities trade in sufficiently broad markets to permit transactions by clients to be completed without an appreciable impact on the markets of the securities. Under certain circumstances, exceptions may be made to the policies stated above. Records of these trades, including the reasons for the exceptions, will be maintained with our records as required.

In addition, open-end mutual funds and/or investment sub-accounts which may comprise a variable insurance product are purchased or redeemed at a fixed net asset value. Therefore, purchases of mutual funds and/or variable insurance products by an advisor are not likely to have an impact on the prices of the fund in which you invest. These types of transactions are not prohibited by our policies and procedures.

Certain affiliated accounts may trade in the same securities with your accounts on an aggregated basis when consistent with our obligation of best execution. When trades are aggregated, all parties will share the costs in proportion to their investment. We will retain records of the trade order (specifying each participating account) and its allocation. Completed orders will be allocated as specified in the initial trade order. Partially filled orders will be allocated on a pro rata basis. Any exceptions will be explained on the Order.

You may request a copy of the firm's Code of Ethics by contacting Kurt Baughman.

## **2. Responsibility**

It is the responsibility of all supervisory personnel to ensure that we conduct business with the highest level of ethical standards and in keeping with our fiduciary duties to you. We must put your interests first and refrain from having outside interests that conflict with your interests.

## **3. Privacy Statement**

We are committed to safeguarding your confidential information and hold all personal information provided to us in the strictest confidence. These records include all personal information that we collect from you or receive from other firms in connection with any of the financial services provided. We do not disclose your personal information except as required by law. We maintain physical, electronic and procedural safeguards that comply with federal standards to safeguard your personal information. Our Privacy Policy is available upon request.

## **4. Prohibited Acts**

The following acts are prohibited:

- Employing any device, scheme or artifice to defraud
- Making any untrue statement of a material fact
- Omitting to state a material fact necessary in order to make a statement, in light of the circumstances under which it is made, not misleading
- Engaging in any fraudulent or deceitful act, practice or course of business
- Engaging in any manipulative practices
- Participating in client's accounts

## **5. Conflicts of Interest**

We have a duty to disclose potential and actual conflicts of interest. We have a duty to report potential and actual conflicts of interest to management. Gifts (other than de minimis gifts, which are usually defined as having a value under \$100.00) should not be accepted from persons or entities doing business with us.

We act in a fiduciary capacity. If a conflict of interest arises between us and you, we shall make every effort to resolve the conflict in your favor. Conflicts of interest may also arise in the allocation of investment opportunities among the accounts that we advise. We will seek to allocate investment opportunities according to what we believe is appropriate for each account. We strive to do what is equitable and in the best interest of all the accounts we advise.

## **6. Use of Disclaimers**

We shall not attempt to limit liability for willful misconduct or gross negligence through the use of disclaimers.

## **8. Business Continuation Plan**

We have developed a Business Continuity Plan to address how we will respond to events that may disrupt business. Since the timing and impact of disasters is unpredictable, the firm will have to be flexible in responding to the events as they occur.

Our plan is designed to permit us to resume operations as quickly as possible, given the scope and severity of the disruption. The Plan covers data backup and recovery, mission critical systems financial and operational assessments, alternative communications, alternate business locations, bank and counter-party impact, regulatory reporting and the assurance of prompt access to funds and securities for our customers.

## **Brokerage Practices**

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### **1. Soft Dollars**

We do not receive any soft dollars from broker-dealers, custodians or third party money managers.

We do however, receive access to Lockwood's proposal generation and/or reporting systems and/or Lockwood may provide back office support for services such as client billing and investment performance reporting. These services are used to benefit all our clients. You are not charged a separate fee for these services.

#### **Research**

It is not our practice to negotiate "execution only" commission rates; therefore you may be paying for other services provided by the broker-dealer which are included in the commission rate. These other services may include research, services such as market publications, advice, analysis, reports or on line financial information. Research services furnished by us to our brokerage clients may or may not be used by us in servicing our investment advisory clients.

#### **Aggregating Orders**

We will generally place your trades individually through your accounts unless we decide to purchase or sell the same securities for several clients at approximately the same time. We may, but are not obligated to, combine or "batch" such orders to obtain best execution, to negotiate more favorable commission rates or to allocate equitably among our clients differences in prices and commission or other transaction costs. Under this procedure, transactions will be price-averaged and allocated among our clients in proportion to the purchase and sale orders placed for each client account on any given day.

### **2. Brokerage for Client Referrals**

We do not receive any compensation or incentive for referring you to broker-dealers for brokerage trades.

### **3. Directed Brokerage**

If requested, we will arrange for the execution of securities brokerage transactions for your account through First Allied Securities, Inc. ("FASI"); who we reasonably believe will provide "best execution." In seeking best execution, the determinative factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution, taking into consideration the full range of a Broker-Dealer's services including the value of research provided, execution capability, commission rates, and responsiveness. Therefore, we will seek competitive commission rates, but we may not obtain the lowest possible commission rates for account transactions. As broker-dealer, FASI executes trades, collects and disburses 12b-1 fees, collects, disburses and refunds asset management fees, prepares quarterly performance reports and provides operations support. FASI receives percentages of 12B-1 fees and asset management fees in exchange for these services.

Not all advisory firms require you to direct brokerage to a specific broker-dealer. By directing brokerage to FASI you may pay higher fees or transaction costs than those obtainable by other broker-dealers. In most cases, we believe you are paying a discounted and reasonable rate. You may pay higher or lower fees if you select another broker-dealer. Generally, we will not negotiate lower rates below the rates established by the executing broker-dealer for this type of directed brokerage account, unless we believe that such rate is unfair or unreasonable for the size and type of transaction. We believe that FASI pays industry standard commissions on transactions they handle for us. These commissions are reasonable and customary.

Lockwood has adopted a Best Execution Policy pursuant to which Lockwood reviews samples of trades daily. Pursuant to its Best Execution Policy, Lockwood reviews and monitors compliance with applicable regulations on a quarterly basis.

## **Review of Accounts**

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### **1. Duty to Supervise**

We are responsible for ensuring adequate supervision over the activities of all persons who act on our behalf. Specific duties include:

- Establish procedures that could be reasonably expected to prevent and detect violations of law by our Advisory personnel
- Analyze operations and create a system of controls to ensure compliance with applicable securities laws
- Ensure that all Advisory personnel fully understand the Company's policies and procedures
- Establish a review system designed to provide reasonable assurance that our policies and procedures are effective and being followed

## 2. Reviews

Your advisor will review all accounts on a quarterly basis, and compare each investment on a transactional basis to insure that each transaction:

- Is suitable to your respective investment objectives
- Meets your quality standards
- Is designed to make sure that your investment objectives are still pertinent to the managed account arrangement.

More frequent reviews may be triggered by material changes in your individual circumstances or the market economic or political environment.

## 3. Reports

You will be provided with account statements from the custodian reflecting the transactions occurring in the account on at least a quarterly basis. These statements will be written or electronic depending upon what you selected when you opened the account. You will be provided with confirmations for each securities transaction executed in the account.

In addition you will receive quarterly performance reports from us. Please verify the accuracy of these statements and notify us of any discrepancies in the account or any concerns you may have about the account.

## Client Referrals and Other Compensation

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We may enter into written agreements to pay referral fees to other persons who are unaffiliated individuals. Prior to entering into any investment advisory agreement with you through these Solicitation Agreements, we will determine if the referral has provided you with a written disclosure document stating that the unaffiliated person is being compensated for referring us and the terms of the compensation arrangement.

## Custody

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We do not have custody of any accounts. We currently use Pershing as the custodian for all your accounts. However, we can use other custodians if there is a need to do so.

We do not debit your fees directly from your advisory account. Only the custodian has the authority to directly charge and debit the advisory fee to your account and forward the fee to us. You should receive at least quarterly statements from the custodian that holds and maintains your investment assets. Monthly statements list the total value of the account at the start and end of the month and itemize all transactions and security positions. We urge you to carefully review such statements and compare this

official custodial record to the account statements that we may provide to you. Our statements may vary from custodial statements based on accounting procedures, reporting dates, or valuation methodologies of certain securities. If you notice any discrepancies, please contact Kurt Baughman.

The Custodian will provide you immediate transaction confirmations and monthly statements, either by mail or electronically per your request. For taxable accounts, the Custodian will provide you consolidated year-end summary statements including IRS forms 1099 and other tax-related forms, as applicable. We are not allowed to make alterations or amendments to the custodian's statement. This preserves the integrity of the Custodian's statement and provides you with an independent appraisal of the account.

## **Investment Discretion**

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We usually receive discretionary authority from you at the beginning of an advisory relationship. This gives us permission to select the security and amount of securities to be bought or sold. This information is described in the Advisory Agreement you sign with us. In all cases, however, this discretion is exercised in a manner consistent with the stated investment objectives for your account.

When selecting securities and determining amounts, we observe the investment policies, limitations and restrictions you have set. Any investment guidelines and restrictions you wish to place on your account must be provided to us in writing.

For registered investment companies, our authority to trade securities may also be limited by certain federal securities and tax laws that require diversification of investments and favor the holding of investments once made.

## **Voting Client Securities**

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As a matter of firm policy and practice, we do not have any authority to and do not vote proxies on behalf of advisory clients. You retain the responsibility for receiving and voting proxies for any and all securities maintained in your portfolios. We may provide advice to you regarding your voting of proxies. We are authorized to instruct the Custodian to forward you copies of all proxies and shareholder communications relating to your account assets.

Under certain circumstances you may elect to give your third party managers discretion to vote your proxies.



## Financial Information

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We are required to provide you with certain financial information or disclosures about our financial condition. We have no financial commitment that would impair our ability to meet any contractual and fiduciary commitments to you, our client. We have not been the subject of any bankruptcy proceedings.

# Requirements for State Registered Advisers

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There is one principal of Baughman Financial Group, Kurt Baughman. His information is as follows:

## J. Kurt Baughman

### Position

President and Chief Compliance Officer (“CCO”)

### Date of Birth

1964

### Education

Bachelor of Science in Business Administration, 1991  
California Lutheran University, Thousand Oaks, CA

Certified Financial Planner Program  
The American College, Pennsylvania

### Designations

Certified Wealth Strategist® (CWS)  
Cannon Financial Institute, Athens, GA

### Minimum Designation Requirements

#### Certified Wealth Strategist® (CWS)

**Issuing Organization:** Cannon Financial Institute

**Prerequisites/Experience Required:** 3+ years of in the financial services industry and significant experience in client-facing roles or a four year degree from an accredited school.

**Educational Requirements:** 32 week program including two 2-day instructor led seminars and 27 weeks of directed study

**Examination Type:** A Capstone Project that includes business plans and case studies

**Continuing Education/Experience Requirements:** 33 hours every 2 years

### Business History

November 1999 – Present	President and Principal Baughman Financial Group
October 2008 – Present	President and CCO of Baughman Wealth Advisors Inc.
April 1996 – November 1999	Vice President of Investments at First Union Securities, Inc.
May 1992 – April 1996	Financial Consultant at Smith Barney

**Other Business Activities**

Kurt is a registered representative offering securities through First Allied Securities, Inc. ("FASI") and is licensed to sell life insurance products. The amount of time spent on these activities generally comprises less than ten (10%) percent of Kurt's time.

**Licenses**

Kurt holds several FINRA licenses including the Series 3, 7, 24, 63 and 65 licenses. He is licensed to transact investment advisory services in Texas and California.

Kurt is also licensed to transact securities business in Arizona, Arkansas, California, Colorado, Georgia, Kansas, Nevada, New Mexico, New York, Oregon, Texas and Washington.

Kurt has a Texas and California insurance license. His Texas Insurance License number is 1548876 and his California Insurance License number is 0B21482.

**Philosophy and Specialty**

Kurt works comprehensively with his clients regarding their wealth management issues using a very disciplined approach. He helps families accumulate, manage, and protect wealth by performing a systematic process to assess a family's financial situation to determine areas that need attention. He then provides solutions by utilizing a comprehensive suite of wealth management services including investment management, insurance, retirement and estate planning.

Kurt believes that every client needs an advocate for their financial well-being. He is committed to placing and supporting your interests before any other. Kurt strives to eliminate any conflicts of interest that may exist in an advisor and client relationship. Kurt is also committed to a high standard of professional integrity and maintaining confidentiality. By listening carefully to understand you and your situation, he seeks to understand your personal objectives and offer the appropriate counsel.

Kurt specializes in developing financial plans, coordinating major financial transactions, estimating and monitoring long-term financial goals and money management for individuals and businesses. Each aspect of the financial and investment planning process is tailored to the unique needs of his clients.

## Glossary of Key Terms

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**Adviser** – Baughman Wealth Advisors Inc. DBA Baughman Financial Group.

**advisor** – Your individual representative at Baughman Financial Group.

**Asset Allocation** – The process of dividing investments among different kinds of assets, such as stocks, bonds, real estate and cash, to optimize the risk/reward tradeoff based on an individual's or institutions specific situation and goals; a key concept in financial planning and money management.

**Asset-class investment portfolios** – An asset class is a grouping of similar investments whose prices tend to move together. Asset classes can be defined on a very general level, such as stocks or on a more specific level, such as American silver producing companies. The concept of asset classes is important because one of the goals when building an investment portfolio is to use different asset classes which are not correlated with each other.

### Designations

**Certified Wealth Strategist® (CWS)** designation prepares practitioners and organizational leaders to better serve the high net worth market - particularly those seeking to move away from a transaction-based business to a consultative, comprehensive practice management and client service model.

**Diversification** – a portfolio strategy designed to reduce exposure to risk by combining a variety of investments, such as stocks, bonds, and real estate, which are unlikely to all move in the same direction. The goal of diversification is to reduce the risk in a portfolio. Volatility is limited by the fact that not all asset classes or industries or individual companies move up and down in value at the same time or at the same rate. Diversification reduces both the upside and downside potential and allows for more consistent performance under a wide range of economic conditions.

**Exchange-Traded Funds** — A type of an investment company (either an open-end company or UIT) whose objective is to achieve the same return as a particular market index. ETFs differ from traditional open-end companies and UITs, because, pursuant to SEC exemptive orders, shares issued by ETFs trade on a secondary market and are only redeemable from the fund itself in very large blocks (blocks of 50,000 shares for example).

**Expense Ratio** — the fund's total annual operating expenses (including management fees, distribution (12b-1) fees, and other expenses) expressed as a percentage of average net assets.

**Fees**— a list of all fees associated with different products we offer are listed below:

1. **12b-1 Fees** — Fees paid by the fund out of fund assets to cover the costs of marketing and selling fund shares and sometimes to cover the costs of providing shareholder services. "Distribution fees" include fees to compensate brokers and others who sell fund shares and to

pay for advertising, the printing and mailing of prospectuses to new investors, and the printing and mailing of sales literature. "Shareholder Service Fees" are fees paid to persons to respond to investor inquiries and provide investors with information about their investments.

2. **Account Fee**— A fee that some funds separately impose on investors for the maintenance of their accounts. For example, accounts below a specified dollar amount may have to pay an account fee.
3. **Distribution Fees** — Fees paid out of fund assets to cover expenses for marketing and selling fund shares, including advertising costs, compensation for brokers and others who sell fund shares, and payments for printing and mailing prospectuses to new investors and sales literature prospective investors. Sometimes referred to as "12b-1 fees."
4. **Management Fee** — fee paid out of fund assets to the fund's investment adviser or its affiliates for managing the fund's portfolio, any other management fee payable to the fund's investment adviser or its affiliates, and any administrative fee payable to the investment adviser that are not included in the "Other Expenses" category. A fund's management fee appears as a category under "Annual Fund Operating Expenses" in the Fee Table.
5. **Operating Expenses** — the costs a fund incurs in connection with running the fund, including management fees, distribution (12b-1) fees, and other expenses.
6. **Purchase Fee** — a shareholder fee that some funds charge when investors purchase mutual fund shares. Not the same as (and may be in addition to) a front-end load.
7. **Redemption Fee** — a shareholder fee that some funds charge when investors redeem (or sell) mutual fund shares. Redemption fees (which must be paid to the fund) are not the same as (and may be in addition to) a back-end load (which is typically paid to a broker). The SEC generally limits redemption fees to 2%.
8. **Sales Charge (or "Load")** — the amount that investors pay when they purchase (front-end load) or redeem (back-end load) shares in a mutual fund, similar to a commission. The SEC's rules do not limit the size of sales load a fund may charge, but FINRA rules state that mutual fund sales loads cannot exceed 8.5% and must be even lower depending on other fees and charges assessed.
9. **Shareholder Service Fees** — fees paid to persons to respond to investor inquiries and provide investors with information about their investments. See also "12b-1 fees."

**Index Fund** — describes a type of mutual fund or Unit Investment Trust (UIT) whose investment objective typically is to achieve the same return as a particular market index, such as the S&P 500 Composite Stock Price Index, the Russell 2000 Index, or the Wilshire 5000 Total Market Index.

**Investment Adviser** — generally, a person or entity who receives compensation for giving individually tailored advice to a specific person on investing in stocks, bonds, or mutual funds. Some investment advisers also manage portfolios of securities, including mutual funds.

**Investment Company** — a company (corporation, business trust, partnership, or limited liability company) that issues securities and is primarily engaged in the business of investing in securities. The three basic types of investment companies are mutual funds, closed-end funds, and unit investment trusts.

**Investment Goals** — objective or target, usually driven by specific future financial needs. Some common goals for an individual are: saving for a comfortable retirement, saving to send children to college, managing finances to enable a home purchase, minimizing taxes, and maximizing return on investments given a certain risk tolerance, and estate or trust planning.

**Investment Objectives** — The financial goal or goals of an investor. An investor may wish to maximize current income, maximize capital gains, or set a middle course of current income with some appreciation of capital. Defining investment objectives helps to determine the investments an individual should select.

**Margin** — borrowing money (usually using securities you already own as collateral) that is used to purchase securities.

**Mutual Fund** — the common name for an open-end investment company. Like other types of investment companies, mutual funds pool money from many investors and invest the money in stocks, bonds, short-term money-market instruments, or other securities. Mutual funds issue redeemable shares that investors purchase directly from the fund (or through a broker for the fund) instead of purchasing from investors on a secondary market.

**NAV (Net Asset Value)** — the value of the fund's assets minus its liabilities. SEC rules require funds to calculate the NAV at least once daily. To calculate the NAV per share, simply subtract the fund's liabilities from its assets and then divide the result by the number of shares outstanding.

**No-load Fund** — a fund that does not charge any type of sales load. But not every type of shareholder fee is a "sales load," and a no-load fund may charge fees that are not sales loads. No-load funds also charge operating expenses.

**Open-End Company** — the legal name for a mutual fund. An open-end company is a type of Investment Company.

**Option Contracts**—the right, but not the obligation, to buy (for a call option) or sell (for a put option) a specific amount of a given stock, commodity, currency, index, or debt, at a specified price (the strike price) during a specified period of time. For stock options, the amount is usually 100 shares. Each option contract has a buyer, called the holder, and a seller, known as the writer. If the option contract is exercised, the writer is responsible for fulfilling the terms of the contract by delivering the shares to the appropriate party. In the case of a security that cannot be delivered such as an index, the contract is settled in cash. For the holder, the potential loss is limited to the price paid to acquire the option. When an option is not exercised, it expires. No shares change hands and the money spent to purchase the

option is lost. For the buyer, the upside is unlimited. Option contracts, like stocks, are therefore said to have an asymmetrical payoff pattern. For the writer, the potential loss is unlimited unless the contract is covered, meaning that the writer already owns the security underlying the option. Option contracts are most frequently as either leverage or protection. As leverage, options allow the holder to control equity in a limited capacity for a fraction of what the shares would cost. The difference can be invested elsewhere until the option is exercised. As protection, options can guard against price fluctuations in the near term because they provide the right to acquire the underlying stock at a fixed price for a limited time. Risk is limited to the option premium (except when writing options for a security that is not already owned). However, the costs of trading options (including both commissions and the bid/ask spread) is higher on a percentage basis than trading the underlying stock. In addition, options are very complex and require a great deal of observation and maintenance.

**Portfolio** — an individual's or entity's combined holdings of stocks, bonds, or other securities and assets.

**Profile** — summarizes key information about a mutual fund's costs, investment objectives, risks, and performance. Although every mutual fund has a prospectus, not every mutual fund has a profile.

**Prospectus** — describes the mutual fund to prospective investors. Every mutual fund has a prospectus. The prospectus contains information about the mutual fund's costs, investment objectives, risks, and performance. You can get a prospectus from the mutual fund company (through its website or by phone or mail). Your financial professional or broker can also provide you with a copy.

**Risks** — a list of all risks associated with the strategies, products and methodology we offer are listed below:

#### 1. Fundamental Analysis Risk

Fundamental analysis, when used in isolation, has a number of risks:

- There are an infinite number of factors that can affect the earnings of a company, and its stock price, over time. These can include economic, political and social factors, in addition to the various company statistics.
- When using this method with mutual funds, the funds are composed of many companies and not all of them will be undervalued.
- The data used may be at least six months out of date.
- It is difficult to give appropriate weightings to the factors.
- In the early 1970s and 1980s price/earnings multiples of 80 or 90 were considered acceptable by some for 'blue chip' stocks in the United States.
- In the 1980s in the United States some biotechnology stocks sold at '50 times sales'. The companies had no earnings and paid no dividend. The new yardstick to value these became 'products in the pipeline'. By the late 1980s most had lost three-quarters of their stock price.
- It assumes that the analyst is competent.

- A fundamental analyst assumes that other fundamental analysts will form the same view about the company and buy the stock, thus restoring its value and returning the trader or investor a capital gain. In practice, an undervalued company's stock price can stay at approximately the same level (or decline) for years.
- It ignores the influence of random events such as oil spills, product defects being exposed, and acts of God and so on.
- It assumes that there is no monopolistic power over markets.
- Even when fundamental analysis reveals an undervalued company, or a stock with high growth prospects, it does not tell us anything about the timing of the purchase of the stock. In other words, we may have discovered a grossly undervalued stock whose price has been falling for some time, and may well continue falling.

## 2. Mutual Funds Risk

Mutual funds can offer the advantages of diversification and professional management. But, as with other investment choices, investing in mutual funds involves risk and fees and taxes will diminish a fund's returns.

But mutual funds also have features that some clients might view as disadvantages, such as:

- **Costs despite Negative Returns** — Clients must pay sales charges, annual fees, and other expenses) regardless of how the fund performs. And, depending on the timing of their investment, clients may also have to pay taxes on any capital gains distribution they receive — even if the fund went on to perform poorly after they bought shares.
- **Lack of Control** — Investors typically cannot ascertain the exact make-up of a fund's portfolio at any given time, nor can they directly influence which securities the fund manager buys and sells or the timing of those trades.
- **Price Uncertainty** — with an individual stock, you can obtain real-time (or close to real-time) pricing information with relative ease by checking financial websites or by calling your advisor. You can also monitor how a stock's price changes from hour to hour. But with a mutual fund, the price you purchase or redeem shares for will typically depend on the fund's NAV, which the fund might not calculate until many hours after you've placed your order. In general, mutual funds must calculate their NAV at least once every business day, typically after the major U.S. exchanges close.

The following is a list of some general risks associated with investing in mutual funds.

- **Country Risk** - The possibility that political events (a war, national elections), financial problems (rising inflation, government default), or natural disasters (an earthquake, a poor harvest) will weaken a country's economy and cause investments in that country to decline.
- **Currency Risk** -The possibility that returns could be reduced for Americans investing in foreign securities because of a rise in the value of the U.S. dollar against foreign currencies. Also called exchange-rate risk.



- Income Risk - The possibility that a fixed-income fund's dividends will decline as a result of falling overall interest rates.
- Industry Risk - The possibility that a group of stocks in a single industry will decline in price due to developments in that industry.
- Inflation Risk - The possibility that increases in the cost of living will reduce or eliminate a fund's real inflation-adjusted returns.
- Manager Risk -The possibility that an actively managed mutual fund's investment adviser will fail to execute the fund's investment strategy effectively resulting in the failure of stated objectives.
- Market Risk -The possibility that stock fund or bond fund prices overall will decline over short or even extended periods. Stock and bond markets tend to move in cycles, with periods when prices rise and other periods when prices fall.
- Principal Risk -The possibility that an investment will go down in value, or "lose money," from the original or invested amount.

### 3. Bond Fund Risk

Bond funds generally have higher risks than money market funds, largely because they typically pursue strategies aimed at producing higher yields of the risks associated with bond funds include:

- Call Risk - The possibility that falling interest rates will cause a bond issuer to redeem—or call—its high-yielding bond before the bond's maturity date.
- Credit Risk — the possibility that companies or other issuers whose bonds are owned by the fund may fail to pay their debts (including the debt owed to holders of their bonds). Credit risk is less of a factor for bond funds that invest in insured bonds or U.S. Treasury bonds. By contrast, those that invest in the bonds of companies with poor credit ratings generally will be subject to higher risk.
- Interest Rate Risk — the risk that the market value of the bonds will go down when interest rates go up. Because of this, you can lose money in any bond fund, including those that invest only in insured bonds or Treasury bonds.
- Prepayment Risk — the chance that a bond will be paid off early. For example, if interest rates fall, a bond issuer may decide to pay off (or "retire") its debt and issue new bonds that pay a lower rate. When this happens, the fund may not be able to reinvest the proceeds in an investment with as high a return or yield.

### 4. Stock Fund Risk

Although a stock fund's value can rise and fall quickly over the short term, historically stocks have performed better over the long term than other types of investments — including corporate bonds, government bonds, and treasury securities.

Overall "market risk" poses the greatest potential danger for investors in stocks funds. Stock prices can fluctuate for a broad range of reasons, such as the overall strength of the economy or demand for particular products or services.

Not all stock funds are the same. For example:

- Growth funds focus on stocks that may not pay a regular dividend but have the potential for large capital gains.
- Income funds invest in stocks that pay regular dividends.
- Index funds aim to achieve the same return as a particular market index, such as the S&P 500 Composite Stock Price Index, by investing in all — or perhaps a representative sample — of the companies included in an index.
- Sector funds may specialize in a particular industry segment, such as technology or consumer products stocks.

#### 5. Alternative Investment Risk

Investing in alternative investments is speculative, not suitable for all clients, and intended for experienced and sophisticated investors who are willing to bear the high economic risks of the investment, which can include:

- Loss of all or a substantial portion of the investment due to leveraging, short-selling or other speculative investment practices
- Lack of liquidity in that there may be no secondary market for the fund and none expected to develop
- Volatility of returns
- Restrictions on transferring interests in the fund
- Absence of information regarding valuations and pricing
- Delays in tax reporting
- Less regulation and higher fees than mutual funds

#### 6. Insurance Product Risk

The rate of return on variable insurance products is not stable, but varies with the stock, bond and money market subaccounts that you choose as investment options. There is no guarantee that you will earn any return on your investment and there is a risk that you will lose money. Before you consider purchasing a variable product, make sure you fully understand all of its terms. Carefully read the prospectus. Some of the major risks include:

- Liquidity and Early Withdrawal Risk – There may be a surrender charges for withdrawals within a specified period, which can be as long as six to eight years. Any withdrawals before a client reaches the age of 59 ½ are generally subject to a 10 percent income tax penalty in addition to any gain being taxed as ordinary income.

- Sales and Surrender Charges –Asset-based sales charges or surrender charges. These charges normally decline and eventually are eliminated the longer you hold your shares. For example, a surrender charge could start at 7 percent in the first year and decline by 1 percent per year until it reaches zero.
- Fees and Expenses – There are a variety of fees and expenses which can reach 2% and more such as:
  - Mortality and expense risk charges
  - Administrative fees
  - Underlying fund expenses
  - Charges for any special features or riders
- Bonus Credits – Some products offer bonus credits that can add a specified percentage to the amount invested ranging from 1 percent to 5 percent for each premium payment. Bonus credits, however, are usually not free. In order to fund them, insurance companies typically impose high mortality and expense charges and lengthy surrender charge periods.
- Guarantees - Insurance companies provide a number of specific guarantees. For example, they may guarantee a death benefit or an annuity payout option that can provide income for life. These guarantees are only as good as the insurance company that gives them.
- Market Risk -The possibility that stock fund or bond fund prices overall will decline over short or even extended periods. Stock and bond markets tend to move in cycles, with periods when prices rise and other periods when prices fall.
- Principal Risk -The possibility that an investment will go down in value, or "lose money," from the original or invested amount.

## 7. Overall Fund Risk

- Clients need to remember that past performance is no guarantee of future results. All funds carry some level of risk. You may lose some or all of the money you invest, including your principal, because the securities held by a fund goes up and down in value. Dividend or interest payments may also fluctuate, or stop completely, as market conditions change.
- Before you invest, be sure to read a fund's prospectus and shareholder reports to learn about its investment strategy and the potential risks. Funds with higher rates of return may take risks that are beyond your comfort level and are inconsistent with your financial goals.
- While past performance does not necessarily predict future returns, it can tell you how volatile (or stable) a fund has been over a period of time. Generally, the more volatile a fund, the higher the investment risk. If you'll need your money to meet a financial goal in the near-term, you probably can't afford the risk of investing in a fund with a volatile history because you will not have enough time to ride out any declines in the stock market.

## 8. Technical Analysis risk

- Technical analysis is derived from the study of market participant behavior and its efficacy is a matter of controversy.
- Methods vary greatly and can be highly subjective; different technical analysts can sometimes make contradictory predictions from the same data.
- Models and rules can incur sufficiently high transaction costs.
- Technical analysis has not received the same level of academic scrutiny as fundamental analysis; academic appraisals often find that it has little predictive power.

## 9. Options Risk

- An option holder runs the risk of losing the entire amount paid for the options in a relatively short period of time. Option writers run the risk of losing more than their original investment.
- The more an option is out of the money and shorter the remaining time to expiration, the greater the risk that an option holder will lose all or part of his investment in the option.
- The exercise provisions of an option may create certain risks for the option holders.
- Exercise restrictions may be imposed by the courts, SEC, other regulators, the Options Clearing Corporation or the respective options market.
- Option writers may be assigned an exercise at any time during the period an option is exercised.
- Spread option strategies are complex and the associated risks are not well understood.
- A trading market in an option may not be available.
- Options do not typically move in linear relationships to their underlying interest; sudden movements in underlying interests or volatility may cause sharp upward or downward spikes in the value of options that can trigger an option to be exercised.
- Counterparty risk.
- Options can increase leverage significantly.
- For more detailed discussions of option risk, please see the pamphlet provided to you entitled "Characteristics & Risks of Standardized Options."

## 10. Performance Risk

- Your individual returns will be reduced by advisory and program fees. Because fees are deducted periodically, the compounding effect will be to increase the impact of fee deductions by an amount directly related to the gross account performance. For example, on an account with an 8.6% gross annual rate of return and a 3% annual fee deducted quarterly (.75%); the compounding effect of the fees would result in a net annual rate of return of 5.5%. Actual results will vary from this example.

- The performance data you will receive represents past performance and does not guarantee future results. Actual account performance may be lower or higher than the generic performance data reported in marketing material. The investment return and principal value of an investment will fluctuate, so that your shares, when redeemed, may be worth more or less than their original cost.

**Risk Tolerance** – the extent to which an investor is willing to accept more risk in exchange for the possibility of a higher return. An investor with a high risk tolerance is likely to invest in securities, such as stocks in startup companies, and is willing to accept the possibility that the value of his/her portfolio will decline, at least in the short-term. An investor with a low risk tolerance, on the other hand, tends to invest predominantly in stable stocks and/or highly-graded bonds. One's risk tolerance is subjective and may vary according to age, needs, goals, and even personal dispositions.

**Third Party Money Manager**— the professional management of various securities (shares, bonds and other securities) and assets (e.g., real estate), to meet specified investment goals for the benefit of the investors. The managers are not the actual advisers working with the investor. Investors may be institutions (insurance companies, pension funds, corporations, individuals etc).

**Total Annual Fund Operating Expense** — the total of a fund's annual fund operating expenses, expressed as a percentage of the fund's average net assets. You'll find the total in the fund's fee table in the prospectus.

**Unit Investment Trust (UIT)** — a type of investment company that typically makes a one-time "public offering" of only a specific, fixed number of units. A UIT will terminate and dissolve on a date established when the UIT is created (although some may terminate more than fifty years after they are created). UITs do not actively trade their investment portfolios.

**You** – the client.