

**Item 1: Cover Page**

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

November 14, 2011

**LFS Asset Management, LLC**

SEC File No. 801-71610

181 Second Avenue, Suite 600  
San Mateo, CA 94401

phone: 650-344-1700  
email: onkwok2006@yahoo.com  
website: [www.lauminancial.com](http://www.lauminancial.com)

This brochure provides information about the qualifications and business practices of LFS Asset Management, LLC. If you have any questions about the contents of this brochure, please contact us at [onkwok2006@yahoo.com](mailto:onkwok2006@yahoo.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.

Additional information about LFS Asset Management, LLC, is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **Item 2: Material Changes**

Initial publication date is March 31, 2011.

## Item 3: Table of Contents

	<u>Page</u>
Item 1: Cover Page .....	1
Item 2: Material Changes.....	2
Item 3: Table of Contents .....	3
Item 4: Advisory Business .....	5
A. Description of Your Advisory Firm .....	5
B. Description of Advisory Services Offered .....	5
C. Client-Tailored Services and Client-Imposed Restrictions .....	7
D. Wrap Fee Programs .....	8
E. Client Assets Under Management.....	8
Item 5: Fees and Compensation.....	9
A. Methods of Compensation and Fee Schedule .....	9
B. Client Payment of Fees .....	10
C. Additional Client Fees Charged.....	10
D. Prepayment of Client Fees .....	11
E. External Compensation for the Sale of Securities to Clients .....	11
Item 6: Performance-Based Fees and Side-by-Side Management .....	12
Item 7: Types of Clients .....	13
Item 8: Methods of Analysis, Investment Strategies and Risk of Loss.....	14
A. Methods of Analysis and Investment Strategies.....	14
B. Investment Strategy and Method of Analysis Material Risks.....	20
C. Security-Specific Material Risks.....	24
Item 9: Disciplinary Information.....	25
A. Criminal or Civil Actions .....	25
B. Administrative Enforcement Proceedings .....	25
C. Self-Regulatory Organization Enforcement Proceedings.....	25
Item 10: Other Financial Industry Activities and Affiliations .....	26
A. Broker-Dealer or Representative Registration .....	26
B. Futures or Commodity Registration .....	26

C. Material Relationships Maintained by this Advisory Business and Conflicts of Interest.....	26
D. Recommendation or Selection of Other Investment Advisors and Conflicts of Interest.....	27
Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading .....	29
A. Code of Ethics Description .....	29
B. Investment Recommendations Involving a Material Financial Interest and Conflicts of Interest.....	29
C. Advisory Firm Purchase of Same Securities Recommended to Clients and Conflicts of Interest.....	29
D. Client Securities Recommendations or Trades and Concurrent Advisory Firm Securities Transactions and Conflicts of Interest.....	29
Item 12: Brokerage Practices .....	30
A. Factors Used to Select Broker-Dealers for Client Transactions.....	30
B. Aggregating Securities Transactions for Client Accounts .....	31
Item 13: Review of Accounts.....	35
A. Schedule for Periodic Review of Client Accounts or Financial Plans and Advisory Persons Involved.....	35
B. Review of Client Accounts on Non-Periodic Basis .....	35
C. Content of Client-Provided Reports and Frequency .....	35
Item 14: Client Referrals and Other Compensation .....	36
A. Economic Benefits Provided to the Advisory Firm from External Sources and Conflicts of Interest.....	36
B. Advisory Firm Payments for Client Referrals .....	36
Item 15: Custody .....	37
Item 16: Investment Discretion .....	38
Item 17: Voting Client Securities .....	39
Item 18: Financial Information .....	40
A. Balance Sheet .....	40
B. Financial Conditions Reasonably Likely to Impair Advisory Firm's Ability to Meet Commitments to Clients.....	40
C. Bankruptcy Petitions During the Past Ten Years.....	40

---

## Item 4: Advisory Business

### A. Description of Your Advisory Firm

LFS Asset Management, LLC ("LFS" or "the firm"), is an independent asset management and financial planning firm offering a variety of financial services to individuals, trusts, corporations, partnerships, retirement plans, tax exempt and other legal entities. Lau Financial Services is the sole member of LFS. John Lau is the sole shareholder of Lau Financial Services.

### B. Description of Advisory Services Offered

For its discretionary asset management services, LFS receives a limited power of attorney to effect securities transactions on behalf of its clients that include securities and strategies as described in Item 8 of this Brochure. In addition, pursuant to the terms of its investment advisory agreement with clients, LFS will remind clients of their obligation to inform the firm of any changes to their personal financial circumstances, investment objectives or risk tolerance, as well as modifications or restrictions that should be imposed on the management of their account. LFS will also contact clients at least annually to determine whether there have been any changes in a client's personal financial circumstances, investment objectives and tolerance for risk.

#### B.1. Discretionary Asset Management Services

LFS' discretionary asset management services are predicated on creating diversified portfolios consisting of individual securities, mutual funds and exchange traded funds. The portfolio allocation chosen seeks a projected return potential consistent with the client's investment objectives, goals, tolerance for risk, and other personal and financial circumstances. In preparing the asset allocation, LFS will analyze each client's current investments, investment objectives, goals, age, time horizon, financial circumstances, investment experience, investment restrictions and limitations, and risk tolerance. LFS' objective is to review the client's tax, financial and financial goals in connection with the client's investment objectives, goals, tolerance for risk, and other personal and financial circumstances and make appropriate portfolio implementation decisions. LFS may engage third-party service providers to assist with the tax and estate planning portion of the services provided to clients. In addition, LFS may utilize third-party software to analyze individual security holdings and separate account managers utilized within the client's portfolio.

LFS will prepare an investment policy statement based on the client's investment objectives, goals, tolerance for risk and such other factors unique to the client and provide appropriate recommendations. On a quarterly basis, LFS, in connection with a third-party service provider, will provide such clients with reports regarding the performance of their portfolios. In addition, LFS will monitor those portfolios and make

additional recommendations from time to time to rebalance and/or reallocate each client's investments as necessary.

LFS' investment advisory services to clients, as noted above, take into account a client's personal financial circumstances, investment objectives and tolerance for risk (e.g., cash-flow, tax and estate). LFS' engagement with a client will include, as appropriate, the following:

- Providing assistance in reviewing the client's current investment portfolio against the client's personal and financial circumstances as disclosed to LFS in response to a questionnaire and/or in discussions with the client and reviewed in meetings with LFS.
- Analyzing the client's financial circumstances, investment holdings and strategy, and goals.
- Providing assistance in identifying a targeted asset allocation and portfolio design.
- Implementing and/or recommending individual equity and fixed income securities, mutual funds and exchange traded funds.
- Reporting to the client on a quarterly basis or at some other interval agreed to with the client, information on contributions and withdrawals in the client's investment portfolio and the performance of the client's portfolio measured against appropriate benchmarks (including benchmarks selected by the client).
- Proposing changes in the client's investment policy statement and/or targeted asset allocation in consideration of changes in the client's personal circumstances, investment objectives and tolerance for risk, the performance record of any of the client's investments, and/or the performance of any fund or manager retained by the client.
- If the client's portfolio and personal circumstances, investment objectives and tolerance for risk make such advice appropriate, providing recommendations to hedge a client's portfolio through the use of derivative strategies, to generate additional income through the use of covered call option writing strategies involving exchange listed or OTC options, and/or to monetize or hedge concentrated stock positions.

In addition to providing LFS with information regarding their personal financial circumstances, investment objectives and tolerance for risk, clients are required to provide any reasonable investment restrictions that should be imposed on the management of their portfolio, and to promptly notify LFS of any changes in such restrictions or in their personal financial circumstances, investment objectives, goals and tolerance for risk. On a quarterly basis, LFS' reports to clients will remind clients of their obligation to inform LFS of any such changes or any restrictions that should be imposed on the management of their account. LFS will also contact clients at least annually to determine whether there have been any changes in a client's personal financial circumstances, investment objectives and tolerance for risk.

When appropriate to the needs of and suitable for a client, LFS will assist the client in developing a strategy for monetizing/hedging a portfolio or a concentrated stock position held by the client. Monetizing a concentrated stock position allows a client to receive funds to diversify the portfolio and limit its downside exposure while allowing for the continued potential to participate, to a lesser extent, in any increase in the price of the concentrated stock. Hedging a concentrated stock position allows a client to protect against losses below a certain stock price while allowing for the potential to participate in any increase in the price of the stock.

## **B.2. Financial Planning Services**

Clients will receive a written or oral report (depending on the client's preference) providing a basic financial plan designed to help achieve the client's stated financial goals and objectives. Based on the client's needs, financial planning services may include (but are not limited to) the following:

- Preparation of a recommended asset allocation that serves to diversify the client's portfolio among different categories of investments, such as domestic and international small, medium and large capitalization securities; corporate and government fixed income (short-, intermediate- and long-term maturities); emerging market securities (i.e., foreign issuers); real estate investment trusts; and such other alternative asset categories that are suitable in light of the client's investment goals, objectives and risk tolerance.
- Preparation of an investment policy statement setting forth the investment plan of the client with specific direction in terms of diversification requirements, tax issues, estate planning issues, risk tolerance, retirement and other identified objectives of the client, including a targeted rate-of-return objective.
- Preparation of a retirement plan that serves to identify whether the client is saving enough and investing in a way that meets retirement objectives in light of the client's financial circumstances and risk tolerance.
- Preparation of cash flow projections to ensure that the client can meet daily living expenses and obligations.
- Insurance planning to meet the needs of the client, taking into account family, business and other financial objectives of the client.

LFS gathers required information through in-depth personal interviews and questionnaires. Information gathered includes a client's current financial status, investment objectives, future goals and attitudes towards risk. Related documents supplied by the client are carefully reviewed, and a report is prepared covering one or more of the above-mentioned topics as directed by the client.

## **C. Client-Tailored Services and Client-Imposed Restrictions**

Each client's account will be managed on the basis of the client's financial situation and investment objectives, and in accordance with any reasonable restrictions imposed by

the client on the management of the account—for example, restricting the type or amount of security to be purchased in the portfolio.

#### **D. Wrap Fee Programs**

LFS does not participate in wrap fee programs. (Wrap fee programs offer investment services for one all-inclusive fee.)

#### **E. Client Assets Under Management**

As of March 29, 2011 LFS has \$43,000,000 in discretionary assets under management and \$0 in non-discretionary assets under management.



## Item 5: Fees and Compensation

### A. Methods of Compensation and Fee Schedule

#### A.1. Asset Management Fee

The annual fee for services provided by LFS will be charged as a percentage of assets under supervision. The fees will be computed in the following manner and charged quarterly in advance:

Basis point charge X market value of assets X actual number of days/365 days

LFS' asset-based fee is 1% for investment advisory clients. Such fee schedule is negotiable.

Generally, fees will be charged in advance. The client and the client's custodian or broker-dealer will be invoiced at the beginning of each calendar quarter, based upon the market value (market value plus any credit balance or minus any debit balance) of the client's account at the end of the previous quarter, as mutually agreed upon by the client and LFS.

Asset-based fees are always subject to the investment advisory agreement between the client and LFS. Such fees are payable quarterly in advance. The fees will be prorated if the investment advisory relationship commences otherwise than at the beginning of a calendar quarter. Adjustments for significant contributions to and distributions from a client's portfolio are prorated for the quarter in which the change occurs.

LFS generally requires a minimum account value of \$500,000 for accounts it manages on a discretionary basis. For accounts utilizing third-party asset managers either through Schwab or NEXT, LFS imposes a minimum account size of \$500,000. Clients are advised that a \$500,000 minimum account size implies a minimum fee of \$5,000. For accounts less than \$500,000, clients may be able to find comparable services at more favorable pricing elsewhere. LFS, in its sole discretion, may waive the required minimum.

#### A.2. Additional Terms for All LFS Client Accounts

Asset-based fees are always subject to the investment advisory agreement between the client and LFS. Such fees are payable quarterly in advance. The fees will be prorated if the investment advisory relationship commences otherwise than at the beginning of a calendar quarter. Adjustments for significant contributions to and distributions from a client's portfolio are prorated for the quarter in which the change occurs.

A client investment advisory agreement may be canceled at any time by the client, or by LFS with thirty (30) days prior written notice to the client. A financial planning agreement may be terminated by either party for any reason upon receipt of written notice. Upon termination of any account, any earned, unpaid fees will be due and payable. The client has the right to terminate an agreement without penalty within five (5) business days after entering into the agreement.

### **A.3. Financial Planning Fees**

LFS offers either hourly or fixed-fee arrangements to all clients. Generally, the more complex the financial planning engagement, the higher the likelihood that fixed fees will be negotiated, as it is difficult with respect to complex cases to discern the exact number of hours required to provide services. In such cases, a fixed fee would be negotiated and then reevaluated at a later point to determine whether the fixed-fee compensation requires adjustment. Fixed fees are computed based upon a good faith estimate of hours required to perform services. Where the time spent can be accurately estimated, then an hourly charge would apply. The applicant attempts to maintain parity with hourly and fixed charges while allowing some flexibility in estimation, taking into account case complexity and client-specific circumstances. Financial planning fees will be billed at the following rate:

Junior staff – \$275/hr

Senior staff – \$450/hr

Principal (John Lau) – \$650/hr

Invoices will be mailed out on a periodic basis reflecting completed work performed. Clients seeking to terminate this service must do so in writing.

### **B. Client Payment of Fees**

Asset-based and financial planning fees are always subject to the investment advisory agreement between the client and LFS. Asset based fees are payable quarterly in advance. The fees will be prorated if the investment advisory relationship commences otherwise than at the beginning of a calendar month or quarter. Adjustments for significant contributions to and distributions from a client's portfolio are prorated for the quarter in which the change occurs. Financial planning fees will be billed in arrears on a periodic basis as work is completed. A client investment advisory agreement may be canceled at any time by the client, or by LFS with thirty (30) days prior written notice to the client. A financial planning agreement may be terminated by either party for any reason upon receipt of written notice. Upon termination of any account, any prepaid, unearned fees will be promptly refunded, and any earned, unpaid fees will be due and payable. The client has the right to terminate an agreement without penalty within five (5) business days after entering into the agreement.

### **C. Additional Client Fees Charged**

The fees charged by LFS do not include fees charged by any exchange traded fund, mutual fund or separate account manager selected by the client. The management fees for investment managers are generally disclosed in each investment manager's disclosure document (Brochure) or, in the case of an exchange traded fund or mutual fund, in the respective fund's prospectus. Clients are advised to read these materials carefully before investing. All fees paid for investment advisory services are separate and distinct from the fees and expenses charged by exchange traded funds, mutual funds,

separate account managers, broker-dealers and custodians retained by clients. Such fees and expenses are described in each exchange traded fund and mutual fund's prospectus, each separate account manager's Form ADV and Brochure and Brochure Supplement or similar disclosure statement, and by any broker-dealer or custodian retained by the client. If a mutual fund also imposes sales charges, a client may pay an initial or deferred sales charge as further described in the mutual fund's prospectus. A client using LFS may be precluded from using certain mutual funds or separate account managers because they may not be offered by the client's custodian.

#### **D. Prepayment of Client Fees**

LFS requires pre-payment of asset based fees only. Financial planning fees will be billed in arrears. LFS' fees will either be paid directly by the client or disbursed to the firm by the qualified custodian of the client's investment accounts, subject to prior written consent of the client. The custodian will deliver directly to the client an account statement, at least quarterly, showing all investment and transaction activity for the period, including fee disbursements from the account.

A client investment advisory agreement may be canceled at any time by the client, or by LFS with thirty (30) days prior written notice to the client. If the agreement terminates other than at the end of a calendar quarter, LFS will promptly refund all unearned, prepaid fees to the client. A financial planning agreement may be terminated by either party for any reason upon receipt of written notice. Upon termination of any account, any earned, unpaid fees will be due and payable. The client has the right to terminate an agreement without penalty within five (5) business days after entering into the agreement.

#### **E. External Compensation for the Sale of Securities to Clients**

Other than as disclosed in Item 10.C. of this Brochure, LFS' financial advisors are compensated solely through a salary and bonus structure. LFS is not paid any sales, service or administrative fees for the sale of mutual funds or any other investment products.

## **Item 6: Performance-Based Fees and Side-by-Side Management**

LFS does not charge performance-based fees and therefore has no economic incentive to manage clients' portfolios in any way other than what is in their best interests.

## **Item 7: Types of Clients**

LFS offers its investment services to various types of clients, including high-net-worth individuals, corporate executive groups, trusts, corporations, partnerships, retirement plans, tax exempt and other legal entities. Although LFS provides investment services to the various types of clients mentioned, the services are conditioned upon meeting certain minimum criteria established by the firm for each of the investment programs it offers.

LFS generally requires a minimum account value of \$500,000 for accounts it manages on a discretionary basis. For accounts utilizing third-party asset managers either through Schwab or GSI, LFS imposes a minimum account size of \$500,000. Clients are advised that a \$500,000 minimum account size implies a minimum fee of \$5,000. For accounts less than \$500,000, clients may be able to find comparable services at more favorable pricing elsewhere. LFS, in its sole discretion, may waive the required minimum.

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

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

The methods of analysis may include fundamental and technical analysis, quantitative methods for optimizing client portfolios, computer-based risk/return analysis, and statistical and/or computer models utilizing long-term economic criteria. LFS may employ outside vendors or utilize third-party software to assist in formulating investment recommendations to clients.

#### **A.1. Mutual Funds, Exchange Traded Funds, Independent Investment Managers, Individual Equity and Fixed Income Securities**

LFS may recommend (i) separate account managers to manage client assets, and (ii) mutual funds and individual securities (including fixed income instruments). Such investments may represent certain asset class styles, such as large-, mid- and small-cap value, growth and core; international and emerging markets; and alternative investments. LFS may also assist the client in selecting one or more appropriate manager(s) for all or a portion of the client's portfolio. Such managers typically manage assets for clients who commit to the manager a minimum amount of assets established by that manager—a factor that LFS will take into account when recommending managers to clients.

A description of the criteria to be used in formulating an investment recommendation for mutual funds, exchange traded funds, individual securities (including fixed-income securities), managers and pooled investment vehicles is set forth below.

LFS has formed relationships with third-party vendors that

- provide a technological platform for separate account management
- prepare performance reports
- perform due diligence monitoring of mutual funds, and managers perform billing and certain other administrative tasks

LFS may utilize additional independent third parties to assist it in recommending and monitoring individual securities, mutual funds and managers to clients as appropriate under the circumstances.

LFS reviews certain quantitative and qualitative criteria related to mutual funds and managers and to formulate investment recommendations to its clients. Quantitative criteria may include:

- the performance history of a mutual fund or manager evaluated against that of its peers and other benchmarks
- an analysis of risk-adjusted returns

- an analysis of the manager's contribution to the investment return (e.g., manager's alpha), standard deviation of returns over specific time periods, sector and style analysis
- the fund, sub-advisor or manager's fee structure
- the relevant portfolio manager's tenure

Qualitative criteria used in recommending mutual funds or managers include the investment objectives and/or management style and philosophy of a mutual fund or manager, a mutual fund or manager's consistency of investment style, and employee turnover and efficiency and capacity. LFS will discuss relevant quantitative and qualitative factors pertaining to its recommendations with clients prior to a client's determination to retain a mutual fund or manager.

Quantitative and qualitative criteria related to mutual funds and managers are reviewed by LFS on a quarterly basis or such other interval as mutually agreed upon by the client and the firm. In addition, mutual funds or managers are reviewed to determine the extent to which their investments reflect efforts to time the market, or evidence style drift such that their portfolios no longer accurately reflect the particular asset category attributed to the mutual fund or manager by LFS (both of which are negative factors in implementing an asset allocation structure). Based on its review, LFS will make recommendations to clients regarding the retention or discharge of a mutual fund or manager.

LFS may negotiate reduced account minimum balances and reduced fees with managers under various circumstances (e.g., for clients with minimum level of assets committed to the manager for specific periods of time, etc.). There can be no assurance that clients will receive any reduced account minimum balances or fees, or that all clients, even if apparently similarly situated, will receive any reduced account minimum balances or fees available to some other clients. Also, account minimum balances and fees may significantly differ between clients. Each client's individual needs and circumstances will determine portfolio weighting, which can have an impact on fees given the mutual funds or managers utilized. LFS will endeavor to obtain equal treatment for its clients with mutual funds or managers, but cannot assure equal treatment.

LFS will regularly review the activities of mutual funds and managers selected by the client. Clients that engage managers or invest in mutual funds should first review and understand the disclosure documents of those managers or mutual funds, which contain information relevant to such retention or investment, including information on the methodology used to analyze securities, investment strategies, fees and conflicts of interest.

## **A.2. Material Risks of Investment Instruments**

LFS typically invests in equity securities, corporate debt instruments, municipal fixed income instruments, government securities including asset-backed securities, and options on securities as detailed below:

- Equity securities
- Warrants and rights
- Mutual fund securities
- Exchange traded funds
- Corporate debt securities, commercial paper and certificates of deposit
- Municipal securities
- U.S. government securities
- Option contracts on securities
- Government and agency mortgage-backed securities
- Corporate debt obligations
- Mortgage-backed securities
- Collateralized obligations

#### **A.2.a. Equity Securities**

Investing in individual companies involves inherent risk. The major risks relate to the company's capitalization, quality of the company's management, quality and cost of the company's services, the company's ability to manage costs, efficiencies in the manufacturing or service delivery process, management of litigation risk, and the company's ability to create shareholder value (i.e., increase the value of the company's stock price). Foreign securities, in addition to the general risks of equity securities, have geopolitical risk, financial transparency risk, currency risk, regulatory risk and liquidity risk.

#### **A.2.b. Warrants and Rights**

LFS may invest in warrants and rights. Warrants are securities, typically issued with preferred stock or bonds, that give the holder the right to purchase a given number of shares of common stock at a specified price and time. The price of the warrant usually represents a premium over the applicable market value of the common stock at the time of the warrant's issuance. Warrants have no voting rights with respect to the common stock, receive no dividends, and have no rights with respect to the assets of the issuer.

Investments in warrants and rights involve certain risks, including the possible lack of a liquid market for the resale of the warrants and rights, potential price fluctuations due to adverse market conditions or other factors, and failure of the price of the common stock to rise. If the warrant is not exercised within the specified time period, it becomes worthless.

#### **A.2.c. Mutual Fund Securities**

Investing in mutual funds carries inherent risk. The major risks of investing in a mutual fund include the quality and experience of the portfolio management team and its ability to create fund value by investing in securities that have positive growth, the



amount of individual company diversification, the type and amount of industry diversification, and the type and amount of sector diversification within specific industries. In addition, mutual funds tend to be tax inefficient and therefore investors may pay capital gains taxes on fund investments while not having yet sold the fund.

#### **A.2.d. Exchange Traded Funds (“ETFs”)**

LFS may invest in ETFs (which may, in turn, invest in equities, bonds and other financial vehicles). ETFs are investment companies whose shares are bought and sold on a securities exchange. An ETF holds a portfolio of securities designed to track a particular market segment or index. Some examples of ETFs are SPDRs<sup>®</sup>, streetTRACKS<sup>®</sup>, DIAMONDS<sup>SM</sup>, NASDAQ 100 Index Tracking Stock<sup>SM</sup> (“QQQs<sup>SM</sup>”), iShares<sup>®</sup> and VIPERs<sup>®</sup>. The funds could purchase an ETF to gain exposure to a portion of the U.S. or foreign market. The funds, as a shareholder of another investment company, will bear their pro rata portion of the other investment company’s advisory fee and other expenses, in addition to their own expenses.

Investing in ETFs involves risk. Specifically, ETFs, depending on the underlying portfolio and its size, can have wide price (bid and ask) spreads, thus diluting or negating any upward price movement of the ETF or enhancing any downward price movement. Also, ETFs require more frequent portfolio reporting by regulators and are thereby more susceptible to actions by hedge funds that could have a negative impact on the price of the ETF. Certain ETFs may employ leverage, which creates additional volatility and price risk depending on the amount of leverage utilized, the collateral and the liquidity of the supporting collateral.

Further, the use of leverage (i.e., employ the use of margin) generally results in additional interest costs to the ETF. Certain ETFs are highly leveraged and therefore have additional volatility and liquidity risk. Volatility and liquidity can severely and negatively impact the price of the ETF’s underlying portfolio securities, thereby causing significant price fluctuations of the ETF.

#### **A.2.e. Corporate Debt, Commercial Paper and Certificates of Deposit**

Fixed income securities carry additional risks than those of equity securities described above. These risks include the company’s ability to retire its debt at maturity, the current interest rate environment, the coupon interest rate promised to bondholders, legal constraints, jurisdictional risk (U.S or foreign) and currency risk. If bonds have maturities of 10 years or greater, they will likely have greater price swings when interest rates move up or down. The shorter the maturity the less volatile the price swings. Foreign bonds also have liquidity and currency risk.

Commercial paper and certificates of deposit are generally considered safe instruments, although they are subject to the level of general interest rates, the credit quality of the issuing bank and the length of maturity. With respect to certificates of deposit, depending on the length of maturity there can be prepayment penalties if the client needs to convert the certificate of deposit to cash prior to maturity.

#### **A.2.f. Municipal Securities**

Municipal securities carry additional risks than those of corporate and bank-sponsored debt securities described above. These risks include the municipality's ability to raise additional tax revenue or other revenue (in the event the bonds are revenue bonds) to pay interest on its debt and to retire its debt at maturity. Municipal bonds are generally tax-free at the federal level, but may be taxable in individual states other than the state in which both the investor and municipal issuer is domiciled.

#### **A.2.g. U.S. Government Securities**

LFS may invest in U.S. government securities. U.S. government securities include securities issued by the U.S. Treasury and by U.S. government agencies and instrumentalities. U.S. government securities may be supported by the full faith and credit of the United States.

#### **A.2.h. Options on Securities**

A call option is a contract under which the purchaser of the call option, in return for a premium paid, has the right to buy the security (or index) underlying the option at a specified price at any time during the term of the option. The writer of the call option, who receives the premium, has the obligation upon exercise of the option to deliver the underlying security against payment of the exercise price. A put option gives its purchaser, in return for a premium, the right to sell the underlying security at a specified price during the term of the option. The writer of the put, who receives the premium, has the obligation to buy, upon exercise of the option, the underlying security (or a cash amount equal to the value of the index) at the exercise price. The amount of a premium received or paid for an option is based upon certain factors, including the market price of the underlying security, the relationship of the exercise price to the market price, the historical price volatility of the underlying security, the option period and interest rates.

#### **A.2.i. Government and Agency Mortgage-Backed Securities**

The principal issuers or guarantors of mortgage-backed securities are the Government National Mortgage Association ("GNMA"), Fannie Mae ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC"). GNMA, a wholly owned U.S. government corporation within the Department of Housing and Urban Development ("HUD"), creates pass-through securities from pools of government-guaranteed (Farmers' Home Administration, Federal Housing Authority or Veterans Administration) mortgages. The principal and interest on GNMA pass-through securities are backed by the full faith and credit of the U.S. government.

FNMA, which is a U.S. government-sponsored corporation owned entirely by private stockholders that is subject to regulation by the secretary of HUD, and FHLMC, a corporate instrumentality of the U.S. government, issue pass-through securities from pools of conventional and federally insured and/or guaranteed residential mortgages. FNMA guarantees full and timely payment of all interest and principal, and FHMLC

guarantees timely payment of interest and ultimate collection of principal of its pass-through securities. Mortgage-backed securities from FNMA and FHLMC are *not* backed by the full faith and credit of the U.S. government.

#### **A.2.j. Corporate Debt Obligations**

LFS may invest in corporate debt obligations. Corporate debt obligations include corporate bonds, debentures, notes, commercial paper and other similar corporate debt instruments. Companies use these instruments to borrow money from investors. The issuer pays the investor a fixed or variable rate of interest and must repay the amount borrowed at maturity. Commercial paper (short-term unsecured promissory notes) is issued by companies to finance their current obligations and normally has a maturity of less than nine months. In addition, LFS may invest in corporate debt securities registered and sold in the United States by foreign issuers (Yankee bonds) and those sold outside the U.S. by foreign or U.S. issuers (Eurobonds).

#### **A.2.k. Mortgage-Backed Securities**

LFS may invest in mortgage-backed securities, including pass-through securities and collateralized obligations. Mortgage-backed securities represent interests in a pool of mortgage loans originated by lenders such as commercial banks, savings associations, and mortgage bankers and brokers. Mortgage-backed securities may be issued by governmental or government-related entities, or by non-governmental entities such as special-purpose trusts created by commercial lenders.

Pools of mortgages consist of whole mortgage loans or participations in mortgage loans. The majority of these loans are made to purchasers of between one and four family homes. The terms and characteristics of the mortgage instruments are generally uniform within a pool but may vary among pools. For example, in addition to fixed-rate, fixed-term mortgages, LFS may purchase pools of adjustable-rate mortgages, growing equity mortgages, graduated payment mortgages and other types. Mortgage poolers apply qualification standards to lending institutions, which originate mortgages for the pools as well as credit standards and underwriting criteria for individual mortgages included in the pools. In addition, many mortgages included in pools are insured through private mortgage insurance companies.

Mortgage-backed securities differ from other forms of fixed income securities, which normally provide for periodic payment of interest in fixed amounts with principal payments at maturity or on specified call dates. Most mortgage-backed securities, however, are pass-through securities, which means that investors receive payments consisting of a pro rata share of both principal and interest (less servicing and other fees), as well as unscheduled prepayments as loans in the underlying mortgage pool are paid off by the borrowers. Additional prepayments to holders of these securities are caused by prepayments resulting from the sale or foreclosure of the underlying property or refinancing of the underlying loans. As prepayment rates of individual pools of mortgage loans vary widely, it is not possible to accurately predict the average life of a particular mortgage-backed security. Although mortgage-backed securities are

issued with stated maturities of up to 40 years, unscheduled or early payments of principal and interest on the mortgages may shorten considerably the securities' effective maturities.

#### **A.2.I. Collateralized Obligations**

LFS may invest in collateralized mortgage obligations ("CMOs") that are collateralized by mortgage-backed securities issued by GNMA, FHLMC or FNMA ("mortgage assets"). CMOs are multiple-class debt obligations. Payments of principal and interest on the mortgage assets are passed through to the holders of the CMOs as they are received, although certain classes (often referred to as "tranches") of CMOs have priority over other classes with respect to the receipt of mortgage prepayments. Each tranche is issued at a specific or floating coupon rate and has a stated maturity or final distribution date. Interest is paid or accrues in all tranches on a monthly, quarterly or semi-annual basis. Payments of principal and interest on mortgage assets are commonly applied to the tranches in the order of their respective maturities or final distribution dates, so that generally no payment of principal will be made on any tranche until all other tranches with earlier stated maturity or distribution dates have been paid in full.

LFS may also invest in collateralized debt obligations ("CDOs"), which include collateralized bond obligations ("CBOs"), collateralized loan obligations ("CLOs") and other similarly structured securities. CBOs and CLOs are types of asset-backed securities. A CBO is a trust that is backed by a diversified pool of high-risk, below-investment-grade fixed income securities. A CLO is a trust typically collateralized by a pool of loans, which may include, among others, domestic and foreign senior secured loans, senior unsecured loans, and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans.

### **B. Investment Strategy and Method of Analysis Material Risks**

LFS utilizes a long term investment strategy for clients either through recommending a diversified portfolio of mutual funds, exchange traded funds, and in certain instances individual equity securities (including fixed income securities) Although equity securities carry risk as described in Item 8.2. above LFS tries to mitigate such risk through recommending to clients diversified portfolios of securities.

#### **B.1. Leverage**

Although LFS, as a general business practice, does not utilize leverage, there may be instances in which ETF's and in very limited circumstances, LFS will utilize leverage. In this regard please review the following:

The use of leverage enhances the overall risk of investment gain and loss to the client's investment portfolio. For example, investors are able to control \$2 of a security for \$1. So if the price of a security rises by \$1, the investor earns a 100% return on their investment.

Conversely, if the security declines by \$.50, then the investor loses 50% of their investment. The use of leverage entails borrowing, which results in additional interest costs to the investor. In addition, the use of leverage enhances the price volatility of the collateral securities which can result in significant loss.

Broker-dealers who carry customer accounts have a minimum equity requirement when clients utilize leverage. The minimum equity requirement is stated as a percentage of the value of the underlying collateral security with an absolute minimum dollar requirement. For example, if the price of a security declines in value to the point where the excess equity used to satisfy the minimum requirement dissipates, the broker-dealer will require the client to deposit additional collateral to the account in the form of cash or marketable securities. A deposit of securities to the account will require a larger deposit, as the security being deposited is included in the computation of the minimum equity requirement. In addition, when leverage is utilized and the client needs to satisfy a required margin deposit or withdraw cash, the client must sell a disproportionate amount of collateral securities to release enough cash to satisfy the withdrawal amount based upon similar reasoning as cited above.

Regulations concerning the use of leverage are established by the Federal Reserve Board and vary if the client's account is held at a broker-dealer versus a bank custodian. Broker-dealers and bank custodians may apply more stringent rules as they deem necessary.

### **B.2. Short-Term Trading**

LFS generally does not engage in high-frequency trading but reserves the right to employ such a strategy given current market conditions for the securities in which it invests. There is an inherent risk for clients who trade frequently in that high-velocity trading creates substantial transaction costs that in the aggregate could negatively impact account performance.

### **B.3. Short Selling**

LFS generally does not engage in short selling but reserves the right to do so in the exercise of its sole judgment. Short selling involves the sale of a security that is borrowed rather than owned. When a short sale is effected, the investor is expecting the price of the security to decline in value so that a purchase or closeout of the short sale can be effected at a significantly lower price. The primary risks of effecting short sales are the availability to borrow the stock, the unlimited potential for loss, and the requirement to fund any difference between the short credit balance and the market value of the borrowed security.

### **B.4. Option Strategies**

Holders of long call options give the holder the right to acquire underlying securities at the contract strike price up until expiration of the option. Each contract is worth 100 shares of the underlying security. LFS as part of its investment strategy may employ any of the following:

- Covered call writing
- Long call options purchases
- Long put options purchases
- Option spreading
- Short call option strategy
- Short put option strategy
- Equity collars
- Long straddles

#### **B.4.a. Covered Call Writing**

Covered call writing is the sale of in-, at-, or out-of-the money call option against a long security position held in the client portfolio. This type of transaction is used to generate income. It also serves to create downside protection in the event the security position declines in value. Income is received from the proceeds of the option sale. Such income may be reduced to the extent it is necessary to buy back the option position prior to its expiration. This strategy may involve a degree of trading velocity, transaction costs and significant losses if the underlying security has volatile price movement. Covered call strategies are generally suited for companies with little price volatility.

#### **B.4.b Long Call Option Purchases**

Long call option purchases allow the option holder to be exposed to the general market characteristics of a security without the outlay of capital necessary to own the security. Options are wasting assets and expire (usually within nine months of issuance), and as a result can expose the investor to significant loss.

#### **B.4.c. Long Put Option Purchases**

Long put option purchases allow the option holder to sell or “put” the underlying security at the contract strike price at a future date. If the price of the underlying security declines in value, the value of the long put option increases. In this way, long puts are often used to hedge a long stock position. Options are wasting assets and expire (usually within nine months of issuance), and as a result can expose the investor to significant loss.

#### **B.4.d. Option Spreading**

Option spreading usually involves the purchase of a call option and the sale of a call option at a higher contract strike price, both having the same expiration month. The purpose of this type of transaction is to allow the holder to be exposed to the general market characteristics of a security without the outlay of capital to own the security, and to offset the cost by selling the call option with a higher contract strike price. In this type of transaction, the spread holder “locks in” a maximum profit, defined as the difference in contract prices reduced by the net cost of implementing the spread.

There are many variations of option spreading strategies; please contact the Options Clearing Corporation for a current Options Risk Disclosure Statement that discusses each of these strategies.

**B.4.e. Short Call Option Strategy**

Short call option strategy is highly speculative and has theoretical potential for unlimited loss. The seller (writer) of the call option receives proceeds (premium) from the sale of the option. The expectation is that the value of the underlying security will remain below the contract strike price and the option will expire worthless, allowing the option writer to keep the entire amount of the sale proceeds (premium). Should the value of the underlying security increase above the contract strike price, then the option writer can either purchase the call option at a loss, or through a process of exercise and assignment be forced to sell the stock at the contract strike price. If this happens, the option writer will have to go in the open market and buy an equivalent amount of stock to cover the sale at prices that can be materially higher than the amount received from the sale.

**B.4.f. Short Put Option Strategy**

Short put option strategy is highly speculative and has theoretical potential for significant loss. The seller (writer) of the put option receives proceeds (premium) from the sale of the option. The expectation is that the value of the underlying security will remain above the contract strike price and the option will expire worthless, allowing the option writer to keep the entire amount of the sale proceeds (premium). Should the value of the underlying security decrease below the contract strike price, the option writer can either purchase the put option at a loss, or through a process of exercise and assignment be forced to buy the stock at the contract strike price. If this happens, the option writer will be purchasing the underlying security at a price potentially well above its then-current market value, exposing the investor to potential loss.

**B.4.g. Equity Collar**

A collar combines both a cap and a floor. A cap gives the purchaser of the cap the right (for a premium payment), but not the obligation, to receive the difference in the cost on some amount when a specified index rises above the specified "cap rate." A floor is the opposite of a cap—it gives the purchaser of the floor the right (for a premium payment), but not the obligation, to receive the difference in interest payable on an amount when a specified index falls below the specified "floor rate." A collar involving stock is called an "equity collar." In a collar transaction, the buyer of the collar purchases a cap while selling a floor indexed to the same rate or asset. A zero-cost collar results when the premium earned by selling a floor exactly offsets the cap premium.

**B.4.h. Long Straddle**

A long straddle is the purchase of a long call and a long put with the same underlying security, expiration date and strike price. This is a speculative trade that may be profitable when volatility is high and will result in a loss when prices of the underlying security are relatively stable.

**B.5. Concentration Risk**

There is an inherent risk for clients whose investment portfolios lack diversification—that is, they have their investment portfolios heavily weighted in one security, one industry or industry sector, one geographic location, one investment manager, one type of investment instrument (equities versus fixed income). Clients who have diversified portfolios, as a general rule, incur less volatility and therefore less fluctuation in portfolio value than those who have concentrated holdings. Concentrated holdings may offer the potential for higher gain, but also offer the potential for significant loss.

**C. Security-Specific Material Risks**

LFS invests in a diversified portfolio of equity and fixed income securities. Please refer to Item 8.A. above.



## **Item 9: Disciplinary Information**

There are no current or pending disclosure items to report on behalf of LFS advisors.

### **A. Criminal or Civil Actions**

There is nothing to report for this item.

### **B. Administrative Enforcement Proceedings**

There is nothing to report for this item.

### **C. Self-Regulatory Organization Enforcement Proceedings**

There is nothing to report for this item.

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

### **A. Broker-Dealer or Representative Registration**

Officers, directors and registered personnel of LFS are associated with Girard Securities, Inc., a registered broker/dealer, investment advisor and member FINRA / SIPC. GSI is a financial services company engaged in the sale of investment products. The officers, directors and registered personnel of LFS are also licensed as insurance agents. LFS' Managing Member, John Lau, is the San Mateo, CA, manager for GSI and receives commissions and overriding commissions from the sales of such investment and insurance products from all sales representatives within the San Mateo office. Approximately 60% of Mr. Lau's time and effort is attributable to the functions of LFS. Approximately 25% of Mr. Lau's time and effort is attributable to tax practitioner activities discussed below, while 10% of time is allocated to the function of securities commission sales and sales supervision of registered representatives of GSI's San Mateo, CA, office. The remaining 5% of Mr. Lau's time is allocated to insurance sales.

LFS' Managing Member and its registered employees are also licensed with GSI, as registered representatives of GSI's broker-dealer affiliate and as investment advisor representatives of GSI's investment advisor affiliate. Services provided by LFS' Managing Member and registered employees are provided through GSI d/b/a Lau Financial Services.

### **B. Futures or Commodity Registration**

Neither LFS nor its affiliates are registered as a commodity firm, futures commission merchant, commodity pool operator or commodity trading advisor and do not have an application to register pending.

### **C. Material Relationships Maintained by this Advisory Business and Conflicts of Interest**

#### **C.1. NEXT Financial Group, Inc.**

LFS' Managing Member and registered employees are also licensed with Girard Securities, Inc., a registered broker/dealer, investment advisor and member FINRA / SIPC ("GSI"), as registered representatives of GSI's broker-dealer affiliate and as investment advisor representatives of GSI's investment advisor affiliate. Services provided by LFS' Managing Member and registered employees are provided through GSI d/b/a Lau Financial Services.

As a result of LFS' managers, members and registered personnel's affiliation with GSI, such professionals, in their capacity as registered representatives of GSI, are subject to the oversight of GSI and the Financial Industry Regulatory Authority, Inc. ("FINRA"). As such, clients of LFS should understand that their personal and account information is

available to FINRA and GSI personnel in the fulfillment of their oversight obligations and duties. Under an agreement with GSI, LFS will allocate and pay 5% of all investment advisory fees to GSI in return for GSI undertaking certain obligations established under FINRA rules with respect to certain brokerage activities performed by personnel in their capacity as GSI-registered representatives.

LFS advisory clients are not compelled to effect securities transactions through GSI. LFS professionals who effect transactions for advisory clients will not receive transaction or commission compensation from either GSI or any other executing broker. LFS may be deemed to have a conflict of interest in that effecting transactions through GSI will benefit LFS by providing leverage to potentially negotiate a better fee structure from GSI.

Managers, members and registered personnel of LFS are associated persons of GSI. GSI may provide brokerage services to one or more of the third-party advisors to whom investment advisor representatives of LFS, in their capacity as LFS investment advisor representatives, refer potential clients. GSI may receive brokerage fees for transactions completed on behalf of customers. As a result, a conflict of interest may be deemed to exist in that referral of separate account managers offered by GSI may benefit LFS by providing leverage for LFS to negotiate a more favorable economic arrangement or to procure additional services with or through GSI.

### **C.2. Relationships with Several Insurance Firms**

Certain managers, members and registered employees of LFS are agents for certain insurance carriers. With respect to the provision of financial planning services, LFS professionals may recommend insurance products offered by such carriers for whom they function as agents and receive a commission for doing so. Clients are advised of a potential conflict of interest in that there is an economic incentive to recommend insurance and other investment products of such carriers. Clients are also advised that LFS professionals strive to put their clients' interests first and foremost. Other than for insurance products that require a securities license, such as variable insurance products, clients may utilize any insurance carrier or insurance agency they desire. For products requiring a securities and insurance license, clients may be limited to those insurance carriers that have a selling agreement with LFS' professionals' employing broker-dealer.

### **C.3. Tax Practitioner Activities**

LFS' Managing Member, John Lau, is a licensed tax practitioner. Mr. Lau spends approximately 25% of his time devoted to such accounting activities.

## **D. Recommendation or Selection of Other Investment Advisors and Conflicts of Interest**

Other than as disclosed in Item 10.C. above, LFS does not recommend separate account managers or other investment products to advisory clients in which it receives compensation. LFS professionals who maintain both a securities broker dealer and insurance license do receive commission payments for the sale of variable annuity and

other insurance products. However, such variable annuity and insurance products are not included as part of the investment advisory relationship between the client and LFS.

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

### **A. Code of Ethics Description**

In accordance with the Advisers Act, LFS has adopted policies and procedures designed to detect and prevent insider trading. In addition, LFS has adopted a Code of Ethics (the "Code"). Among other things, the Code includes written procedures governing the conduct of LFS' advisory and access persons. The Code also imposes certain reporting obligations on persons subject to the Code. The Code and applicable securities transactions are monitored by the Chief Compliance Officer of LFS. LFS will send clients a copy of its Code of Ethics upon written request.

LFS has policies and procedures in place to ensure that the interests of its clients are given preference over those of LFS, its affiliates and its employees. For example, there are policies in place to prevent the misappropriation of material nonpublic information, and such other policies and procedures reasonably designed to comply with federal and state securities laws.

### **B. Investment Recommendations Involving a Material Financial Interest and Conflicts of Interest**

LFS does not engage in principal trading (i.e., the practice of selling stock to advisory clients from a firm's inventory or buying stocks from advisory clients into a firm's inventory). In addition, LFS does not recommend any securities to advisory clients in which it has some proprietary or ownership interest.

### **C. Advisory Firm Purchase of Same Securities Recommended to Clients and Conflicts of Interest**

LFS, its affiliates, employees and their families, trusts, estates, charitable organizations and retirement plans established by it may purchase the same securities as are purchased for clients.

### **D. Client Securities Recommendations or Trades and Concurrent Advisory Firm Securities Transactions and Conflicts of Interest**

LFS, its affiliates, employees and their families, trusts, estates, charitable organizations and retirement plans established by it may effect securities transactions for their own accounts that differ from those recommended or effected for other LFS clients. LFS will make a reasonable attempt to trade securities in client accounts at or prior to trading the securities in its affiliate, corporate, employee or employee-related accounts. Trades executed the same day will likely be subject to an average pricing calculation. It is the policy of LFS to place the clients' interests above those of LFS and its employees.

## Item 12: Brokerage Practices

### A. Factors Used to Select Broker-Dealers for Client Transactions

LFS may recommend/require that clients establish brokerage accounts with the Schwab Advisor Services division of Charles Schwab & Co., Inc. ("Schwab"), a FINRA-registered broker-dealer, member SIPC, to maintain custody of clients' assets and to effect trades for their accounts. Although LFS may recommend/require that clients establish brokerage accounts with Schwab, LFS is independently owned and operated and not affiliated with Schwab.

Schwab does not charge separately for custody services, but is compensated by account holders through commissions and other transaction-related or asset-based fees for securities trades that are executed through or that settle into Schwab accounts.

In certain instances and subject to approval by the firm, LFS will recommend to clients certain broker-dealers and/or custodians based on the needs of the individual client and taking into consideration the nature of the services required, the experience of the broker-dealer or custodian, the cost and quality of the services, and the reputation of the broker-dealer or custodian. The final determination to engage a broker-dealer or custodian recommended by LFS will be made by and in the sole discretion of the client. The client recognizes that broker-dealers and/or custodians have different cost and fee structures and trade execution capabilities. As a result, there may be disparities with respect to the cost of services and/or the transaction prices for securities transactions executed on behalf of the client. Clients are responsible for assessing the commissions and other costs charged by broker-dealers and/or custodians.

#### A.1. Institutional Trading and Custody Services

Schwab provides LFS with access to its institutional trading and custody services, which are typically not available to Schwab retail investors. These services are generally available to independent investment advisors on an unsolicited basis, at no charge to them so long as a total of at least \$10 million of the advisor's clients' assets are maintained in accounts at Schwab. These services are not contingent upon LFS committing to Schwab any specific amount of business (assets in custody or trading commissions). Schwab's brokerage services include the execution of securities transactions, custody, research, and access to mutual funds and other investments that are otherwise generally available only to institutional investors or that would require a significantly higher minimum initial investment.

#### A.2. Other Products and Services

Schwab also makes available to LFS other products and services that benefit LFS but may not directly benefit its clients' accounts. Many of these products and services may be used to service all or some substantial number of LFS' accounts, including accounts not

maintained at Schwab. Schwab also makes available to LFS its managing and administering software and other technology that

- provide access to client account data (such as trade confirmations and account statements)
- facilitate trade execution and allocate aggregated trade orders for multiple client accounts
- provide research, pricing and other market data
- facilitate payment of LFS' fees from its clients' accounts
- assist with back-office functions, recordkeeping and client reporting

Schwab also offers other services intended to help LFS manage and further develop its business enterprise. These services may include

- compliance, legal and business consulting
- publications and conferences on practice management and business succession
- access to employee benefits providers, human capital consultants and insurance providers

Schwab may make available, arrange and/or pay third-party vendors for the types of services rendered to LFS. Schwab may discount or waive fees it would otherwise charge for some of these services, or pay all or a part of the fees of a third-party providing these services to LFS. Schwab may also provide other benefits such as educational events or occasional business entertainment of LFS personnel. In evaluating whether to recommend or require that clients custody their assets at Schwab, LFS may take into account the availability of some of the foregoing products and services and other arrangements as part of the total mix of factors it considers and not solely on the nature, cost or quality of custody and brokerage services provided by Schwab, which may create a potential conflict of interest.

### **A.3. Independent Third Parties**

Schwab may make available, arrange and/or pay third-party vendors for the types of services rendered to LFS. Schwab may discount or waive fees it would otherwise charge for some of these services or all or a part of the fees of a third party providing these services to LFS.

## **B. Aggregating Securities Transactions for Client Accounts**

### **B.1. Best Execution**

LFS, pursuant to the terms of its investment advisory agreement with clients, has discretionary authority to determine which securities are to be bought and sold and the price of such securities to effect such transactions. LFS recognizes that the analysis of execution quality involves a number of factors, both qualitative and quantitative. LFS will follow a process in an attempt to ensure that it is seeking to obtain the most favorable

execution under the prevailing circumstances when placing client orders. These factors include but are not limited to the following:

- The financial strength, reputation and stability of the broker
- The efficiency with which the transaction is effected
- The ability to effect prompt and reliable executions at favorable prices (including the applicable dealer spread or commission, if any)
- The availability of the broker to stand ready to effect transactions of varying degrees of difficulty in the future
- The efficiency of error resolution, clearance and settlement
- Block trading and positioning capabilities
- Performance measurement
- Online access to computerized data regarding customer accounts
- Availability, comprehensiveness, and frequency of brokerage and research services
- Commission rates
- The economic benefit to the client
- Related matters involved in the receipt of brokerage services

Consistent with its fiduciary responsibilities, LFS seeks to ensure that clients receive best execution with respect to their transactions by blocking client trades to reduce transactions costs. To the best of LFS' knowledge, these custodians provide high-quality trade execution, and LFS' clients do not pay higher transaction costs in return for such execution.

Commission rates and securities transaction fees charged to effect such transactions are established by the client's independent custodian and/or broker-dealer. Based upon its own knowledge of the securities industry, LFS believes that such commission rates are competitive within the securities industry. Lower commissions or better execution may be able to be achieved elsewhere.

## **B.2. Directed Brokerage**

### **B.2.a. LFS Recommendations**

LFS currently recommends Schwab as custodian for clients' funds and securities and to execute securities transactions on its clients' behalf.

### **B.2.b. Client-Directed Brokerage**

Occasionally, clients may direct LFS to use a particular broker-dealer to execute portfolio transactions for their accounts or request that certain types of securities not be purchased for their accounts. Clients who designate the use of a particular broker-dealer should be aware that they will lose any possible advantage LFS derives from aggregating transactions. Such client trades are typically effected after the trades of



clients who have not directed the use of a particular broker-dealer. LFS loses the ability to aggregate trades with other LFS advisory clients, potentially subjecting the client to inferior trade execution prices as well as higher commissions.

### **B.3. Security Allocation**

Since LFS may be managing accounts with similar investment objectives, LFS may aggregate orders for securities for such accounts. In such event, allocation of the securities so purchased or sold, as well as expenses incurred in the transaction, is made by LFS in the manner it considers to be the most equitable and consistent with its fiduciary obligations to such accounts.

LFS' allocation procedures seek to allocate investment opportunities among clients in the fairest possible way, taking into account the clients' best interests. LFS will follow procedures to ensure that allocations do not involve a practice of favoring or discriminating against any client or group of clients. Account performance is never a factor in trade allocations.

LFS' advice to certain clients and entities and the action of the firm for those and other clients are frequently premised not only on the merits of a particular investment but also on the suitability of that investment for the particular client in light of his or her applicable investment objective, guidelines and circumstances. Thus, any action of LFS with respect to a particular investment may, for a particular client, differ or be opposed to the recommendation, advice or actions of the firm to or on behalf of other clients.

### **B.4. Order Aggregation**

Orders for the same security entered on behalf of more than one client will generally be aggregated (i.e., blocked or bunched) subject to the aggregation being in the best interests of all participating clients. Subsequent orders for the same security entered during the same trading day may be aggregated with any previously unfilled orders. Subsequent orders may also be aggregated with filled orders if the market price for the security has not materially changed and the aggregation does not cause any unintended duration exposure. All clients participating in each aggregated order will receive the average price and, subject to minimum ticket charges and possible step outs, pay a pro rata portion of commissions.

To minimize performance dispersion, "strategy" trades should be aggregated and average priced. However, when a trade is to be executed for an individual account and the trade is not in the best interests of other accounts, then the trade will only be performed for that account. This is true even if LFS believes that a larger size block trade would lead to best overall price for the security being transacted.

### **B.5. Allocation of Trades**

All allocations will be made prior to the close of business on the trade date. In the event an order is "partially filled," the allocation will be made in the best interests of all the clients in the order, taking into account all relevant factors including, but not limited to,

the size of each client's allocation, clients' liquidity needs and previous allocations. In most cases, accounts will get a pro forma allocation based on the initial allocation. This policy also applies if an order is "over-filled."

LFS acts in accordance with its duty to seek best price and execution and will not continue any arrangements if it determines that such arrangements are no longer in the best interest of its clients.

#### **B.6. Soft Dollar Arrangements**

LFS does not utilize soft dollar arrangements. LFS does not direct brokerage transactions to executing brokers for research and brokerage services.

#### **B.7. Brokerage for Client Referrals**

LFS does not engage in the practice of directing brokerage commissions in exchange for the referral of advisory clients.

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

### **A. Schedule for Periodic Review of Client Accounts or Financial Plans and Advisory Persons Involved**

The review of accounts of high-net-worth and affluent clients, including corporations, partnerships and trusts, is conducted in the first instance by the professional servicing the client relationship on at least a quarterly basis. Such professionals are subject to the general authority of LFS' Managing Member. The Managing Member or his designee(s) must review and approve the opening of each new advisory relationship and oversee reviews of client accounts. The Managing Member or his designee(s) is also responsible for ensuring that any significant change in a client's investment strategy or in the concentration of a client's assets is appropriate for and has been reviewed with the client.

### **B. Review of Client Accounts on Non-Periodic Basis**

LFS may perform *ad hoc* reviews on an as-needed basis if there have been material changes in the client's investment objectives or risk tolerance, or a material change in how LFS formulates investment advice.

### **C. Content of Client-Provided Reports and Frequency**

All investment advisory clients receive customized performance reports of their accounts as well as comparative performance of underlying benchmark market indices and of their benchmark composite index on a quarterly basis. Investment advisory clients also receive standard account statements from the custodian of their accounts on a monthly basis, but no less than frequently than quarterly. Financial planning clients do not normally receive investment reports. There are no post-plan reviews unless engaged to do so by the client.

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

### **A. Economic Benefits Provided to the Advisory Firm from External Sources and Conflicts of Interest**

Other than as described in Item 10.C. and Item 12 of this Brochure, LFS does not receive economic benefits from external sources.

### **B. Advisory Firm Payments for Client Referrals**

LFS may enter into agreements with solicitors who will refer prospective advisory clients to the firm in return for a portion of the ongoing investment advisory fee. Such arrangements will comply with the cash solicitation requirements of Rule 206(4)-3 under the Investment Advisers Act of 1940. Generally, these requirements require the solicitor to have a written agreement with LFS. The solicitor must provide the client with a disclosure document describing the fees it receives from LFS, whether those fees represent an increase in fees that LFS would otherwise charge the client, and whether an affiliation exists between LFS and the solicitor.

## **Item 15: Custody**

Clients will receive at least quarterly account statements directly from their custodian containing a description of all activity, cash balances and portfolio holdings in their accounts. LFS urges its clients to compare the account balance(s) shown on their LFS performance review to the quarter-end balance(s) on their custodian's monthly statement. The custodian's statement is the official record of the account.

## **Item 16: Investment Discretion**

Clients may grant a limited power of attorney to LFS with respect to trading activity in their accounts by signing the appropriate custodian limited power of attorney form. In such cases, LFS will exercise full discretion as to the nature and type of securities to be purchased and sold and the amount of securities for such transactions. Investment limitations may be designated by the client as outlined in the investment advisory agreement.

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

LFS does not vote proxies on behalf of its clients. All proxy material will be forwarded to the client for the client's review and action.

## **Item 18: Financial Information**

### **A. Balance Sheet**

LFS does not require the prepayment of fees of \$1,200 or more, six months or more in advance, and as such is not required to file a balance sheet.

### **B. Financial Conditions Reasonably Likely to Impair Advisory Firm's Ability to Meet Commitments to Clients**

LFS does not have any financial issues that would impair its ability to provide services to clients.

### **C. Bankruptcy Petitions During the Past Ten Years**

There is nothing to report for this item.