

**1. Part 2A Form ADV and Part 2B Form  
ADV/Brochure/Cover Page**

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**Date of ADV 2A and 2B: February 28, 2011**

This brochure provides information about the business practices of Pengra Capital Management, Inc. (“PCM”), a registered investment adviser, registered since March 1990, managing discretionary, long-only equity portfolios for high net worth individuals, trusts, and corporations. The term “registered investment adviser” does not imply that the Securities and Exchange Commission or any state securities authority has in any way approved, verified, or reviewed the activities of this firm or the information in the brochure, or that the principal has any particular level of experience or skills. All investments have risk, including loss of principal. If you have any questions about this brochure, please contact Molly Pengra at (206) 628 0891. Additional information about Pengra Capital Management, Inc. is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). This brochure must be sent to clients annually within 90 days of the close of the firm’s fiscal year which ends December 31. Nothing contained herein constitutes a solicitation to invest in any product managed by Pengra Capital Management, Inc. (the “Firm”). This brochure is provided for information purposes only and is designed to make certain disclosures and describe compliance policies. It does not contain adequate information upon which to base a decision to become an investor.

**2. Material Changes/Conflicts of Interest: No material changes have occurred since the firm’s last ADV filing January 26, 2010. A material change occurred December 1, 2007, when Pengra Capital Management, Inc. founded and became the General Partner of Cohasset Capital Partners, L.P. (“CCP”), a private long-only, equity fund, employing a multi-capitalization, opportunistic investment style.**

CCP does not use options or derivatives, or short stock. It may employ margin on a limited basis. The existence of two separate investment products managed by the same firm creates certain conflicts of interest. The firm’s Disclosure Statement (attached to this document as Exhibit A) was revised at that time, and is revised on

## **Part 2A-Form ADV/Cover Page**

**an ongoing basis, to reflect these conflicts. All clients of the firm, and all recipients of performance data for the firm, receive the Disclosure Statement at least once a quarter and with all performance reports and investment strategy letters, as well as on an interim basis as requested. The Offering Memorandum for Cohasset Capital Partners, L.P. discusses these conflicts in detail and was provided to all clients of PCM in 2007 for information purposes. An updated version is available upon request to prospective clients of PCM Separate Accounts and to any current client of PCM Separate Accounts. Request must be made by email or letter and state whether the client or prospective client is viewing the Offering Memorandum to assess conflicts or because he would like to be offered a partnership interest. If he wants to be offered an interest, he must state in writing that he meets the test for a Qualified or Accredited Investor.**

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**Exhibits A – Q:** The following *standing documents* of PCM are continuously revised and provided to clients on a regular basis to make them aware of compliance policies and procedures, conflicts of interest, and to give them the tools they need to exercise vigilance over their assets. The exhibits below are cited in the text of ADV 2(A) so that prospective investors can see how PCM communicates Best Practices policies to clients:

<b>Exhibit A – Disclosure Statement – Separate Accounts Equity Composite (SAEC)</b> provided to all clients and non-client recipients of firm’s performance data with all performance information or strategy letters. The <b>Disclosure Statement</b> attempts to summarize all material aspects of this brochure in three pages, and is revised on an ongoing basis.	31-33
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#### 4. Advisory Business:

- A. Description of the firm:** Pengra Capital Management, Inc. (“PCM”) is a registered investment adviser, registered in March 1990 under the Investment Adviser Act of 1940. The firm offers discretionary management of separate accounts for high net worth individuals and families, trusts, foundations and corporations. All separate accounts of PCM are custodied at **Schwab Institutional**. PCM also serves as the General Partner of Cohasset Capital Partners, L.P. (“CCP”), a private partnership fund offered under the exemption provided by Section 4(2) of the Securities Act of 1933 and/or Regulation D, and founded December 1, 2007. CCP is a private fund under Section 3(c)(1) of The Investment Company Act of 1940. CCP is not registered under The Securities Act of 1933 or the securities laws of any state or jurisdiction, and is an advisory client of PCM open only to Qualified/Accredited Investors. CCP does not short stock or use options or derivatives. It may employ margin subject to certain constraints.

The fund administrator for Cohasset Capital Partners, L.P. is **ALPS Price Meadows, LLC**. The audit firm for CCP is **Spicer, Jeffries, LLC**. CCP is custodied at **Goldman Sachs Execution & Clearing, L.P. (GSEC)** through **Baypoint Securities (BTIG, LLC)** as prime broker.

The firm is solely owned by Molly E. Pengra, its president, who manages all separate accounts for PCM as well as serving as fund manager of CCP. Ms. Pengra is solely responsible for investment management and compliance.

- B. Advisory services offered:** PCM offers discretionary management of separate account equity portfolios for sophisticated, high net worth clients, trusts, foundations, and institutions. See **Composite List** (Exhibit C, pages 35-36 ). The firm also serves as the General Partner of Cohasset Capital Partners, L.P., a private fund under Section 3(c)(1) of The Investment Company Act of 1940 (see above), and this implies certain conflicts of interest described in the **Disclosure Statement** (see Exhibit A, pages 31-33 ) and **Cohasset Capital Partners, L.P. Offering Memorandum** (see Exhibit B, page 34).

**PCM Separate Accounts does not employ margin, options or derivatives in any separate accounts and does not short stock. CCP does not use options or derivatives, and may employ margin subject to significant constraints. CCP does not short stock.**

**The firm does not participate in initial public offerings (“IPO’s”). A “No IPO” policy was implemented May 1, 2000 for all separate accounts of PCM, and CCP does not participate in IPO’s under terms of Offering Memorandum.**

**The firm participates in no brokerage “wrap-fee” programs.**

The primary product offered by the firm and available to new investors is the discretionary management of separate-account large-to-mid capitalization domestic equity portfolios, employing a concentrated style suitable for an “above-average risk” allocation. This product’s investment performance is presented as **Separate Accounts Equity Composite (SAEC)**. (See **Composite List**, Exhibit C, pages 35-36 , for a description of this Composite). The performance history of this Composite is filed with various institutional databases and consulting firms. PCM will provide upon request to any client of **Separate Accounts Equity Composite** the performance differential over any interval between his account and the Composite return, as well as the benchmark S & P 500 Index. No fully-funded account past or present has ever been removed from the SAEC.

The firm also manages Cohassett Capital Partners, L.P., a long-only private fund employing an opportunistic, multi-cap investment style. CCP does not adhere to any “style box” constraints, does not use derivatives or options or short stock, and may employ margin on a limited basis subject to extensive constraints specified in the **Offering Memorandum**.

- C. How we work with you as a prospective client to determine if PCM is the right place for you:** PCM screens prospective clients in a “suitability” interview, as to whether they would be well-served investing in the firm’s **Separate Accounts Equity Composite (SAEC)**. Clients are encouraged to communicate on an ongoing basis with regard to topics discussed in the initial interview. It is important that a prospective client consider and disclose his overall financial situation as it relates to appropriate diversification across his investment portfolio, tax considerations, income needs, amount and timing of liquidity requirements, and volatility tolerance with respect to withdrawal needs. Client is provided with **Client Suitability** document and other information (see Exhibit E, page 50)

Client is informed that the **Separate Accounts Equity Composite (SAEC)** employs a specific investment style which entails above-average risk and may have high tracking error and high beta. Clients are informed that successful investing is probabilistic and not predictive, and that self-consistency of investment style improves the probability of successful outcomes. Frequent and high withdrawal levels may cause a client’s account performance to deviate from others in the **SAEC**. The interview seeks to screen out prospective clients who would react to market conditions by requesting to deviate from the firm’s strategic approach, as well as those whose specific situations with respect to taxes, income and cash flow requirements, and other issues render them unsuitable for participation in **SAEC**. Under the terms of the firm’s **Advisory**



**Agreement** (see Exhibit D, pages 37-51) it is the responsibility of the client to notify the firm if his financial situation, goals, or objectives change. ***Requests to deviate from the firm's investment strategy must be made in writing.***

**Constraints which clients may impose:** Clients may impose constraints to accommodate timing of liquidity needs, tax considerations, and income needs. A client who wanted to “co-manage” the portfolio, participating in stock or sector selection or investment strategy, is advised to hire a different type of firm. When client-imposed constraints, particularly high withdrawals as a percentage of assets, render it unlikely that he will be able to participate in the self-consistent investment style of **SAEC**, client may have his account managed as a separate composite outside of **SAEC**, and he is advised that he cannot rely upon past performance of **SAEC** as being indicative of what he can expect by choosing a heavily constrained approach to his needs. That is, he would not be hiring PCM based on performance history or any metrics related to **SAEC**, but for a customized approach which may or may not be benchmarked to an index. The firm currently maintains two such accounts, the inception month of which is August 2009, which are not part of **SAEC**. Each of these accounts comprises its own Composite, and both of these accounts are owned by same client of PCM. These account Composites are described in Sections 2 and 3 of **Composite List**, and these Composites are titled “**SAZC**” and “**SATS**” to distinguish them from **SAEC**.

- D. The firm participates in no “wrap-fee” programs.
- E. As of February 28, 2011, the firm manages \$48,408,132 on a fully-discretionary basis, and one \$16,269,640 million account in a separate Composite, **SAZC**, from **Separate Account Equity Composite (SAEC)**, on a partially-discretionary basis. See **Composite List**, Section 4 for a description of the partially-discretionary account, **SAZC**, inception August 2009, which is not included in **SAEC**. The firm has full discretion over all investment decisions; however the account is temporarily constrained by extreme tax-sensitivity. The manager expects to continue to diversify **SAZC** out of zero-cost stock and in to **SATS** or **CCP** at a rate in excess of 6% per year. The timing, rate of withdrawal, and investments made with withdrawals are at full discretion of manager. These numbers are calculated as of February 28, 2011.

## 5. Fees and Compensation:

- A. **Fees:** PCM is compensated with fees deducted in *arrears* quarterly or semi-annually, as chosen by the client, and based on client assets under management. Fees can be waived at manager's discretion and are negotiable for institutional investors.

**Fee Schedule:**

The standard advisory fee for an equity account is as follows:

Accounts up to \$10 million – 1.0%; \$10 mill to \$20 million – 0.8%; above \$20 million – 0.7%.

- B. Automatic deduction of fees mandatory:** Fees are automatically deducted from client account according to a consistently-applied protocol described in the **Advisory Agreement – Section 9** (Exhibit D, pages 37-51). Clients may not choose to have account billed, and fees must be automatically deducted. As of July 8, 2010, all clients were sent a Best Practices Letter which included **How to Verify Accuracy of Fee Deductions** (see sample showing an account with semi- annual billing):

**SAMPLE:****How to Verify Accuracy of Fee Deduction from Your Account**

Note that the custodial brokerage firm, Schwab Institutional, does not verify accuracy of fee deductions, as stated in PCM Disclosure Statements.

- (1) Your billing rate is 1% per annum, billed semi-annually at .005%. [An account billed quarterly would use .025% multiplier].
- (2) You are billed in April and October.
- (3) In your Monthly Statement from Schwab Institutional for each of the above months, you will find in “Transaction Detail – Cash Sweep and Money Funds Activity” a line item “Mgt. fee to advisor”.
- (4) Go to first page of Schwab Monthly Statement to “Ending Account Value” on right side of page.
- (5) Multiply this Ending Account Value amount by .005%.

This should equal the amount in Item (3), “Mgt. fee to advisor”

Your total fee amount each year will show on the Expense Report you receive in January for the preceding calendar year, included in your Performance and Tax

Summary. Your fee deduction also shows on all quarterly, annual, and interim performance reports, as a line item “Management Fees” (all performance reports include both net and gross of fee performance for your account), and on the fee invoice sent during billing month.

**Clients are able to keep track of fees through five documents they receive.** They are advised of how to keep track of and verify accuracy of fees in Section 9 of the **Advisory Agreement** and in the **Reports to Clients** document provided at time account is opened and on a regular basis in the Best Practices Letter sent at least annually (see Exhibits F and G, pages 52-55 ) and, in recent years, more often:

### **REPORTS TO CLIENTS**

Any client may request an SEC Form ADV – Part 2A at any time. All Clients are provided ADV – Part 2A at least 48 hours before signing the **Advisory Agreement** and all clients receive an updated ADV-Part 2A each January.

Clients must receive **Advisory Agreement**, 48 hours before signing. All clients must be offered a copy of Cohasset Capital Partners, L.P. **Offering Memorandum** for purposes of assessing conflicts of interest between Separate Accounts and Cohasset Capital Partners, L.P.

All new clients are sent a copy of the custodian’s financial statement, Internal Control Letter, and the prospectus for the Money Market Fund which is employed for cash sweeps.

Upon signing **Advisory Agreement**, Client is provided **How to Verify Accuracy of Fee Deductions**.

All clients receive monthly **Account Statements** from **Schwab Institutional** and **Trade Confirmations** from **Schwab Institutional** within 5 business days of trade date. These documents are sent **directly to client** from Schwab and not by Pengra Capital.

All clients receive PCM-generated **Portfolio Statements** quarterly, and on an interim basis as requested.

All clients are provided with quarterly PCM-generated **Performance Reports**, as well as **Realized Gain and Loss** and **Unrealized Gain and Loss Reports** prepared by PCM. The **Disclosure Statement** is included with all **Performance Reports** and **Strategy Letters**.

All clients receive all **Best Practices Letters** sent since 2004 and all new **Best Practices Letters** as they are issued. See Exhibits F-Q in ADV – Part 2A

Interim reports of any kind are available upon request at any time.

All clients receive the following annually with the ADV - Part 2A which is sent with the PCM annual report packet and which includes updated **Advisory Agreement** and **How to Verify Accuracy of Fee Deductions**:

1. Annual Performance Report
2. Annual Realized Gain and Loss Report
3. Annual Unrealized Gain and Loss Report
4. Expense Report
5. Income Report
6. Since-Inception Withdrawals and Contributions
7. Privacy Notice
8. Disclosure Statement
9. Client Suitability Statement
10. Reports to Clients

In any year when significant changes have occurred in the following documents, the revised version will be included in the annual report packet. All of these documents are provided with the new account packet, as are Items 7-10 above, which clients must receive at least 48 hours before signing **Advisory Agreement**:

1. Email Policy
2. Code of Ethics
3. Best Execution and Soft Dollar Policy
4. Proxy Statement

All clients are advised of fees deducted from their account. PCM sends a **Fee Advice** form the day that fees are deducted. Clients are also notified in four other ways of fee deductions:

1. Monthly statements generated by the custodian
2. Quarterly and interim performance reports generated by PCM
3. Expense Report sent by PCM in January
4. Expense Report included in custodian year-end statement

An AIMR® – Level II Verification was issued by PriceWaterhouseCoopers, L.P. on December 28, 2001 for the interval January 1, 1991 through December 31, 2000.

#### **C. Costs of Doing Business Other than PCM Management Fees:**

Client must pay brokerage commissions on trades and certain “exchange-processing fees”, both of which are shown on the **Trade Confirmations** issued by custodial broker which client is required to receive within five business days after each trade. Custodial broker also charges wiring fees when client requests funds to be wired out of account, and these fees show on monthly **Account Statement** client receives from **Schwab Institutional**. All expenses and fees paid by client are shown on **Expense Report** which is included in annual performance and tax summary sent by PCM to client, and commissions are shown in the year-end monthly statement provided directly to client by custodial broker.

- D. Fees are deducted in *arrears*, never in advance.
- E. PCM or any employee is prohibited from accepting asset-based sales charges, or service fees from the sale of mutual funds or any other product issued by any other firm. PCM or its supervised persons receive no compensation of any kind from any entity other than the management fees paid by clients as direct compensation for account management as specified in Section 9 of the **Advisory Agreement**.

#### 6. Performance-Based Fees and Side-by-Side Management:

- A. PCM does not offer a performance-based fee structure for its Separate Accounts product and charges a flat 1% per annum for that product, with fee breaks at larger account sizes (see **Fee Schedule**, Item 5A above). PCM serves as the General Partner of Cohasset Capital Partners, L.P. which is an advisory client of PCM. Limited Partners of CCP all pay a 1% per annum management fee regardless of size of their partnership interest, and there are no exceptions. The General Partner may receive an incentive allocation of 10% of profits in excess of the benchmark MSCI US Equity Broad Market, based on a “threshold” test, which is described in detail in the **Cohasset Capital Partners, L.P. Offering Memorandum**. A “threshold” test is applied after the high water mark is met, and means that the incentive fee (10% of profits in excess of the benchmark) cannot be allocated to any Limited Partner if it would leave him with a return for the calendar year less than that he would have received had he invested in the benchmark MSCI US Broad Market Equity Index. Such incentive allocation to the General Partner represents a conflict for clients of Separate Accounts, as it is reasonable to expect that a fund manager would allocate his best efforts where he could expect the highest return for himself.
- B. **Conflict of interest inherent in managing clients’ separate accounts alongside the sub-advisory client Cohasset Capital Partners, L.P.:** Because PCM as General Partner of CCP is eligible to receive an incentive allocation should CCP outperform its benchmark and meet its high water mark as well as a

“threshold” test, the General Partner and fund manager could be prone to exert more effort and resources in outperforming the benchmark of CCP (MSCI Broad Market U.S. Equity) than in outperforming the S & P 500 for the Separate Accounts of PCM. *Neither CCP nor the Separate Accounts will participate in initial public offerings* which may constitute a “scarce” resource and therefore create compromising allocation choices. CCP and the Separate Accounts of PCM may, however, both transact in the same securities, and this implies conflicts of interest in allocating between CCP and the Separate Accounts, as well as execution price differentials, since trades in same security on same day are usually done at the respective custodial broker for each entity (see Exhibit L, page 63-64). CCP and the Separate Accounts have different investment goals, tax considerations, and risk constraints. The two entities may own the same security concurrently and yet each is seeking to capture a different trait of that security. We do not consider these conflicts to be material or relevant to investment outcome for either entity. See emboldened portion of **Disclosure Statement** (pages 15-16) for a discussion of these conflicts:

**PENGRA CAPITAL MANAGEMENT (“PCM”)  
SEPARATE ACCOUNTS EQUITY COMPOSITE (“SAEC” or “Composite”)  
DISCLOSURE STATEMENT**

Results are time-weighted and gross of fees unless otherwise noted. These performance results are net of commissions on securities. Returns include reinvestment of dividends and interest earned. The net results reflect the deduction of Management Fees. The deduction of Management Fees and other expenses significantly reduces performance results. For example, an investment advisory fee of 1.0% of average managed assets will reduce a 15.0% annualized (304.56% cumulative) return to approximately 13.89% annualized (267.29% cumulative) over a period of 10 years. The management fee schedule is as follows: Accounts up to \$10 million – 1.0%; \$10 mill to \$20million – 0.8%; above \$20 million – 0.7%. Actual management fees incurred by clients may vary. Fees may be waived or reduced at discretion of PCM. Past performance is no guarantee of future results. Figures are not audited and are subject to change. The figures for the S & P 500 include dividends received and their timely reinvestment. The index returns do not, however, reflect any brokerage commissions or management fees that might be incurred in actually investing in the securities represented in these indexes. Index returns are calculated by Standard & Poors. The investment style utilized by the manager produces significantly greater volatility of investment returns than that of the S & P 500. Significant risk is associated with the investment style employed by SAEC, including risk associated with concentration in few sectors and individual securities. The Separate Accounts Equity Composite (SAEC) does not employ margin, options, derivatives or short-selling. There may be significant performance deviation between accounts and any one account may deviate significantly from the Composite. PCM will provide upon request the performance differential between Client account and Composite. PCM will provide upon request the performance of best and worst performing accounts in SAEC over any interval. As of May 1, 2000, in consideration of what the portfolio manager felt to be an overheated IPO market, a “No IPO Rule” was implemented. The information provided in this or any report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in SAEC at the time you receive this report. The securities discussed do not represent all of the securities purchased, sold, or held by the advisor. It should not be assumed that investments in the securities identified were or will be profitable. Composite includes all discretionary, fully-funded accounts, including any accounts terminated since the Firm’s inception. An AIMR® – Level II Verification was issued by PriceWaterhouseCoopers, L.P. on December 28, 2001 for the interval January 1, 1991 through December 31, 2000. A copy of

this report is available to all clients upon request at any time, and is included in the documents provided at least 48 hours before a client signs the PCM Advisory Agreement. Securities included in the Composite performance reflect the investment style of the Firm, with the exception of certain accounts over certain intervals as described in Footnote 2 below. The Firm does not remove fully-funded accounts from the Composite in the event of client-driven style deviation. The Composite account composition remains consistent over time, subject to the account being fully funded as described in the Report of Independent Auditors. Composite prices for given securities transactions represent the average price at which a security was acquired or liquidated in block transactions or individual transactions over time. Actual prices in any given account will vary from these Composite prices described in Strategy Letters. While all accounts of SAEC are managed using the same general investment style, subject to the exceptions described in Footnote 3 below, not all portfolios are identical in structure. Not all accounts of SAEC contain the same securities or the same weightings of individual securities. Allocation from block trades are not done formulaically and weightings in any security will vary between portfolios. There are differences between accounts attributable to different inception dates, cash availability at time of block trades done in SAEC, cash withdrawal rates, legacy positions, risk tolerance, and other subjective variables. Allocations are made with respect to these variables and at the discretion of the portfolio manager. Accounts with different inception dates may have significantly different portfolio structure. The portfolio manager seeks to obtain reasonable execution on trades through an institutional Prime Broker arrangement, and in practice may direct the majority of trades through the custodial broker. Quality of back office service and the financial stability of the Prime Broker or any executing broker are deemed more important than insignificant execution price differentials. The Firm has no soft dollar arrangements and no arrangements with individual brokers or any brokerage firm wrap programs whereby the Firm or its principal would receive referrals in exchange for directing trades to any brokerage firm. From time to time, the portfolio manager refers clients to other institutional money management firms (registered investment advisors who are competitors of PCM, and not to brokerage firms or banks) when a client requires style and asset class diversification. Neither PCM or its principal has ever received any compensation or consideration for such referrals, either from the advisory firm or from the client. These referrals are provided as a courtesy in the interest of the client, and such referrals are intended to help the client avoid paying fees to middle providers or “gatekeepers”, and to ensure that the client has adequate diversification in his overall investment program. All letters sent to clients or interested parties summarizing the strategic investment approach of the Firm are not reflective of all portfolio activity, but rather are intended as a partial description of investment tactics or strategy. These letters may contain forward-looking statements which represent the opinion of the portfolio manager and are subject to a variety of risks, uncertainties, and other factors which could cause results to differ materially from any projections or correlations implied in the forward-looking statements. No such letter constitutes a solicitation to invest, and investors are advised to read Form ADV – Part II before becoming clients of the Firm, as well as a copy of the Firm’s performance report, Client Suitability Policy, Disclosure Statement, Proxy Statement, and all Reports to Clients listed in the Advisory Agreement, all of which are to be provided to the client at least 48 hours before he signs the Firm’s Advisory Agreement. The investment style is suitable for sophisticated investors, individual or institutional, who meet certain standards related to net worth, financial goals, and investment experience. Self-consistency of investment style is an important component of long term investment return. Persons who expect frequent changes in financial situation or goals may be well advised not to invest with a style-adherent institutional money manager, since the client’s individual goals may preclude his benefiting from self-consistency and integrity of investment style. It is the duty of the client to notify PCM if his risk tolerance or goals change. Clients will receive annually an updated “Disclosure Statement,” “Privacy Disclosure,” and “Client Suitability Statement.” Clients also receive annually a “Reports to Clients” document showing a list of the Firm’s policy statements opposite SEC “Best Practices” guidelines, as well as all other reports about their accounts they should expect to receive on a regular basis. The Firm’s other “Best Practices” policy statements as listed in the “Reports to Clients” documents will be sent with the client’s annual report package in January in any year where a significant change in the document has occurred. No employee/access person of the Firm may own or trade in any individual securities. Should such person come into possession of any

individual security, he must report it to principal of Firm within ten days and obtain pre-clearance from principal to make any transaction in the security. **In addition to managing the Separate Accounts Equity Composite product which is covered by this Disclosure Statement, the portfolio manager also serves as president of the General Partner and Fund Manager for Cohasset Capital Partners, L.P. (CCP). Certain conflicts of interest are implied by this arrangement. CCP and the Separate Accounts Equity Composite of PCM have different investment objectives, investment styles, and suitability standards, and CCP may and will utilize strategies which differ from those employed in SAEC. SAEC trades primarily in large to mid cap stocks, whereas CCP has no restrictions with regard to market capitalization and employs other differentiating strategies. SAEC may or may not transact in the same securities as would be placed in CCP. To the extent the two entities invest in the same securities, they may be bought and sold at different times for different reasons and utilizing different valuation parameters and investment considerations. Under no circumstances will any trade be “crossed” between the two entities. There is no guarantee that a situation will not arise where a transaction takes place in one entity proximate to one in the other entity which contributes to price displacement and disadvantages the other entity as to the price it receives. When purchasing a security for both entities on the same day, PCM is under no obligation to combine the trades as a block, although it may do so. It is likely that SAEC trades will usually be executed where those accounts are custodied, and CCP trades at that entity’s prime broker. The fee levied by each Prime Broker for trades done at another broker offset any fractional amount saved on execution. Investors in either SAEC or CCP should assume that trades done at the same time in both entities at separate brokers may contribute to displacement which disadvantages one or the other. PCM, as General Partner of CCP, may receive an incentive allocation for investment performance subject to a “high water” and “threshold” test as described in the offering memorandum for CCP. Such incentive allocation could cause the fund manager to favor CCP in its allocations of securities between PCM SAEC and CCP. In addition to SAEC and CCP, the Firm maintains two single-account, single-client Composites, SATS and SAZC, defined by Client-specific tax and income constraints and objectives, and subject to same conflicts as SAEC has, as described above, with CCP. Inception date of SATS was August 2009, and it is an unadvertised, discretionary, fully-funded, fee-paying account. SAZC, inception August 2009, is an unadvertised, partially-discretionary, fully-funded, reduced-fee account. SATS and SAZC may be included in block trades which encompass accounts in SAEC and/or include an allocation for CCP. No account in any Composite has ever been moved from its Composite to another.**

1. The maximum percentage of the overall AUM invested in IPOs at any given time before the “No IPO Rule” was implemented May 1, 2000, was 0.145%.

2. In 2002, certain accounts chose to deviate from the investment strategy and style against the advice of the portfolio manager. This style deviation varied in form between accounts, and variously included the purchase of consumer noncyclicals, and the sale of Nextel Communication and/ or Corning, or the failure to purchase Western Wireless. These accounts were not removed from the Composite as it is defined in the Report of Independent Auditors – 2000. Since Nextel Communications, Corning, and Western Wireless contributed disproportionately to Composite performance from Fourth Quarter 2002 through Second Quarter 2005, the continued inclusion of these style-deviant accounts in the Composite reduces Composite performance for the interval *ceteris paribus*. On March 6, 2009 a client requested to raise cash in reaction to market conditions against advice of PCM.

## 7. Types of Clients:

The firm offers its Separate Accounts product to high net worth individuals, trusts, foundations, and corporations. The stated minimum account size at inception is \$2 million, and may be waived at manager’s discretion. See **Client Suitability** (Exhibit E, page 50). The firm maintains a list for regulatory perusal of all persons who have approached us or who we have approached to become clients of Separate Accounts or Limited Partners of CCP. We also maintain a list of all persons or entities who have received performance information on Separate Accounts or CCP. If we



discover any error in a performance report, that error must be reported to any entity which received the reports.

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

**A. Risk and Benchmark:** Investing in securities entails risk of loss of principal, and investing in the **Separate Accounts Equity Composite (SAEC)** product entails above-average risk. **SAEC** is highly concentrated by investment theme, sector, and individual securities. As such, its more volatile than its benchmark index the S&P 500. The portfolio is likely to yield less than the S&P 500 over long intervals. A portion of the portfolio may over some intervals be allocated to securities with below investment-grade ratings. Equity investing entails volatility which may render it unsuitable for clients with high and consistent cash withdrawal needs. It is important that a client consider the extent to which liquidity/withdrawal needs may force tax consequences and therefore reduce cash available for other purposes. The firm does not employ margin, options, or derivatives in the Separate Accounts. **SAEC** may have a high tracking error or beta over various intervals. Tracking the benchmark S & P 500 Index over short intervals is not an objective of **SAEC**. The objective of **SAEC** is to outperform S&P 500 over a five-year interval. There is no guarantee **SAEC** will meet this objective. Investors who are uncomfortable with volatility should not invest in **SAEC**. Portfolio turnover has been low over most intervals and tax-efficiency is a consideration, however an investor who is highly tax-sensitive is advised not to participate in **SAEC**. Under the terms of the **Limited Partnership Agreement** for Cohasset Capital Partners, L.P., margin may be deployed subject to significant constraints. CCP does not use options or derivatives or short stock. As with any investment in equity markets, there are numerous variables which create risk including, but not limited to, changes in level and direction of interest rates. There are fundamental risks associated with individual companies in the portfolio, as well as valuation risks associated with changes in interest rates, inflation, and other macroeconomic variables. Capital markets have experienced record volatility in recent years, and we expect that to continue. Investors should not rely on the portion of their assets in equities for living expenses. Tax-efficiency is a goal and there is no guarantee it will be met.

**B. Methods of Analysis:** The firm employs fundamental securities analysis and does not rely on technical analysis or macroeconomic forecasting. We identify investment themes which drive secular growth. These themes include, and are not limited to, regulatory change, changes in industrial market structure, innovation cycles, demographics, underinvestment in productivity, capacity or innovation, and other. The firm does not employ macroeconomic forecasting, and focuses primarily on sector analysis along themes, and bottom-up security selection. The focus is on internal profitability ratios such as ROIC and ROE. Valuation is not a formulaic process, and includes the use of many different metrics. Growth and value are an integral function of each other, and while

certain institutional databases and consultants categorize **Separate Accounts Equity Composite (SAEC)** as Large Cap Growth, the manager does not screen individual stocks by “value” or “growth” parameters.

- C. Risk of equities and cash as asset classes:** The portfolios are primarily invested in domestic equities, and this entails high volatility, fundamental risk, economic risk, and cyclical risk. Investors should not invest in equities any portion of their net worth on which they depend for living expenses and current liquidity requirements. No person should invest all his assets with one firm of any kind, or in one asset class or investment style. The firm may increase allocation to cash vehicles such as money market funds when the portfolio manager deems equities as an asset class are overvalued on cyclically-adjusted P/E or under other metrics. Holding cash can create opportunity-cost risk: In December, 2007, **SAEC** was composed of 47% cash and gold in anticipation of a credit crisis. Had the market continued to rise, clients would have significantly underperformed benchmark S&P 500 by virtue of being underinvested in stocks.

**9. Disciplinary information:**

Neither the firm or its principal Molly Pengra have ever been the subject of any civil or criminal action or the named subject of any criminal or disciplinary proceeding before any court, arbitration panel, regulatory authority, self-regulatory organization or other.

**10. Other Financial Industry Activities and Affiliations:**

- A.** PCM is not registered, nor does it intend to register, as a broker-dealer.
- B.** Neither PCM or its principal is registered or intends to register as a futures commission merchant, commodity pool operator, commodity trading advisor, or associated person of such entities.
- C.** PCM or its principal Molly E. Pengra has no relationship with, investment in, or employment with, any broker-dealer, investment company, mutual fund, fund-of-funds, pooled fund, hedge fund, private equity or venture fund, or any entity which represents a conflict of interest with its clients. See **Conflicts of Interest, Section 6B.**
- D. Recommendations we may make to clients regarding other money management firms they may wish to use for purposes of diversification or in the event of death or incapacitation of Molly Pengra:** PCM maintains a list for regulatory body perusal of well-known mutual funds and institutional

separate account managers to which it may refer clients, at no charge, and with no compensation or consideration of any kind from the firms to which clients are referred, or from clients. Persons who might be referred to a competitor include prospective clients who do not qualify as clients of SAEC under the **Client Suitability** standard, as well as clients of PCM who require additional diversification across managers, investment styles, and asset classes. Additionally, the list is an integral part of the firm's **Death or Incapacitation of Principal** plan as described in the PCM Compliance Manual and the Best Practices Letter to clients dated January 20, 2007 (see Exhibit O, pages 68-71). Discussions are held with clients on an ongoing basis regarding firms which would be suitable for them to use upon the death or incapacitation of Molly Pengra. It is against firm policy for PCM or any principal or employee to accept compensation of any kind from any other firm for referring clients. No other investment adviser, financial planner, broker, bank, accountant, lawyer or other refers business to PCM. PCM is not part of the Schwab Advisor Network and does not participate in the referral networks between financial planners, accountants, and lawyers. These referrals to other money managers who are our competitors are made at no charge to client as a courtesy to the prospective client or current client of PCM, and are intended to facilitate diversification and help clients avoid middle man fees associated with use of retail "allocator" firms. These are "introductions" which sometimes entail getting a large institutional money manager to lower his minimum for investment a high net worth retail client. PCM has no obligation to monitor the client's relationship with another manager once the introduction has been made, and this is made clear to clients (see Exhibit O, pages 68-71). Discussions with clients about what types of money managers would be suitable for them upon the death or incapacitation of the firm's principal are an ongoing and evolving part of the **Death or Incapacitation of Principal** policy.

**11. Code of Ethics (Rule 204A-1), participation or interest in client transactions, and Employee Trading Policy:**

**A.**

**CODE OF ETHICS**

It is the policy of Pengra Capital Management, Inc. to comply with all aspects of the Investment Advisers Act of 1940 and all current policy and procedure requirements set forth by the SEC. To that end, the Firm makes every effort on an ongoing basis to maintain policies and procedures which will serve clients well and will empower them to ask questions and assess if they are being treated fairly and in accordance with consistently applied standards and methods.

*All employees who may have access to clients information ("access persons") are required to read and understand the Firm's Compliance Manual, and to meet with*

*its principal on a regular basis to discuss the Firm's policies and procedures. This does not applied to outside consultants such as technology consultants. These persons are required to sign a Confidentiality Agreement and are not required to read the PCM Compliance Manual.*

It is the responsibility of the Firm's principal to exercise supervisory vigilance in ensuring that employees are complying with all regulations and that they understand the importance of proper conduct at all times, and to require employees to sign certain documents which render explicit the obligation of an employee to exercise proper conduct. The principal seeks to create a culture which fosters a common sense thought process about what is right and what is wrong through ongoing discussion of reasons underlying documents and daily procedures. This process has to do with an attitude of treating client accounts with the respect and care with which one would like one's own assets to be handled. This is not something that can be completely taught in a manual or a regulatory document and, as such, is not completely tangible or quantifiable. The principal of the firm attempts to impart the notion that ethics are something beyond compliance with rules and laws, and that everything else we do is meaningless if there is not a rigorous ethical sensibility.

Clients are empowered when they are informed. We provide regular **"Best Practices Letters"** designed to make clients aware of the issues which impact the stewardship of their assets. Clients receive upon signing the Advisory Agreement, and annually thereafter, a list of documents and reports which they should expect to receive annually. The purpose of providing clients with this information is to make them aware of reports to which they are entitled and which are intended to assist in their role as prudent stewards of assets for which they are responsible. Documents written in response to regulatory requirements, including and not limited to those relating to the SEC "Best Practices", are offered to the clients on a regular basis annually as part of ADV—Part 2A mailing.

The **Code of Ethics** is part of a list of documents which our compliance program requires be provided to all clients upon opening accounts and on a regular basis thereafter, as described in **Reports to Clients**. **Reports to Clients** shows clients all "best practices" documents which are available to them.

## **REPORTS TO CLIENTS**

Any client may request an SEC Form ADV – Part 2A at any time. All Clients are provided ADV – Part 2A at least 48 hours before signing the **Advisory Agreement** and all clients receive an updated ADV-Part 2A each January.

Clients must receive **Advisory Agreement**, 48 hours before signing. All clients must be offered a copy of **Cohassett Capital Partners, L.P. Offering**

**Memorandum** for purposes of assessing conflicts of interest between Separate Accounts and Cohassett Capital Partners, L.P.

All new clients are sent a copy of the custodian's financial statement, Internal Control Letter, and the prospectus for the Money Market Fund which is employed for cash sweeps.

Upon signing **Advisory Agreement**, Client is provided **How to Verify Accuracy of Fee Deductions**.

All clients receive monthly statements **Accounts Statements** from **Schwab Institutional** and **Trade Confirmations** from **Schwab Institutional** within 5 business days of trade date. These documents are sent **directly to client** from Schwab and not by Pengra Capital.

All clients receive PCM-generated **Portfolio Statements** quarterly, and on an interim basis as requested.

All clients are provided with quarterly PCM-generated **Performance Reports**, as well as **Realized Gain and Loss** and **Unrealized Gain and Loss Reports** prepared by PCM. The **Disclosure Statement** is included with all **Performance Reports** and **Strategy Letters**.

All clients receive all **Best Practices Letters** sent since 2004 and all new **Best Practices Letters** as they are issued. See Exhibits F-Q in ADV – Part 2A

Interim reports of any kind are available upon request at any time.

All clients receive the following annually with the ADV - Part 2A which is sent with the PCM annual report packet and which includes updated **Advisory Agreement** and **How to Verify Accuracy of Fee Deductions**:

1. Annual Performance Report
2. Annual Realized Gain and Loss Report
3. Annual Unrealized Gain and Loss Report
4. Expense Report
5. Income Report
6. Since-Inception Withdrawals and Contributions
7. Privacy Notice
8. Disclosure Statement
9. Client Suitability Statement
10. Reports to Clients

In any year when significant changes have occurred in the following documents, the revised version will be included in the annual report packet. All of these documents

are provided with the new account packet, as are Items 7-10 above, which clients must receive at least 48 hours before signing **Advisory Agreement**:

1. Email Policy
2. Code of Ethics
3. Best Execution and Soft Dollar Policy
4. Proxy Statement

All clients are advised of fees deducted from their account. PCM sends a **Fee Advice** form the day that fees are deducted. Clients are also notified in four other ways of fee deductions:

5. Monthly statements generated by the custodian
6. Quarterly and interim performance reports generated by PCM
7. Expense Report sent by PCM in January
8. Expense Report included in custodian year-end statement

An AIMR® – Level II Verification was issued by PriceWaterhouseCoopers, L.P. on December 28, 2001 for the interval January 1, 1991 through December 31, 2000.

*Since compliance is an evolving process, clients are also provided with **Best Practices Letters** on a regular basis, at least annually, and, in recent years, more frequently. These letters discuss best practices issues and are standing documents of the firm which are also provided to new clients so that they have the same information old clients of the firm have about what they should expect from PCM in terms of reporting, and what regulations apply to PCM. See Exhibits F-Q, pages 52-75 of this document.*

**B. Transactions for clients which may pose a conflict of interest for PCM and/or its principal:** The firm's **Employee Trading Policy** forbids any employee of the firm from directly owning any securities in a personal account. The purpose of this policy is to prevent "front-running" of client trades. See Exhibit I – **Access Person/Employee Trading Disclosure, January 9, 2009**, page 57, and Exhibit L -- **Best Execution and Soft Dollar Policy, August 2, 2010** pages 63-64. An employee or access person of PCM may invest in Cohasset Capital Partners, L.P., and Molly Pengra as General Partner of Cohasset Capital Partners, L.P. is also an investor in and limited partner of CCP. CCP from time to time owns some of the same securities as the separate accounts clients of PCM. Neither PCM or its principal participate in client transactions in any way. The firm owns no interest in any broker-dealer. See Item 6B above.

**C.** See Item 11B above.

**D.** See Item 11B above.

## 12. Brokerage Practices:

- A. Pengra Capital Management, Inc. custodies all separate accounts it manages under a prime broker arrangement at **Schwab Institutional**. It has no account custodied at any other entity, except for Cohasset Capital Partners, L.P. which is custodied at **Goldman Sachs Execution & Clearing, L.P.** through **Baypoint Securities, LLC**.

The fact that a client account will be custodied at Schwab Institutional is specified in the **Advisory Agreement** (see Exhibit D - Section 1, page 38)

**Schwab Institutional** was selected for back office reliability, responsiveness of the service team in handling client requests for wires, information, and document flow, financial stability, and efficiency in transactions processing. Additionally, Schwab publishes compliance bulletins which are sent to all its institutional clients and which have been useful in the development of PCM's compliance program. See Exhibit J, pages 58-60. In this **Best Practices Letter** to clients, we discuss the reason for doing almost all trades for separate accounts at Schwab where the accounts are custodied. PCM has no soft dollar arrangements of any kind with any firm, and receives no research from Schwab, and receives compliance bulletins which are provided by **Schwab Institutional** to all its institutional clients. Similarly, **Goldman Sachs Execution & Clearing, L.P.** through the **Baypoint Securities, LLC (BTIG, LLC)** prime broker platform provides excellent back office service for CCP, and expedites seamless flow of information between the audit firm **Spicer, Jeffries, LLC** and the fund administrator **ALPS Price Meadows**. The General Partner deems reliability of portfolio data and performance reporting more important than minor execution price differentials, and the level of reporting and responsiveness to queries has met client and PCM requirements. The fees levied by prime brokers on trades done away and allocated back to the prime broker render any insignificant execution price differential moot. Moreover, execution price depends on type of order entered by the portfolio manager (whether he chooses electronic order routing, volume-weighted average price, market, limit, or other), not on which firm he uses on any given trade.

1. **Research and other soft dollar benefits:** PCM receives no research from Schwab Institutional. Schwab Institutional provides all its clients with compliance bulletins, and that is the only benefit PCM receives from Schwab Institutional other than execution of trades and extensive back office service for client accounts; the responsiveness of the Schwab service team to client requests for wire transfers or information about their accounts is excellent. PCM pays for none of its technology, subscriptions or other

costs of doing business through any commission or soft dollar arrangement with any broker or entity.

- a. If a firm uses client commission dollars to pay for research instead of selecting brokerage firms purely on the basis of execution and back office capability, it is receiving a benefit by using client assets to pay for services it should pay for out of firm revenues (management fees paid by clients directly to the firm). PCM receives no research from Schwab Institutional. It may pay hard dollars for research provided by an institutional research boutique or service other than Schwab, and will not allocate commission trades to that research boutique, but will issue a check directly to such research firm out of PCM firm revenues (management fees paid by clients).
  - b. PCM states contractually in its **Advisory Agreement** that client Separate Accounts are custodied at **Schwab Institutional**. PCM does not custody client assets at any firm for reasons of receiving research in exchange for generating transactions (commissions to brokerage firm) with client assets or to obtain any other benefit such as technology, subscriptions, capital introductions, or participation in manager searches.
  - c. PCM does not cause clients to pay commissions or markups or markdowns on trades in return for soft dollar benefits. See Exhibit J, page 58-60.
  - d. PCM uses no soft dollar benefits and no client account has ever paid disproportionately for research.
  - e. **PCM acquired no products, services, capital introductions, referrals, participation in manager searches or conventions or seminars, technology, subscriptions or other benefits through soft dollar arrangements of any kind in any year since inception.**
  - f. No transactions were directed over the past year to obtain any of the benefits mentioned in item “e” above, or any other kind of benefit.
2. **Brokerage for client referrals:** PCM receives no referrals in exchange for transactions business nor does it receive referrals from any broker-dealer, bank, accountant, or lawyer in exchange for referring business to that entity. Client assets are not used as a tool to generate business or receive benefits. PCM participates in no “pay-to-play” programs and has never doled out transactions business in exchange for capital introductions or referrals or inclusion in manager searches. PCM is not a member of the Schwab Advisor network and does not receive referrals from any network of



accountants, lawyers, financial planner/independent adviser firms or other which may be so entwined.

**3. Directed brokerage:**

a. PCM manages assets on a discretionary basis and does not “advise clients” to “direct business” anywhere. As is contractually stated in the **Advisory Agreement**, and for reasons specified in the **Best Practices Letter** to clients dated January 15, 2010 which discloses the reasons for the selection of Schwab Institutional as the custodial broker and the transacting broker for almost all trades (see Exhibit J., page 58-60), the selection of Schwab is not based on PCM obtaining anything in return other than the services described in Exhibit J, and Schwab Institutional was chosen after an extensive due diligence process which is documented for regulatory inspection at the office of the firm. Some money managers allow clients to choose a retail stockbroker to whom they would like to direct business. PCM does not allow this, as the transactions costs may be higher and it creates an extra layer of processing work for PCM which distracts the portfolio manager from research and compliance. Clients are best served when they participate in larger block transactions with other clients of separate accounts product. PCM is an institutional money management firm, and if the client wishes to “pay” a retail broker, PCM cannot accept his account.

b. We do not permit clients to direct brokerage. See above item “a”.

**B. Block transactions and Allocations:** Clients of Separate Accounts participate in block transactions where all clients trades are aggregated as a block. If some client trades are done separately, the brokerage firm will provide an “average price on the day” which is applied to all accounts so that every client’s Trade Confirmation sent directly to him by Schwab Institutional will show the same price. Occasionally, a client will not participate in that block price and will execute separately. Under this circumstance, his trade may be executed at a higher or lower price than the allocation done under the “average on the day”. These differentials have had no material impact on any account’s performance. PCM will provide in writing upon request information on any trade and the amount by which a client’s execution price differed from that applied to other accounts. Not all accounts in **Separate Accounts Equity Composite** contain exactly the same securities or the same weightings of individual securities. Allocations from block trades are not done formulaically and weightings in any security will vary between portfolios. There are differences between accounts attributable to different inception dates, cash availability at time of block trades done for separate accounts, tax considerations, cash withdrawal rates, timing of client liquidity needs, legacy positions, risk tolerance, and other subjective

variables. Allocations are made with respect to these variables and at the discretion of the portfolio manager. Accounts with different inception dates may have significantly different composition in terms of individual stocks. The portfolio manager seeks to obtain reasonable execution on trades by entering the appropriate type of order with respect to a security's trading volume and market conditions, but does not "shop" between different brokerage firms for execution. The firm has an institutional prime broker arrangement with the brokerage firm where all separate accounts are custodied (Schwab Institutional), and, in fact, may and does execute almost all its trades at that custodial brokerage. Quality of back office service and the financial stability of the prime broker or any executing broker are deemed more important than insignificant execution price differentials which are often offset by "trade away" fees levied by prime broker on trades done at another brokerage for "better execution." The firm has no soft dollar arrangements and receives no research, technology, subscriptions, referrals, or capital introductions for any transactions business it generates.

The firm does not participate in initial public offerings ("IPO's") since a "No IPO" rule was implemented in May 2000.

On rare occasion, a thinly-traded stock has created an allocation fairness issue in Separate Accounts. A **Special Disclosure Letter** dated June 12, 2007, was sent to clients advising them of allocation issues on thinly-traded stocks.

### **13. Review of accounts/frequency and level of review at individual account level:**

- A. Accounts are under continuous supervision and review:** Since the separate accounts in **Separate Accounts Equity Composite (SAEC)** are all managed according to a specific investment style and strategy, the manager is, on a day to day basis, focused on research and strategic outlook as it relates to the investment performance and risk levels of the overall Composite, and not on each account individually except as it relates to client-imposed constraints, usually involving taxes, and sometimes timing of withdrawals. See **Firmwide Composite List**, Exhibit C, pages 35-36, for a description of the two accounts of firm which exist outside **SAEC** and are each designated as a separate Composite. These two accounts receive an additional step of individual attention in that the constraints posed by tax considerations require that they not always participate in block trades which include accounts in the **Separate Accounts Equity Composite (SAEC)**. Under the firm's compliance policies, supervisory obligations of Molly Pengra include not only investment management, but overseeing all performance and tax reports generated by the firm's outside consultant, Terri Vedders, C.P.A. who maintains the performance and tax reports described in **Reports to Clients**. No email can be sent to clients without Ms. Pengra being copied on the email, as she is responsible for any and all errors

which any report or information conveyed to clients may contain. It is the written policy of the firm that any error in performance calculation, fee deduction, or any document or representation must be corrected in writing to the client as soon as it is discovered, and documented to an Error Log or Procedures Violation file maintained by the firm for perusal by regulators.

**B.** Each client account is individually reviewed at least monthly when accounts are reconciled to the custodial broker's statements, and quarterly when quarterly performance, tax, and capital flows reports are generated.

**C. Written reports to clients:** See **Reports to Clients**, Exhibit K, pages 61-62. This document is an integral part of **Advisory Agreement**. The following disclosure appears on all Portfolio Performance Review pages of quarterly and interim reports to clients showing performance of their individual account: *PCM is obligated to provide upon request the performance differential over any interval between client account and the PCM Separate Accounts Equity Composite and benchmark, as well as a printout of client account from the Schwab Institutional website as of date of request.*

Performance calculations are prepared in conformity with AIMR-PPS®.

No performance information may be sent to client or third party without a **Disclosure Statement** attached. No email may be sent to client by employee unless email "cc's" Molly Pengra who is responsible for any errors or omissions, and must notify client and his appropriate representatives in writing if any errors are found and document those errors to Error Correction and/or Procedures Violation files.

Clients receive at least once, and in recent years, more frequently, **Best Practices Letters** (see Exhibits F through Q, pages 52-75) which make clients aware of what they should expect of PCM in terms of reports they receive, and compliance policies which govern the stewardship of their assets. Many advisory firms write internal compliance policies in response to SEC rulings, but do not share with the clients what those policies are, except for providing the required **Privacy Disclosure** and a few other documents. This means that clients do not always know how to protect themselves from inadequate information, erroneous information, and unethical practices. **Best Practices Letters** include clients in the internal compliance process, making them aware of reports to which they are entitled and ways they can protect themselves from failure of custodial broker to send statements and confirmations, failure of PCM to provide performance, cash flow, and tax summaries, overbilling, errors in fee calculation, and other errors or misstatements.

Clients periodically receive **Investment Strategy Letters** describing equity strategy. These strategy letters are not issued regularly, but as the portfolio

manager has something meaningful to say. See Exhibits R through V, pages 76-94

**14. Client referrals and other compensation:**

- A. PCM accepts no compensation or economic benefit or incentives from any entity to sell that entity's products or promote its services.
- B. PCM compensates no third party of any kind to bring in business or refer clients or market to prospective clients.

**15. Custody:**

PCM does not internally custody securities or client accounts. All accounts are custodied at **Schwab Institutional**, except for Cohasset Capital Partners, L.P. which is custodied at **Goldman Sachs Execution & Clearing, L.P.** PCM may not and will not handle client funds directly. All funds being wired into or deposited by check into the client account at **Schwab Institutional** must be sent directly from client bank or brokerage account to Schwab and not pass through any entity owned or controlled by PCM. Client may not wire funds from a bank or brokerage account not owned by him. A limited partner of Cohasset Capital Partners, L.P. must wire funds or send check directly from a bank or brokerage account owned by him to **JP Morgan Chase**, the bank of the custodian **Goldman Sachs Execution & Clearing, L.P.** as per instructions in the **Subscription Agreement** which is part of the **Cohasset Capital Partners, L.P., Offering Memorandum**. A limited partner of CCP withdrawing from his partnership interest must have funds wired directly from the bank of **Goldman Sachs Execution & Clearing, L.P., J.P. Morgan Chase**, directly to his bank account owned by him. No funds coming out of a client separate account may pass through any entity owned or controlled by PCM and must go directly from **Schwab Institutional** to a client destination bank account of record which he has specified to PCM and to **Schwab Institutional** at time account is opened. PCM may not and will not handle checks of any kind flowing to client account or coming out of client account to client, nor will it handle physical securities certificates. All assets must pass directly from client or a bank or brokerage account owned by him to custodial broker directly or from custodial broker to client. See **Advisory Agreement**, Exhibit D, Section 4, page 39 for information regarding **Anti-Money Laundering** provisions and protection of client from unauthorized wire transfers.

**How clients can monitor fee deductions for accuracy and proper timing, as well as all funds flowing out of account:** PCM provides internally generated performance and tax reports with **Portfolio Statements** reconciled to the custodial brokerage **Schwab Institutional** monthly **Account Statement**. PCM requires **Schwab Institutional** to provide a monthly **Account Statement** as well as **Trade**

**Confirmations** each time a trade is done within five business days. Client should carefully review statements for wires or checks which may have been sent out of account, as well as to be sure that PCM *internal* Portfolio Statement for any month-end date reconciles to that of Schwab. Clients should also verify accuracy of fee deductions as the custodial broker does not do so. Each client receives on a one-time basis **How to Verify Accuracy of Fee Deductions** (see “Fees and Compensation – Section B” above) which shows his specific billing interval dates, quarterly or semi-annual, and the fee calculation rate and methodology, so that he can verify the accuracy of fee deduction shown in the various documents he receives as itemized in **Reports to Clients**, and be sure that the fee deductions shown in PCM-generated documents he receives matches that shown on the **Schwab Institutional Account Statement** for the month the fee was deducted.

#### 16. Investment Discretion:

PCM manages only fully discretionary accounts, with the one exception described in **Composite List**, Section 4 of Exhibit C, pages 35-36 of this document (**SAZC**). This one account is a partially discretionary account for the reason that it has specific constraints having to do with extreme tax sensitivity. PCM has full discretion over investment choices subject to an after-tax-return-on-capital test.

The procedure followed in accepting discretion includes the client signing the Schwab One Account Application® in which he specifies that PCM has full investment authority, and the PCM **Advisory Agreement** (Exhibit D, pages 37-51).

#### 17. Proxy:

- A. PCM accepts the obligation to vote client securities. Some clients choose this and others do not. PCM will accept from an institutional investor instruction to vote in a certain manner, and has not to date been required to do so. Should such direction result in PCM voting that client’s securities differently from its vote on behalf of other clients, this would be disclosed to all clients of the firm. Firm maintains all proxy forms it votes and agrees to show them to any client upon request, as is stated to clients in **Proxy Policy**. PCM tends to vote with management, as it does not tend to own companies where it does not perceive management to act in best interest of shareholders. Clients may receive a copy of PCM **Proxy Policy** upon request.
- B. If a client has not authorized us to vote on his behalf by stating that he is assigning PCM that obligation on the Schwab One Application®, he will receive proxy solicitations directly from Schwab Institutional or the transfer agent and not from PCM. Any client may contact PCM for information on how it is voting that solicitation by calling Molly Pengra (206) 628-0891.

## 18. Financial Information:

- A-B.** PCM does not solicit or accept payment of fees in advance and provides notification of fee deduction in arrears in several ways listed in **Reports to Clients**, Exhibit K, pages 61-62.
- C.** PCM or its principal has never been the subject of a bankruptcy petition.

## 19. Requirements for State-Registered Advisers – ADV Part 2B

- A. Principal Executive Officer:** Molly E. Pengra serves as president and compliance officer (SEC Rule 206(4)-7). Ms. Pengra founded Pengra Capital Management, Inc. in 1990, and has served as its portfolio manager, president, and compliance officer since the firm's inception. Ms. Pengra also founded and has served as the General Partner and fund manager of Cohasset Capital Partners, L.P., since December 1, 2007. From October 1984 through March 1986, she was a vice-president in Institutional Equities at Montgomery Securities in San Francisco. From April 1986 through February 1988 she was a vice-president, Institutional Equities at Altman, Brenner & Wasserman, an institutional research firm in New York City. From March 1988 to November 1989, Ms. Pengra was a vice-president, Institutional Equities at Brean Murray Foster Securities, an institutional research firm in New York City. From October 1984 to February 1986, she was a vice-president/Institutional Equities at Montgomery Securities in San Francisco. Ms. Pengra holds a B.A. in Economics from the University of Washington.
- B.** Ms. Pengra is not engaged in any business activity other than PCM.
- C. Performance-based fees are not offered by PCM to any of the separate accounts it manages.** See Item 6A above for information about Cohasset Capital Partners, L.P., (CCP) a private fund of which PCM is the General Partner and fund manager, and which allows an incentive allocation to the General Partner subject to a "threshold" standard described on page 2 of the **Offering Memorandum** for CCP (under "General Partner Compensation").
- D.** PCM or Molly Pengra has not been involved in any of the events listed in Item 19-D of ADV Part 2A, and has never been the subject of any civil or criminal complaint or proceeding, arbitration, litigation, regulatory proceeding or investigation of any kind. PCM or Molly Pengra has never been involved in directly or peripherally, or found liable in, any fraudulent, illegal, or dishonest, unethical, or unfair practices including but not limited to acts of embezzlement, theft, bribery, forgery, wrongful taking of property, false statements, omissions,

or failure to file appropriate documents with regulatory bodies including the SEC, IRS, or any state securities agencies.

**E.** PCM has no relationship with any issuer of securities, investment bank or venture capital or private equity fund which would pose a conflict of interest with its clients or create an incentive for PCM to place unsuitable securities in client accounts. PCM or its principal Molly Pengra is not an insider or Control Person of any publicly traded company. PCM's compliance policy prohibits its participation in initial public offerings of securities of any kind. This policy is intended to reduce situations where "scarcity" poses a fairness challenge in allocations.

## **EXHIBIT A**

### **PENGRA CAPITAL MANAGEMENT ("PCM") SEPARATE ACCOUNTS EQUITY COMPOSITE ("SAEC" or "Composite") DISCLOSURE STATEMENT**

Results are time-weighted and gross of fees unless otherwise noted. These performance results are net of commissions on securities. Returns include reinvestment of dividends and interest earned. The net results reflect the deduction of Management Fees. The deduction of Management Fees and other expenses significantly reduces performance results. For example, an investment advisory fee of 1.0% of average managed assets will reduce a 15.0% annualized (304.56% cumulative) return to approximately 13.89% annualized (267.29% cumulative) over a period of 10 years. The management fee schedule is as follows: Accounts up to \$10 million – 1.0%; \$10 mill to \$20 million – 0.8%; above \$20 million – 0.7%. Actual management fees incurred by clients may vary. Fees may be waived or reduced at discretion of PCM. Past performance is no guarantee of future results. Figures are not audited and are subject to change. The figures for the S & P 500 include dividends received and their timely reinvestment. The benchmark, the S&P 500 Index is a market-capitalization weighted index containing the 500 most widely held companies (400 industrial, 20 transportation, 40 utility and 40 financial companies) chosen with respect to market size, liquidity, and industry. The volatility of the S&P 500 Index may be materially different from that of the strategy depicted, and the holdings in the strategy may differ significantly from the securities that comprise the S&P 500 Index. The S&P 500 Index is calculated on a total return basis with dividends reinvested and is not assessed a management fee. The index returns do not, however, reflect any brokerage commissions or management fees that might be incurred in actually investing in the securities represented in these indexes. Index returns are calculated by Standard & Poors. The investment style utilized by the manager produces significantly greater volatility of investment returns than that of the S & P 500. Significant risk is associated with the investment style employed by SAEC, including risk associated with concentration in few sectors and individual securities. The Separate Accounts Equity Composite (SAEC) does not employ margin, options, derivatives or short-selling. There may be significant performance deviation between accounts and any one account may deviate significantly from the Composite. PCM will provide upon request the performance differential between Client account and Composite. PCM will provide upon request the performance of best and worst performing accounts in SAEC over any interval. As of May 1, 2000, in consideration of what the portfolio manager felt to be an overheated IPO market, a "No IPO Rule" was implemented Footnote 1. The information provided in this or any report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in SAEC at the time you receive this report. The securities discussed do not represent all of the securities purchased, sold, or held by the advisor. It should not be assumed that investments in the securities identified were or will be profitable. Composite includes all discretionary, fully-funded accounts, including any accounts terminated since the Firm's inception. An AIMR® – Level

II Verification was issued by PriceWaterhouseCoopers, L.P. on December 28, 2001 for the interval January 1, 1991 through December 31, 2000. A copy of this report is available to all clients upon request at any time, and is included in the documents provided at least 48 hours before a client signs the PCM Advisory Agreement. Securities included in the Composite performance reflect the investment style of the Firm, with the exception of certain accounts over certain intervals as described in Footnote 2 below. The Firm does not remove fully-funded accounts from the Composite in the event of client-driven style deviation. The Composite account composition remains consistent over time, subject to the account being fully funded as described in the Report of Independent Auditors. Composite prices for given securities transactions represent the average price at which a security was acquired or liquidated in block transactions or individual transactions over time. Actual prices in any given account will vary from these Composite prices described in Strategy Letters. While all accounts of SAEC are managed using the same general investment style, subject to the exceptions described in Footnote 2 below, not all portfolios are identical in structure. Not all accounts of SAEC contain the same securities or the same weightings of individual securities. Allocation from block trades are not done formulaically and weightings in any security will vary between portfolios. There are differences between accounts attributable to different inception dates, cash availability at time of block trades done in SAEC, cash withdrawal rates, legacy positions, risk tolerance, and other subjective variables. Allocations are made with respect to these variables and at the discretion of the portfolio manager. Accounts with different inception dates may have significantly different portfolio structure. The portfolio manager seeks to obtain reasonable execution on trades through an institutional Prime Broker arrangement, and in practice may direct the majority of trades through the custodial broker. Quality of back office service and the financial stability of the Prime Broker or any executing broker are deemed more important than insignificant execution price differentials. The Firm has no soft dollar arrangements and no arrangements with individual brokers or any brokerage firm wrap programs whereby the Firm or its principal would receive referrals in exchange for directing trades to any brokerage firm. From time to time, the portfolio manager refers clients to other institutional money management firms (registered investment advisors who are competitors of PCM, and not to brokerage firms or banks) when a client requires style and asset class diversification. Neither PCM or its principal has ever received any compensation or consideration for such referrals, either from the advisory firm or from the client. These referrals are provided as a courtesy in the interest of the client, and such referrals are intended to help the client avoid paying fees to middle providers or "gatekeepers", and to ensure that the client has adequate diversification in his overall investment program. All letters sent to clients or interested parties summarizing the strategic investment approach of the Firm are not reflective of all portfolio activity, but rather are intended as a partial description of investment tactics or strategy. These letters may contain forward-looking statements which represent the opinion of the portfolio manager and are subject to a variety of risks, uncertainties, and other factors which could cause results to differ materially from any projections or correlations implied in the forward-looking statements. No such letter constitutes a solicitation to invest, and investors are advised to read Form ADV – Part II before becoming clients of the Firm, as well as a copy of the Firm's performance report, Client Suitability Policy, Disclosure Statement, Proxy Statement, and all Reports to Clients listed in the Advisory Agreement, all of which are to be provided to the client at least 48 hours before he signs the Firm's Advisory Agreement. The investment style is suitable for sophisticated investors, individual or institutional, who meet certain standards related to net worth, financial goals, and investment experience. Self-consistency of investment style is an important component of long term investment return. Persons who expect frequent changes in financial situation or goals may be well advised not to invest with a style-adherent institutional money manager, since the client's individual goals may preclude his benefiting from self-consistency and integrity of investment style. It is the duty of the client to notify PCM if his risk tolerance or goals change. Clients will receive annually an updated "Disclosure Statement," "Privacy Disclosure," and "Client Suitability Statement." Clients also receive annually a "Reports to Clients" document showing a list of the Firm's policy statements opposite SEC "Best Practices" guidelines, as well as all other reports about their accounts they should expect to receive on a regular basis. The Firm's other "Best Practices" policy statements as listed in the "Reports to Clients" documents will be sent with the client's annual report package in January in any year where a significant change in the document has occurred. No employee/access person of the Firm may own or trade in any individual securities. Should such person come into possession of any individual security, he must report it to principal of Firm within ten days and obtain pre-clearance from principal to



make any transaction in the security. In addition to managing the Separate Accounts Equity Composite product which is covered by this Disclosure Statement, the portfolio manager also serves as president of the General Partner and Fund Manager for Cohasset Capital Partners, L.P. (CCP). Certain conflicts of interest are implied by this arrangement. CCP and the Separate Accounts Equity Composite of PCM have different investment objectives, investment styles, and suitability standards, and CCP may and will utilize strategies which differ from those employed in SAEC. SAEC trades primarily in large to mid cap stocks, whereas CCP has no restrictions with regard to market capitalization and employs other differentiating strategies. SAEC may or may not transact in the same securities as would be placed in CCP. To the extent the two entities invest in the same securities, they may be bought and sold at different times for different reasons and utilizing different valuation parameters and investment considerations. Under no circumstances will any trade be “crossed” between the two entities. There is no guarantee that a situation will not arise where a transaction takes place in one entity proximate to one in the other entity which contributes to price displacement and disadvantages the other entity as to the price it receives. When purchasing a security for both entities on the same day, PCM is under no obligation to combine the trades as a block, although it may do so. It is likely that SAEC trades will usually be executed where those accounts are custodied, and CCP trades at that entity’s prime broker. The fee levied by each Prime Broker for trades done at another broker offset any fractional amount saved on execution. Investors in either SAEC or CCP should assume that trades done at the same time in both entities at separate brokers may contribute to displacement which disadvantages one or the other. PCM, as General Partner of CCP, may receive an incentive allocation for investment performance subject to a “high water” and “threshold” test as described in the offering memorandum for CCP. Such incentive allocation could cause the fund manager to favor CCP in its allocations of securities between PCM SAEC and CCP. In addition to SAEC and CCP, the Firm maintains two single-account, single-client Composites, SATS and SAZC, defined by Client-specific tax and income constraints and objectives, and subject to same conflicts as SAEC has, as described above, with CCP.

Inception date of SATS was August 2009, and it is an unadvertised, discretionary, fully-funded, fee-paying account. SAZC, inception August 2009, is an unadvertised, partially-discretionary, fully-funded, reduced-fee account. SATS and SAZC may be included in block trades which encompass accounts in SAEC and/or include an allocation for CCP. No account in any Composite has ever been moved from its Composite to another.

1. The maximum percentage of the overall AUM invested in IPOs at any given time before the “No IPO Rule” was implemented May 1, 2000, was 0.145%.
2. In 2002, certain accounts chose to deviate from the investment strategy and style against the advice of the portfolio manager. This style deviation varied in form between accounts, and variously included the purchase of consumer noncyclicals, and the sale of Nextel Communication and/ or Corning, or the failure to purchase Western Wireless. These accounts were not removed from the Composite as it is defined in the Report of Independent Auditors – 2000. Since Nextel Communications, Corning, and Western Wireless contributed disproportionately to Composite performance from Fourth Quarter 2002 through Second Quarter 2005, the continued inclusion of these style-deviant accounts in the Composite reduces Composite performance for the interval *ceteris paribus*. On March 6, 2009 a client requested to raise cash in reaction to market conditions against advice of PCM.

**EXHIBIT B – Offer to provide Cohassett Capital Partners, L.P. Offering Memorandum for information purposes to any client of Separate Accounts**

PCM is obligated to provide to any client of Separate Accounts upon request the **Cohassett Capital Partners, L.P. Offering Memorandum** for information purposes only. The purpose of this is to enable clients to analyze potential conflicts of interest between PCM Separate Accounts and CCP. Request must be made in writing and state whether client or prospective client is viewing the Offering Memorandum to assess conflicts or because he would like to be offered a partnership interest. If he wants to be offered an interest, he must state in writing that he meets the test for a Qualified or Accredited Investor.

Similarly, all limited partners of CCP are provided with the **PCM Separate Accounts Disclosure Statement**.

## EXHIBIT C

### PENGR CAPITAL MANAGEMENT, INC. COMPOSITE LIST

#### 1. Separate Accounts Equity Composite (“SAEC”):

This product’s inception was March 1990. Composite includes actively managed discretionary, un-levered equity accounts above \$200,000 at inception with the S & P 500 as the benchmark. This product does not attempt to track the S & P 500 Index on a quarter-by-quarter basis, and seeks to outperform it over five years. The product may be highly concentrated in terms of number of securities and sectors, holding as few as fifteen equity names. Sector concentration may be thematic or by industry sector. Concentration increases volatility. Portfolio may from time to time contain some stocks with no earnings. Dividend yield is not an objective of the product. The manager considers growth and value to be an integral function of each other and does not screen ideas with regard to whether they fit a “value” or “growth” profile, however most investment consultants and databases classify it as a Large Cap Growth style. The Firm places no limit on the proportion of cash which can be held as a residual or when in the judgment of the portfolio manager equities as an asset class are overvalued on Cyclically-Adjusted P/E and fundamentals suggest a low probability of cash holdings creating opportunity cost. Protection of clients’ capital takes precedence over fitting a “style-box” for the convenience of consultants. *No account past or present has been removed from the Composite due to client-driven style deviations or significant client withdrawals.* Episodes of client driven style-deviation are documented in Section III of “Performance Standards Compliance Manual”.

#### 2. Separate Accounts – Tax-Sensitive, High Withdrawal (“SATS”):

Separate Accounts – Tax-Sensitive, High Withdrawal (SATS), inception August 2009, is an unadvertised, discretionary, full fee paying account of PCM Separate Accounts Composites, rendered unsuitable for current participation in pure SAEC style by client-specific requirements.

#### 3. Separate Accounts – Zero-Cost-Basis, Single-Stock With Objective of Diversification Over Time (“SAZC”):

Separate Accounts – Zero-Cost-Basis, Single-Stock (SAZC), inception August 2009, is an unadvertised, partially-discretionary, reduced-fee account of the PCM Separate Accounts, the objective of which is diversification over time into various discretionary strategies. The manager expects to continue to diversify SAZC out of zero-cost stock and into SATS or CCP at a rate in excess of 6% of beginning-of-year asset value per year (the withdrawal rate for 2010 and 2011). The timing, rate of withdrawal, and investments made are at full discretion of manager.

The single-stock in the portfolio features the characteristics currently required by SAEC for investment. It is on the SAEC Equity List as tactically appropriate for SAEC style, and its retention constitutes a discretionary investment decision.

#### **4. Cohassett Capital Partners, L.P. (“CCP”):**

This Composite was founded in November 2007 and contains one account: Cohassett Capital Partners, L.P., the “Fund” (CCP). CCP is a private fund under Section 3(c)(1) of The Investment Company Act of 1940. CCP is an advisory client of the General Partner Pengra Capital Management, Inc. The minimum investment for a limited partnership unit is \$250,000 and this can be waived at discretion of General Partner. Cohassett is not style-box constrained and may invest opportunistically across the entire market capitalization spectrum. Its benchmark is the MSCI US Broad Equity Index. Up to 30% of the asset value of the Fund’s Liquid Publicly Traded Securities at time of inception of position may be leveraged at such time as the Fund Manager deems equities as an asset class to be undervalued. The criteria for “undervalued” is not formulaically stated in the Offering Memorandum, and Limited Partners are dependent on the judgment of the Fund Manager. The Fund may be highly concentrated in few sectors and may hold as few as ten stocks over some intervals. Up to 10% of the asset value of the Fund’s Liquid Publicly Traded Securities at time of inception of position may be invested in bond rated BAA or below. The Fund has a 1% per annum management fee and the General Partner will receive a 10% incentive allocation as a threshold subject to a high water mark provision and provided such allocation does not reduce the return of any Limited Partner’s investment below what he would have received had he invested in the benchmark index.

Beside SAEC and CCP, the Firm maintains two “*unadvertised*” Composites, “SATS” and “SAZC”, the Firm definition of which is:

*“Unadvertised” describes a Composite which is not represented as a product of the Firm open to new investors. The Client or owner of the account receives performance and portfolio data provided under the Policy guidelines of this Manual, and such data may be made available for transparency purposes to an institutional consultant performing a due diligence of the Firm by way of an interest in investing in SAEC or CCP. Any data provided in a due diligence process must contain disclaimer that SATS and SZAC are not products of the Firm available to new investors and do not represent the investment style of either SAEC or CCP. Performance and portfolio data for SATS and SAZC may not be and are not filed publicly with any database, institutional consultant, or on any website, nor is such information provided to any prospective individual investor client of the Firm. SATS and SAZC each contain one Client account, and both the SATS and SAZC accounts are owned by same Client.*

The next 13 pages constitute the **ADVISORY AGREEMENT** for PCM Separate Accounts in its entirety.

## EXHIBIT D

### PENGRA CAPITAL MANAGEMENT, INC – SEPARATE ACCOUNTS ADVISORY AGREEMENT

The undersigned client (“Client”) hereby retains Pengra Capital Management, Inc., (“PCM”) a Washington Corporation to perform certain services on Client’s behalf under the terms and conditions set forth in this Advisory Agreement (“Agreement”).

- 1) Engagement of PCM to Provide Investment Advisory Services. Client hereby retains PCM as its investment advisor to review, analyze, and provide advice to Client regarding the assets held in a custodian account to be opened directly by Client and maintained in Client’s name with **Schwab Institutional**. Client expressly acknowledges that PCM will not receive or take title in or to any of the investment assets. PCM will not receive dividend, interest or proceeds checks. PCM will not handle any stock or bond certificates or cash. PCM will not utilize margin accounts, options or derivatives. Client agrees to notify PCM in writing of any changes in his financial situation or risk tolerance which occur after inception date. Client acknowledges having received Form ADV-Part 2A, **Disclosure Statement**, a prospectus for the institutional money market fund in which cash balances will be invested, and a performance presentation prepared in conformity with AIMR-PPS®, and that these documents were received at least 48 hours before he signed this agreement. Client acknowledges having read the **Disclosure Statements** attached and Section 8 of this Agreement regarding **Reports** he should expect to receive. Client may not direct transactions to a particular broker. All brokerage transactions are executed through an institutional broker chosen by PCM. PCM does not direct brokerage transactions to any firm in exchange for soft dollar benefits of any kind. PCM pays for all technology, subscriptions, research and other with firm revenues, and accepts no benefits in the form of capital introductions or referrals from any brokerage firm, bank, or other entity.
- 2) Discretionary Investment Authority. Client specifically authorizes PCM to exercise discretionary authority with respect to but not limited to common and preferred stocks, government and corporate bonds and notes, tax-exempt bonds, convertible bonds and stocks, and further acknowledges that PCM shall have the authority to buy, sell and trade any other securities relating to the same, on Client’s behalf and risk and in Client’s name. It is also understood that all or a portion of Investment Assets held in the Account may be held in cash equivalents. PCM is expressly authorized to instruct registered brokerage agents in every respect concerning Client’s Investment Assets and PCM is hereby empowered to act for and in Client’s behalf and name. Client further agrees to execute any further separate agreements or authorization as may be reasonably required to confirm the authority granted herein. Client shall not make trades or withdraw funds from this account except by requesting directly of PCM that such trades or withdrawals be executed.
- 3) Investment Style. Client understands that PCM employs an investment style which entails high portfolio volatility over certain intervals, low level of diversification, and concentration along a small number of investment themes and individual securities,

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and that stocks in portfolio may not pay dividends. Client understands that this style is suitable for that portion of assets he has designated as “above-average risk”, and that there may be a dispersion of returns between individual accounts in the Composite. Client may obtain from PCM at any time a comparison of his account performance over any interval to that of the Composite. Client has read **Disclosure Statement** and **Client Suitability** document.

*Client agrees to notify PCM in writing should he wish to deviate from Firm’s investment strategy.*

Client understands that reactive tactical maneuvers he may request in response to volatile markets may not be in his best interest and that successful investing entails adherence to a self-consistent investment process.

- 4) Compliance with Anti-Money Laundering Regulations. Client agrees to file one destination bank account of record with the custodial broker and with PCM. Client agrees that funds wired out of his account directly from custodial broker will go only to this destination account of record with the exception described in Section 4(a). Client agrees that funds wired **to** his PCM-managed account at the custodial broker will originate from an account in his name held at a brokerage firm or bank from which he is transferring assets, and not from an account owned by another individual or entity.

A client of PCM Separate Accounts product who wants to invest in Cohasset Capital Partners, L.P. may wire funds from his Separate Account custodied at Schwab Institutional under advisory contract with PCM directly to JP Morgan Chase to the account of Goldman Sachs Execution & Clearing, L.P. for further credit to Cohasset Capital Partners, L.P. subject to the following constraints:

i) PCM may not initiate Wiring Instruction from Client account at Schwab to any account not owned by Client: Client must initiate the wire transfer out of his Schwab Institutional Account managed by PCM with a letter signed by him specifically authorizing such transfer from his account at Schwab to JP Morgan Chase, and mailed or sent via facsimile to PCM. PCM agrees not to initiate such wire transfer request to JP Morgan Chase under any Standing Authorization which Client may have signed which is designed to allow PCM to initiate wire transfers. Such Standing Letter of Authorization exists for the purpose of allowing PCM to transfer funds **only** to a destination checking account of record which is **owned by client**, and not to initiate wire transfers to any other account whatsoever. Under no circumstance is it permissible for PCM to initiate a wire transfer out of a client account to any account which is not owned by the Client.

ii) A Separate Account Client may only wire funds directly out of his Separate Account at Schwab to JP Morgan Chase for purpose of investing in Cohasset Capital Partners, L.P. provided the name and legal ownership, and Taxpayer Identification Number are identical between the Separate Account and the Limited Partnership interest to which the wire going into JP Morgan Chase is credited. This means that the Limited Partnership Interest in Cohasset Capital Partners, L.P. must be registered with the Fund Administrator ALPS Price

Meadows under an identical name and Taxpayer Identification Number as that on the Separate Account at Schwab.

- 5) Allocations. Client understands that while all accounts are managed using the same general investment style, not all portfolios are identical in structure. All accounts do not contain the same securities or the same weightings of individual securities. Allocations from block trades are not done formulaically and weightings in any given security will vary between portfolios. All clients have different cash withdrawal requirements, tax-sensitivity and short term risk tolerance. Accounts with different inception dates may have significantly different portfolio structure. Allocations are made with respect to these variables and at the discretion of the manager. Under certain circumstances, a Client account might not be included in a block trade done for other accounts. PCM is obligated to provide in writing upon request the execution price differential, if any, between any trade in Client account and price obtained by other client accounts, as well as the reason his trade was executed separately.
- 6) E-mail Policy. PCM does not accept instructions regarding client accounts via e-mail. All instructions regarding wiring of funds, transactions or any activity in the accounts must be made directly to an employee of the Firm in person or by telephone, backed up by written letter or facsimile. PCM retains all such communications in the Client's file, and agrees to provide Client with a copy of all material in his file upon request. PCM may provide **Performance Reports, Tax Reports, Disclosure Statements** and all other reports listed in **Reports to Clients** document (see Section 8) via e-mail upon request. PCM agrees not to keep physical evidence of Client Social Security number in office, in computer files or e-mail.

It is the policy of PCM to require that any communications whatsoever sent to Client via e-mail by an employee or outside provider be copied on the "cc" line of email to Molly Pengra who is responsible for accuracy and compliance of all representation to Clients or outside third parties. Client agrees to notify Molly Pengra if he receives any communication regarding accounts which does not follow this procedure.

- 7) Trusts. By signing this agreement as a trustee, Client represents that he is authorized as trustee by his trust to hire a discretionary investment advisor and further that there is nothing in the investment style of this firm that the terms of his trust prohibit. Client further represents that he is in compliance with the terms of his trust and has verified this with his legal advisor. PCM does not give legal advice. Client agrees to provide PCM with trust documents as requested by the custodial broker.
- 8) Reports to Clients. Any client may request an SEC Form ADV – Part 2A at any time. All Clients are provided ADV – Part 2A at least 48 hours before signing the **Advisory Agreement** and all clients receive an updated ADV-Part 2A each January.

Client must receive **Advisory Agreement**, 48 hours before signing. All clients must be offered a copy of Cohasset Capital Partners, L.P. **Offering Memorandum** for purposes of assessing conflicts of interest between Separate Accounts and Cohasset Capital Partners, L.P.

All new clients are provided a copy of Schwab Institutional financial statement, Internal Control Letter, and the prospectus for the Money Market Fund which is employed for cash sweeps.



Upon signing **Advisory Agreement**, Client is provided **How to Verify Accuracy of Fee Deductions**.

All clients receive monthly **Accounts Statements** from **Schwab Institutional** and **Trade Confirmations** from **Schwab Institutional** within 5 business days of trade date. These documents are sent **directly to client** from Schwab and not by Pengra Capital.

All clients receive PCM-generated **Portfolio Statements** quarterly, and on an interim basis as requested.

All clients are provided with quarterly PCM-generated **Performance Reports**, as well as **Realized Gain and Loss and Unrealized Gain and Loss Reports** prepared by PCM. The **Disclosure Statement** is included with all **Performance Reports** and **Strategy Letters**.

All clients receive all **Best Practices Letters** sent since 2004 and all new **Best Practices Letters** as they are issued. See Exhibits F-Q in ADV – Part 2A

Interim reports of any kind are available upon request at any time.

All clients receive the following annually with the ADV – Part 2A which is sent with the PCM annual report packet and which includes updated **Advisory Agreement** and **How to Verify Accuracy of Fee Deductions**:

1. Annual Performance Report
2. Annual Realized Gain and Loss Report
3. Annual Unrealized Gain and Loss Report
4. Expense Report
5. Income Report
6. Since-Inception Withdrawals and Contributions
7. Privacy Notice
8. Disclosure Statement
9. Client Suitability Statement
10. Reports to Clients

In any year when significant changes have occurred in the following documents, the revised version will be included in the annual report packet. All of the following documents are provided with the new account packet, as are Items 7-10 above, which clients must receive at least 48 hours before signing **Advisory Agreement**:

1. Email Policy
2. Code of Ethics
3. Best Execution and Soft Dollar Policy
4. Proxy Statement

All clients are advised of fees deducted from their account. PCM sends a **Fee Advice** form the day that fees are deducted. Clients are also notified in four other ways of fee deductions:

4. Monthly Account Statements generated by the custodial brokerage firm Schwab Institutional

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5. Quarterly and interim performance reports generated by PCM
6. Expense Report sent by PCM in January
7. Expense Report included in custodian year-end statement

An AIMR® – Level II Verification was issued by PriceWaterhouseCoopers, L.P. on December 28, 2001 for the interval January 1, 1991 through December 31, 2000, and is provided to client at least 48 hours before he signs **Advisory Agreement**.

- 9) Fees. Client agrees to pay PCM a fee of 1% per annum. See Exhibit A-Full Fee Schedule. The fee shall be deducted automatically, quarterly in the amount of .0025% x Total Investment Assets in Account or semi-annually in the amount of .005% x Total Investment Assets in Account. Fees must be deducted automatically and Client may not elect to have fees billed. Fee deduction will be based on the total asset value of the account as shown on the Schwab Institutional Account Statement on the statement closing date for the Client's billing period. PCM will not determine this Investment Assets figure or alter it in any way. Client acknowledges and agrees that PCM's fee may be automatically deducted by custodian from the investment account, and paid directly to PCM. PCM will retain for Client perusal all fee statements. All fees deducted will show on the custodial broker statement for the month in which they were deducted. PCM agrees to notify Client in writing of the advisory fee deduction within five business days, including a copy of brokerage statement showing amount of assets on which fees were charged. Notification will include billing rate, total value of assets managed on which advisory fee is based, and amount billed. ***The custodial broker does not review fee deductions for accuracy.*** It is the responsibility of Client to verify accuracy. Fee deductions are also shown on all quarterly, annual, and interim **Performance Reports**, and on the annual **Expense Report** generated by PCM. Fees may be waived or reduced at manager's discretion. Client has read **Disclosure Statement** and understands that fees greatly reduce the ability of his assets to compound. The deduction of Management Fees and other expenses significantly reduces performance results. For example, an investment advisory fee of 1.0% of average managed assets will reduce a 15.0% annualized (304.56% cumulative) return to approximately 13.89% annualized (267.29% cumulative) over a period of 10 years. If the account is generating negative investment returns, the fee deduction renders it more difficult to recoup investment losses than if no fees were charged.
- 10) Termination. This agreement shall continue in effect until terminated upon receipt of written notice from either party and shall be automatically extended for an additional year until written notice is so provided within 30 days of the end of any calendar quarter. Client must provide PCM with written termination letter signed by him at least 48 hours before termination. Client has the right to terminate this contract without consequence if SEC Form ADV-Part 2A and PCM **Disclosure Statement** and **Reports to Clients** are not received by Client 48 hours prior to signing of this agreement. Client may terminate this contract for any reason at no consequence to him within five business days of signing it.
- 11) Assignments. No assignment of this Agreement by PCM shall be effective without the written consent of Client, and any attempted assignment without Client's consent shall be grounds for immediate termination of this Agreement by Client without penalty.

- 12) Governing Law. This Agreement and the interpretation of the provisions hereof shall be governed by the laws of the State of Washington.
- 13) Notices. Any and all notices permitted or required to be given under this Agreement shall be in writing and delivered by certified mail, return receipt requested, postage prepaid, and addressed to the party to be notified at the address specific by such party's signature to this Agreement, or by delivering the same in person.
- 14) Civil Liability. Federal and state securities laws impose liabilities under certain circumstances on persons who act in good faith, and therefore nothing in the Agreement will waive or limit any rights that Client may have under those laws.

AGREED to this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_.

CLIENT: \_\_\_\_\_  
(Signature)

Name: \_\_\_\_\_

Account Title: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

ACCEPTED BY PENGRA CAPITAL  
MANAGEMENT, INC.:

By: \_\_\_\_\_

Title: President

Date: \_\_\_\_\_

Address: 601 Union Street – Suite 4515  
Seattle, WA 98101

**PENGRA CAPITAL MANAGEMENT, INC.**  
**EXHIBIT A – Engagement Letter**  
**Full Fee Schedule**

<b>\$0 – 10 Mill</b>	<b>1.00% per annum</b>
<b>\$10 Mill to 20 Mill</b>	<b>0.80% per annum</b>
<b>\$20 Mill +</b>	<b>0.70% per annum</b>

Fees must be deducted quarterly or semi-annually on a consistent cycle. Custodial brokerage firm does not verify accuracy of fee deductions.

## **SAMPLE**

### **How to Verify Accuracy of Fee Deduction from Your Account**

Note that the custodial brokerage firm, Schwab Institutional, does not verify accuracy of fee deductions, as stated in PCM Disclosure Statements.

- (1) Your billing rate is 1% per annum, billed semi-annually at .005%.
- (2) You are billed in April and October.
- (3) In your Monthly Statement from Schwab Institutional for each of the above months, you will find in “Transaction Detail – Cash Sweep and Money Funds Activity” a line item “Mgt. fee to advisor”.
- (4) Go to first page of Schwab Monthly Statement to “Ending Account Value” on right side of page.
- (5) Multiply this Ending Account Value amount by .005%.

This should equal the amount in Item (3), “Mgt. fee to advisor”

Your total fee amount each year will show on the Expense Report you receive in January for the preceding calendar year, included in your Performance and Tax Summary. Your fee deduction also shows on all quarterly, annual, and interim performance reports, as a line item “Management Fees” (all performance reports include both net and gross of fee performance for your account), and on the fee invoice sent during billing month.

***This document must be included with Advisory Agreement***

## **CLIENT SUITABILITY – PCM SEPARATE ACCOUNTS EQUITY COMPOSITE (“SAEC”)**

The investment style is suitable for experienced, sophisticated high-net-worth individual investors and institutions. Client is responsible for reading the **Disclosure Statement** and **Reports to Clients** document, as well as Form ADV – Part 2A which are provided at least 48 hours before client signs **Advisory Agreement**.

Client understands that successful investment outcomes are driven by integrity of investment process and style adherence, and are contingent on a probabilistic, not a predictive approach.

A client prone to tactical or reactive investment behavior tends not to benefit from integrity of process. Self-consistency of investment style drives successful outcomes. It is important that a client notify the PCM immediately if his situation or goals change from those he represents before entering into an **Advisory Agreement** with PCM. While client may access his account for cash withdrawals as part of an overall cash withdrawal plan which includes other assets and sources of income, withdrawals which represent a high percentage of the average annual balance (more than 5%), or are frequent in occurrence, may impede investment returns. Client should not invest in equities those funds on which he is dependent to meet his living requirements and financial obligations, nor should he invest all his assets with **any** one firm or in any one investment style or asset class.

The investment style is highly concentrated by investment theme and individual security and is not diversified across sector or individual security names. As such, it is more volatile than the indexes, including the S & P 500. The portfolio at any given time is likely to yield less than the dividend yield on the S & P 500, and may pay no dividends. The return on any given client portfolio over any interval may deviate from the SAEC return or the return on any other separate account. **A client may obtain at any time the deviation of his account return from that of the SAEC.** Equities included in the SAEC may be highly cyclical or volatile such that the earnings or cash flow stream is neither consistent or predictable.

It is suggested that clients read Style Investing by Richard Bernstein to achieve an understanding of various investment styles. The style employed by SAEC is categorized by most institutional databases and consultants as Large Cap Growth, however the portfolio manager does not screen for stocks using “growth” or “value” as the criterion.

***This document must be included with Advisory Agreement***

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**PENGRA CAPITAL MANAGEMENT (“PCM”)  
SEPARATE ACCOUNTS EQUITY COMPOSITE (“SAEC” or “Composite”)  
DISCLOSURE STATEMENT**

Results are time-weighted and gross of fees unless otherwise noted. These performance results are net of commissions on securities. Returns include reinvestment of dividends and interest earned. The net results reflect the deduction of Management Fees. The deduction of Management Fees and other expenses significantly reduces performance results. For example, an investment advisory fee of 1.0% of average managed assets will reduce a 15.0% annualized (304.56% cumulative) return to approximately 13.89% annualized (267.29% cumulative) over a period of 10 years. The management fee schedule is as follows: Accounts up to \$10 million – 1.0%; \$10 mill to \$20 million – 0.8%; above \$20 million – 0.7%. Actual management fees incurred by clients may vary. Fees may be waived or reduced at discretion of PCM. Past performance is no guarantee of future results. Figures are not audited and are subject to change. The figures for the S & P 500 include dividends received and their timely reinvestment. The benchmark, the S&P 500 Index is a market-capitalization weighted index containing the 500 most widely held companies (400 industrial, 20 transportation, 40 utility and 40 financial companies) chosen with respect to market size, liquidity, and industry. The volatility of the S&P 500 Index may be materially different from that of the strategy depicted, and the holdings in the strategy may differ significantly from the securities that comprise the S&P 500 Index. The S&P 500 Index is calculated on a total return basis with dividends reinvested and is not assessed a management fee. The index returns do not, however, reflect any brokerage commissions or management fees that might be incurred in actually investing in the securities represented in these indexes. Index returns are calculated by Standard & Poors. The investment style utilized by the manager produces significantly greater volatility of investment returns than that of the S & P 500. Significant risk is associated with the investment style employed by SAEC, including risk associated with concentration in few sectors and individual securities. The Separate Accounts Equity Composite (SAEC) does not employ margin, options, derivatives or short-selling. There may be significant performance deviation between accounts and any one account may deviate significantly from the Composite. PCM will provide upon request the performance differential between Client account and Composite. PCM will provide upon request the performance of best and worst performing accounts in SAEC over any interval. As of May 1, 2000, in consideration of what the portfolio manager felt to be an overheated IPO market, a “No IPO Rule” was implemented. The information provided in this or any report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in SAEC at the time you receive this report. The securities discussed do not represent all of the securities purchased, sold, or held by the advisor. It should not be assumed that investments in the securities identified were or will be profitable. Composite includes all discretionary, fully-funded accounts, including any accounts terminated since the Firm’s inception. An AIMR® – Level II Verification was issued by PriceWaterhouseCoopers, L.P. on December 28, 2001 for the interval January 1, 1991 through December 31, 2000. A copy of this report is available to all clients upon request at any time, and is included in the documents provided at least 48 hours before a client signs the PCM Advisory Agreement. Securities included in the Composite performance reflect the investment style of the Firm, with the exception of certain accounts over certain intervals as described in Footnote 2 below. The Firm does not remove fully-funded accounts from the Composite in the event of client-driven style deviation. The Composite account composition remains consistent over time, subject to the account being fully funded as described in the Report of Independent Auditors. Composite prices for given securities transactions represent the average price at which a security was acquired or liquidated in block transactions or individual transactions over time. Actual prices in any given account will vary from these Composite prices described in Strategy Letters. While all accounts of SAEC are managed using the same general investment style, subject to the exceptions described in Footnote 3 below, not all portfolios are identical in structure. Not all accounts of SAEC contain the same securities or the same weightings of individual securities. Allocation from block trades are not done formulaically and weightings in any security will vary between portfolios. There are differences between accounts attributable to different inception dates, cash availability at time of block trades done in SAEC, cash withdrawal rates, legacy positions, risk tolerance, and other subjective variables. Allocations are made with respect to these variables and at the discretion of the portfolio manager. Accounts with different inception dates may have significantly different portfolio structure. The portfolio manager seeks to obtain reasonable execution on trades through an institutional

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Prime Broker arrangement, and in practice may direct the majority of trades through the custodial broker. Quality of back office service and the financial stability of the Prime Broker or any executing broker are deemed more important than insignificant execution price differentials. The Firm has no soft dollar arrangements and no arrangements with individual brokers or any brokerage firm wrap programs whereby the Firm or its principal would receive referrals in exchange for directing trades to any brokerage firm. From time to time, the portfolio manager refers clients to other institutional money management firms (registered investment advisors who are competitors of PCM, and not to brokerage firms or banks) when a client requires style and asset class diversification. Neither PCM or its principal has ever received any compensation or consideration for such referrals, either from the advisory firm or from the client. These referrals are provided as a courtesy in the interest of the client, and such referrals are intended to help the client avoid paying fees to middle providers or “gatekeepers”, and to ensure that the client has adequate diversification in his overall investment program. All letters sent to clients or interested parties summarizing the strategic investment approach of the Firm are not reflective of all portfolio activity, but rather are intended as a partial description of investment tactics or strategy. These letters may contain forward-looking statements which represent the opinion of the portfolio manager and are subject to a variety of risks, uncertainties, and other factors which could cause results to differ materially from any projections or correlations implied in the forward-looking statements. No such letter constitutes a solicitation to invest, and investors are advised to read Form ADV – Part II before becoming clients of the Firm, as well as a copy of the Firm’s performance report, Client Suitability Policy, Disclosure Statement, Proxy Statement, and all Reports to Clients listed in the Advisory Agreement, all of which are to be provided to the client at least 48 hours before he signs the Firm’s Advisory Agreement. The investment style is suitable for sophisticated investors, individual or institutional, who meet certain standards related to net worth, financial goals, and investment experience. Self-consistency of investment style is an important component of long term investment return. Persons who expect frequent changes in financial situation or goals may be well advised not to invest with a style-adherent institutional money manager, since the client’s individual goals may preclude his benefiting from self-consistency and integrity of investment style. It is the duty of the client to notify PCM if his risk tolerance or goals change. Clients will receive annually an updated “Disclosure Statement,” “Privacy Disclosure,” and “Client Suitability Statement.” Clients also receive annually a “Reports to Clients” document showing a list of the Firm’s policy statements opposite SEC “Best Practices” guidelines, as well as all other reports about their accounts they should expect to receive on a regular basis. The Firm’s other “Best Practices” policy statements as listed in the “Reports to Clients” documents will be sent with the client’s annual report package in January in any year where a significant change in the document has occurred. No employee/access person of the Firm may own or trade in any individual securities. Should such person come into possession of any individual security, he must report it to principal of Firm within ten days and obtain pre-clearance from principal to make any transaction in the security. In addition to managing the Separate Accounts Equity Composite product which is covered by this Disclosure Statement, the portfolio manager also serves as president of the General Partner and Fund Manager for Cohasset Capital Partners, L.P. (CCP). Certain conflicts of interest are implied by this arrangement. CCP and the Separate Accounts Equity Composite of PCM have different investment objectives, investment styles, and suitability standards, and CCP may and will utilize strategies which differ from those employed in SAEC. SAEC trades primarily in large to mid cap stocks, whereas CCP has no restrictions with regard to market capitalization and employs other differentiating strategies. SAEC may or may not transact in the same securities as would be placed in CCP. To the extent the two entities invest in the same securities, they may be bought and sold at different times for different reasons and utilizing different valuation parameters and investment considerations. Under no circumstances will any trade be “crossed” between the two entities. There is no guarantee that a situation will not arise where a transaction takes place in one entity proximate to one in the other entity which contributes to price displacement and disadvantages the other entity as to the price it receives. When purchasing a security for both entities on the same day, PCM is under no obligation to combine the trades as a block, although it may do so. It is likely that SAEC trades will usually be executed where those accounts are custodied, and CCP trades at that entity’s prime broker. The fee levied by each Prime Broker for trades done at another broker offset any fractional amount saved on execution. Investors in either SAEC or CCP should assume that trades done at the same time in both entities at separate brokers may contribute to displacement which disadvantages one or the other. PCM, as General Partner of CCP, may receive an incentive allocation for investment performance subject to a “high water” and “threshold” test as described in the offering



memorandum for CCP. Such incentive allocation could cause the fund manager to favor CCP in its allocations of securities between PCM SAEC and CCP. In addition to SAEC and CCP, the Firm maintains two single-account, single-client Composites, SATS and SAZC, defined by Client-specific tax and income constraints and objectives, and subject to same conflicts as SAEC has, as described above, with CCP.

Inception date of SATS was August 2009, and it is an unadvertised, discretionary, fully-funded, fee-paying account. SAZC, inception August 2009, is an unadvertised, partially-discretionary, fully-funded, reduced-fee account. SATS and SAZC may be included in block trades which encompass accounts in SAEC and/or include an allocation for CCP. No account in any Composite has ever been moved from its Composite to another.

1. The maximum percentage of the overall AUM invested in IPOs at any given time before the "No IPO Rule" was implemented May 1, 2000, was 0.145%.
2. In 2002, certain accounts chose to deviate from the investment strategy and style against the advice of the portfolio manager. This style deviation varied in form between accounts, and variously included the purchase of consumer noncyclicals, and the sale of Nextel Communication and/ or Corning, or the failure to purchase Western Wireless. These accounts were not removed from the Composite as it is defined in the Report of Independent Auditors – 2000. Since Nextel Communications, Corning, and Western Wireless contributed disproportionately to Composite performance from Fourth Quarter 2002 through Second Quarter 2005, the continued inclusion of these style-deviant accounts in the Composite reduces Composite performance for the interval *ceteris paribus*. On March 6, 2009 a client requested to raise cash in reaction to market conditions against advice of PCM.

## EXHIBIT E

### CLIENT SUITABILITY – PCM SEPARATE ACCOUNTS EQUITY COMPOSITE ("SAEC")

The investment style is suitable for experienced, sophisticated high-net-worth individual investors and institutions. Client is responsible for reading the **Disclosure Statement** and **Reports to Clients** document, as well as Form ADV – Part 2A which are provided at least 48 hours before client signs **Advisory Agreement**.

Client understands that successful investment outcomes are driven by integrity of investment process and style adherence, and are contingent on a probabilistic, not a predictive approach.

A client prone to tactical or reactive investment behavior tends not to benefit from integrity of process. Self-consistency of investment style drives successful outcomes. It is important that a client notify the PCM immediately if his situation or goals change from those he represents before entering into an **Advisory Agreement** with PCM. While client may access his account for cash withdrawals as part of an overall cash withdrawal plan which includes other assets and sources of income, withdrawals which represent a high percentage of the average annual balance (more than 5%), or are frequent in occurrence, may impede investment returns. Client should not invest in equities those funds on which he is dependent to meet his living requirements and financial obligations, nor should he invest all his assets with **any** one firm or in any one investment style or asset class.

The investment style is highly concentrated by investment theme and individual security and is not diversified across sector or individual security names. As such, it is more volatile than the indexes, including the S & P 500. The portfolio at any given time is likely to yield less than the dividend yield on the S & P 500, and may pay no dividends. The return on any given client portfolio over any interval may deviate from the SAEC return or the return on any other separate account. **A client may obtain at any time the deviation of his account return from that of the SAEC.** Equities included in the SAEC may be highly cyclical or volatile such that the earnings or cash flow stream is neither consistent or predictable.

It is suggested that clients read Style Investing by Richard Bernstein to achieve an understanding of various investment styles. The style employed by SAEC is categorized by most institutional databases and consultants as Large Cap Growth, however the portfolio manager does not screen for stocks using "growth" or "value" as the criterion.

***This document must be included with Advisory Agreement***

END OF ADVISORY AGREEMENT  
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**EXHIBIT F**  
**BEST PRACTICES LETTER**

May 14, 2010

**Subject:        Protecting yourself from failure of custodial broker to send statements, overbilling, unauthorized withdrawals, and errors in performance and tax reports sent by PCM**

Dear Client:

Kindly take a minute to be sure you are receiving monthly an Account Statement sent directly to you by Schwab Institutional (not by PCM), as well as Trade Confirmations each time we execute a trade in your account at Schwab. If you are not receiving these documents, let me know immediately, as the SEC “Custody Rule” requires that you receive statements directly from the custodial entity at least quarterly, and our policy requires that you receive Schwab statements monthly.

Also attached are an updated “Reports to Clients” list and Disclosure Statement. The “Reports to Clients” list is provided to you at least once a year in “ADV-II Letter” and on an interim basis, so that you are aware of what reports are available to you.

The Disclosure Statement is provided with **all** performance reports-quarterly, annual, and interim, and randomly with other letters. It is especially important that you receive a brokerage Account Statement every month directly from the custodial broker, Schwab Institutional, as well as confirmations of any trades executed in your account, within a few days of trade date. We are required under the SEC “Custody Rule” to take reasonable steps to verify that you are receiving an Account Statement every month **directly** from Schwab Institutional (that is, it does not pass through an intermediary and is not revised in any way).

You should always check your Schwab monthly Account Statement to verify that the fees PCM shows as being deducted from your account in its documents match the amount shown on the Schwab statement for the month in which it is deducted. It is not the responsibility of the custodial brokerage firm (Schwab Institutional) to verify that the investment advisor (PCM) has deducted the correct amount in fees. Fees are always based on the total account value shown on custodial brokerage firm statement at market close on last day of quarter or semi-annual interval for which you are being billed.

You will soon receive a document reviewing your billing cycle, billing rate, and instructions on how to use information provided on your Schwab Institutional monthly Account Statements to verify that the fees automatically deducted by PCM are correct.

You also receive with all PCM quarterly performance packets a report called “Capital Flows and Valuation”. This shows you all contributions and withdrawals initiated by you

to and from your account. You should review this to be sure you recognize all contributions and withdrawals. Your Schwab Institutional monthly Account Statement gives information on the destinations to which wires were sent, and you should review this monthly to be sure you recognize all withdrawals and destinations. Notify me immediately if you find any activity which you do not recognize as being authorized by you.

If you are an investor in Cohasset Capital Partners, L.P., you should have a password enabling you to access value of your partnership interest on the website of the Fund Administrator, ALPS Price Meadows. You should also receive a monthly performance report via email sent by me and showing the Fund Administrator's performance report for the Fund. You should rely only on the Fund Administrator performance report and not on any representation made by General Partner which contradicts it.

The performance reports you receive from PCM must always show both gross and net of fee performance.

Our "eMail Policy" requires that Terri Vedders, CPA, copy me on any eMail communication with any client or outside party. Should you receive your performance packet or any other information from Terri without my being "cc'd" in the eMail heading, kindly let me know so I can remind Terri. I am responsible for all reporting or fee deduction errors and am required to notify you in writing of any information you may have received which is incorrect.

Finally, PCM is obligated to provide upon request in writing the performance dispersion over any interval between your account and the PCM Separate Accounts Equity Composite, and to disclose in writing percentage of Assets Under Management not paying full fee over any interval.

Sincerely,

Molly Pengra

## EXHIBIT G BEST PRACTICES LETTER

July 8, 2010

Dear Client:

Attached please find the most recently revised ***Disclosure Statement For Separate Accounts Equity Composite*** and the most recently revised advisory agreement ***Engagement Letter***, as well as ***How to Verify Accuracy of Fee Deductions***.

There is no reason you need to sign a new advisory agreement, but it is the policy of this firm that all clients, old and new, have the same information about firm policies, so that every client can protect himself from being treated differently from others or from potential conflicts of interest.

The current advisory agreement incorporates more of the information available in the ***Disclosure Statement***. Specifically, it makes clients aware that a conflict exists between Cohassett Capital Partners, L.P. and Separate Accounts Equity Composite and other separate accounts maintained by the Firm\*, and it gives specific information enabling each client to protect himself from wire transfers out of his accounts into accounts not owned by him.

Additionally, there is a more comprehensive discussion of the impact of fee deductions on investment performance in the revised agreement.

Most importantly, in ***Item 3 – Investment Style***, the revised agreement states “Client agrees to notify PCM in writing should he wish to deviate from PCM investment strategy”. Please be aware that when any client account in the Separate Accounts Equity Composite (SAEC) deviates from the SAEC strategy, it impacts our Separate Accounts Equity Composite performance which we file with various institutional consultants and databases. As a matter of Firm policy and in regard to performance-audit compliance, these client-driven deviations must be documented.

Please review your investment goals, liquidity needs, and risk tolerance, and if any of this has changed since you became a client of the Separate Accounts Equity Composite product, please let me know immediately. I am always available to discuss your specific issues.

I encourage you to reread the Best Practices Letter dated May 14, 2010, so that you can protect yourself from any errors in performance and tax reporting, fee deductions, or wiring of funds made by PCM or the custodial broker.

No cash, checks, or securities certificates shall pass through the office of PCM or any account or entity owned by or affiliated with PCM. All cash, checks, securities, wire transfers must occur directly between you and the custodial broker (or, in the case of CCP, the bank for Goldman Sachs Execution & Clearing, JP Morgan, as per instructions provided in Subscription Agreement for CCP). I cannot touch a check you want to send to Schwab for your Separate Account or to Cohasset for your partnership interest, nor can I handle a stock certificate you intend to deposit in your account or send to a transfer agent. You all know this, and no one has asked to proceed differently, but it is important to reiterate.

It continues to be a pleasure to have you as a client.

Sincerely,

Molly Pengra

\*In addition to SAEC, PCM maintains two separate single-account Composites, the differentiating characteristics of which in either case are extreme tax-sensitivity and client-specific income requirements which render these accounts unsuitable for inclusion in the investment style employed by SAEC. The performance of these accounts is not included in SAEC or advertised or reported to institutional consultants, databases, or prospective clients. The investment strategy employed by these two single-account Composites is not available to new clients of the Firm. These two Composites may participate in block trades which include the accounts of SAEC, and may be exposed to the same conflicts of interest with regard to Cohasset Capital Partners, L.P. as are clients of SAEC, and as described in the Disclosure Statement.

## **EXHIBIT H**

### **LIST OF DOCUMENTS TO BE PROVIDED TO ALL PROSPECTIVE NEW CLIENTS BEFORE SIGNING ADVISORY AGREEMENT**

#### **Documents a new client receives**

1. ADV-1 and ADV- 2A, Reports to Clients, Client Suitability, Disclosure Statement, Firmwide Composite List, and Advisory Agreement must be given to client at least 48 hours before he signs Advisory Agreement
2. PriceWaterhouseCoopers, L.P. AIMR® - Level II Verification through 2000.
3. Schwab Institutional Money Funds prospectuses and Schwab Internal Control/SIPC information



**EXHIBIT I**  
**BEST PRACTICES LETTER**

January 9, 2009

Re: Offer of ADV-II Mailing  
Rule 204A-1 – Access Person/Employee Trading Disclosure

Dear Client:

We are required by the SEC to notify you that you are entitled to receive free of charge our ADV – Part II filing and any reports listed on the Reports to Clients document attached to this mailing.

Effective December 23, 2004, it is the policy of Pengra Capital that no employee or “access person” (any person with access to information about trades done in client accounts, securities owned by Pengra Capital Management or Cohassett Capital Partners, L.P., or any other aspect of client accounts) may own or trade in individual securities in any account controlled by him.

Before December 23, 2004, any employee or “access person” was required to submit regularly statements of all activity in any personal account controlled by him which held, bought, or sold individual securities, and to receive pre-clearance from the Firm’s principal before trading in securities in order to prevent front-running client accounts or the potential for use of “insider information” which he may have accidentally acquired as a result of working for the Firm, or which he may not be aware of, but would be coincidental to knowledge held by the Firm’s principal on a confidential basis.

Any employee or “access person” who comes into direct ownership of individual securities through inheritance or other means must report such event within ten calendar days of such possession transpiring.

Any sale or disposition of such securities must receive pre-clearance from the Firm’s principal in order to avoid front-running of client accounts and to ensure that no trades occur coincidental to any “insider information” held by the Firm’s principal, even if such information has not been disclosed to the employee or “access person”. Such “insider information” may, for example, be disclosed to the Firm’s principal on a confidential basis as it relates to specific tax or investment allocation concerns of a particular client, and may not be acted upon or divulged to any party.

Employees or “access persons” may invest in mutual funds, private equity funds, private partnerships and other vehicles where they exert no direct control, and may invest as Limited Partners with Cohassett Capital Partners, L.P.

Sincerely,  
Molly Pengra

## **EXHIBIT J**

### **BEST PRACTICES LETTER**

January 15, 2010

Dear Client:

Every year you receive from us a letter which discusses various “Best Practices” issues which affect your account.

In recent years, the letters have covered client suitability, client privacy and confidentiality, death or incapacitation of principal, eMail policy, best execution, allocation of securities between accounts, conflicts of interest between Separate Accounts and Cohasset Capital Partners, L.P., and other subjects.

The letter also includes “List of Reports to Clients” showing you what reports are available to you or are automatically sent to you, as well as a “Client Suitability”, “Privacy Policy”, and “Disclosure Statement”. It advises you that you are entitled to receive SEC Form ADV – Part II at no charge.

**BEST EXECUTION:** The SEC requires investment advisory firms to seek the best prices on execution of all trades, and to avoid any conflict of interest which puts the interest of the advisory firm ahead of that of the client. Clients should be aware of whether an advisory firm gets referrals from a brokerage firm, bank, or any third party consultant. Advisors are required to disclose any soft dollar relationships which would require him to execute trades where he has incurred soft dollar obligations in the form of technology, subscriptions or other considerations. Neither PCM or Cohasset Capital Partners, L.P. has any arrangements of any kind which would require the firm to execute trades at any particular firm in exchange for referrals, research, technology, or consideration of any kind. We participate in no brokerage firm “wrap programs” or any third party referral networks. Advisory firms should pay for research and services out of firm revenues, not through soft dollar arrangements. We participate in no “pay-to-play” relationships with any consultants, and are not part of the Schwab Advisor Network.

As far as “shopping” for best execution, a firm this size and its clients are better served by selecting a custodial broker and a prime brokerage platform based on back office reliability and service, responsiveness in handling client document flow and special requests, financial stability, and efficiency in transactions processing. I focus on the investment side, and having multiple brokerage relationships creates complexity of processing and takes time. Most of our trades are done at the custodial broker. Were we to be doing multi-million share block trades which required the executing trading desk to commit capital, this would not be an appropriate stance, but clients are best served when I can concentrate on research and valuation, not on transactions.

Schwab Institutional has demonstrated excellent responsiveness to specific client needs regarding document processing and cash management. They respond promptly and efficiently to requests and complaints, and have an well-trained staff. They provide us with compliance support in the form of frequent compliance bulletins written by various contributing law firms, and they deserve to be paid for their back office and compliance support. Trading away does not improve clients' risk-adjusted returns, and undermines the efforts of sell-side firms such as Schwab to provide extensive compliance information to their institutional clients.

Similarly, Goldman Sachs Execution & Clearing through Baypoint Securites provides excellent back office, reporting, and audit support for Cohassett. They work seamlessly with the Fund Administrator, ALPS Price Meadows, and the audit firm, Spicer Jeffries, LLP. The confidence I get from knowing the fund reporting conforms to the highest standards exceeds any possible benefit of fractional execution price differentials.

We do not use outside research. In past years, we had used a particular quantitative research product at Merrill Lynch, and had directed them a small amount of commission business to pay for that service. No trades have ever been directed to pay for referrals or soft dollar considerations.

**CONFLICTS:** The Disclosure Statement you receive with all performance reports and strategy letters covers most of the best practices issues. In 2008, a statement was added to the Disclosure Statement explaining that there is a theoretical conflict between Cohassett Capital Partners, L.P. and Pengra Capital Separate Accounts large Growth product. That is, trades either entity are most often executed at that entity's custodial brokerage firm. The execution in one entity could displace stock price for the trade being done at the other entity on the same day or even with the same hour. Our trades are not big enough that, at the margin they are responsible for price changes in the market. The execution prices are randomly different, and such difference does not determine the investment performance of either entity. No account of the Separate Accounts receives different execution prices from the others, as all blocks are traded at an average price, and allocated to the accounts using that price. Occasionally, some account with a special need (for example, a client who calls with an urgent cash need) will trade separately and not participate in the average price if a block is done later in the day on behalf of all accounts. If you have concerns, let me know, but investment performance (risk-adjusted returns) is my primary concern, and I do what I can to streamline.

**DEATH OR INCAPACITATION OF PRINCIPAL:** Written procedures are in place to facilitate the timely transfer of your assets in the event of my death or incapacitation. Do not hesitate to discuss this with Terri Vedders or me.

**CLIENT SUITABILITY:** When you initiated your relationship with Pengra Capital or, as the case may be, Cohassett Capital Partners, L.P., you were asked many questions about your investment goals and tolerance for risk. If your goals have changed, please let me know. For tactical reasons described in the strategy letters from 2006 through 2008,

the portfolios are becoming more yield-oriented, however for tactical reasons, yield has not generally been an objective of the investment product.

**PERFORMANCE REPORTING:** PCM is obligated to provide to you upon request the performance differential between your account and the PCM Composite over any interval. One of the causes of dispersion in performance between client accounts is client-driven style-deviation, such as reacting to volatile markets and requesting to raise cash at troughs or to take on valuation risk by migrating to Treasuries and blue-chips at recession troughs instead of reducing valuation risk and adding beta. Under AIMR protocol, a client whose withdrawals exceed 10% per year may be removed from the Composite, since such withdrawals may cause performance deviation. As our Disclosure Statement states, no fully-funded account past or present has ever been removed from the Composite, even though there have been instances of withdrawals significantly in excess of 10% in a given year, and of style-deviation. These deviations are infrequent and episodic, but have had an impact on dispersion. As of March 2009, any request to deviate from PCM investment strategy must be in writing.

**ADV – PART II:** You are entitled to receive SEC Form ADV-II every year at no charge.

Please do not hesitate to call with any questions you have about your account or any of the best practices issues.

Sincerely,

Molly Pengra

## **EXHIBIT K BEST PRACTICES LETTER**

### **REPORTS TO CLIENTS**

Any client may request an SEC Form ADV – Part 2A at any time. All Clients are provided ADV – Part 2A at least 48 hours before signing the **Advisory Agreement** and all clients receive an updated ADV-Part 2A each January.

Client must receive **Advisory Agreement**, 48 hours before signing. All clients must be offered a copy of Cohasset Capital Partners, L.P. **Offering Memorandum** for purposes of assessing conflicts of interest between Separate Accounts and Cohasset Capital Partners, L.P.

All new clients are provided a copy of Schwab Institutional financial statement, Internal Control Letter, and the prospectus for the Money Market Fund which is employed for cash sweeps.

Upon signing **Advisory Agreement**, Client is provided **How to Verify Accuracy of Fee Deductions**.

All clients receive monthly **Account Statements** from **Schwab Institutional** and **Trade Confirmations** from **Schwab Institutional** within 5 business days of trade date. These documents are sent **directly to client** from Schwab and not by Pengra Capital.

All clients receive PCM-generated **Portfolio Statements** quarterly, and on an interim basis as requested.

All clients are provided with quarterly PCM-generated **Performance Reports**, as well as **Realized Gain and Loss and Unrealized Gain and Loss Reports** prepared by PCM. The **Disclosure Statement** is included with all **Performance Reports** and **Strategy Letters**.

All clients receive all **Best Practices Letters** sent since 2004 and all new **Best Practices Letters** as they are issued. See Exhibits F-Q in ADV – Part 2A

Interim reports of any kind are available upon request at any time.

All clients receive the following annually with the ADV – Part 2A which is sent with the PCM annual report packet and which includes updated **Advisory Agreement** and **How to Verify Accuracy of Fee Deductions**:

1. Annual Performance Report
2. Annual Realized Gain and Loss Report
3. Annual Unrealized Gain and Loss Report
4. Expense Report
5. Income Report
6. Since-Inception Withdrawals and Contributions
7. Privacy Notice
8. Disclosure Statement
9. Client Suitability Statement
10. Reports to Clients

In any year when significant changes have occurred in the following documents, the revised version will be included in the annual report packet. All of the following documents are provided with the new account packet, as are Items 7-10 above, which clients must receive at least 48 hours before signing **Advisory Agreement**:

1. Email Policy
2. Code of Ethics
3. Best Execution and Soft Dollar Policy
4. Proxy Statement

All clients are advised of fees deducted from their account. PCM sends a **Fee Advice** form the day that fees are deducted. Clients are also notified in four other ways of fee deductions:

8. Monthly Account Statements generated by the custodial brokerage firm Schwab Institutional
9. Quarterly and interim performance reports generated by PCM
10. Expense Report sent by PCM in January
11. Expense Report included in custodian year-end statement

An AIMR® – Level II Verification was issued by PriceWaterhouseCoopers, L.P. on December 28, 2001 for the interval January 1, 1991 through December 31, 2000, and is provided to client at least 48 hours before he signs Advisory Agreement.

## **EXHIBIT L**

### **BEST PRACTICES LETTER**

#### **BEST EXECUTION AND SOFT DOLLAR POLICY – August 2, 2010**

The Securities & Exchange Commission requires that registered investment advisors make every effort to obtain best execution on all trades.

PCM evaluates its policy regarding trade execution and custodial service on an ongoing basis. The prime broker is selected for financial stability, general reputation among its prime broker clients, back office reliability, technology which is compatible with that of PCM, and service in resolving client issues. It has been our experience that the service component – how a prime broker handles the numerous issues regarding document flow and providing quick response to us and to our clients, more important to client well-being in the long run than any small differential which occurs in execution price on trades. Clients are best served when the principal of the money management firm can concentrate on investment strategy, not on dealing with back office issues.

Specifically, we have been pleased with the responsiveness, execution and document processing of Schwab Institutional over time. As with any custodial relationship, there are problems from time to time, but these are resolved in a manner which serves the clients well.

We have only traded with two other firms beside Schwab Institutional since moving accounts to Schwab (DeLafield Hambrecht and Merrill Lynch), and do not pretend to scout for execution on a trade by trade basis. We believe that old-fashioned loyalty in business relationships has intangible benefits over time which improve the well being of clients. We are concerned about the effects some of these regulations are having on the ability of firms to develop relationships that are productive to the clients in ways that cannot be measured in pennies per trade.

We are concerned that the “law of unintended outcome” may come into play with the well-intentioned Best Execution guidelines as they relate to small firms. Clients are well served when a small firm is concentrating on research and portfolio management, not on monitoring insignificant price differentials on trades. If we do not pay for what we take, eventually we will be relegated to a lower service level. PCM demands a high level of responsiveness to client requests and in implementation of document flow.

Your commission rate shows on each Confirmation of Trade you receive from Schwab Institutional. Additionally, you receive an Expense Report every January with your performance packet. Investment performance at PCM is not driven by insignificant trade execution differentials, and PCM does not require that proprietary capital be committed by the trading desks with which it executes.

PCM does not have, nor has it ever had, any entwinements of any kind with any brokerage firm such that any broker refers business to PCM or provides capital introductions. PCM does not have, nor has it ever had, any soft dollar agreements. We pay for all hardware, software, and subscription services out of firm revenue and not with commission dollars.

Should you have any concerns or feel that your best interests are not being served, please let us know.

Retail clients are not permitted to designate a brokerage for custodial services or to direct brokerage commission.

As of December 1, 2007, Pengra Capital Management, Inc. became the General Partner of Cohasset Capital Partners, L.P. As stated in the Disclosure Statement (see ADV Part 2A) which is attached to any report sent to clients or prospective clients which mentions investment performance, "PCM" and "CCP" are custodized at separate Prime Brokers:

**No employee/access person of the Firm may own or trade in any individual securities. Should such person come into possession of any individual security, he must report it to principal of Firm within ten days and obtain pre-clearance from principal to make any transaction in the security. In addition to managing the Separate Accounts product which is covered by this Disclosure Statement, the portfolio manager also serves as General Partner and Fund Manager for Cohasset Capital Partners, L.P. ("CCP"). Certain conflicts of interest are implied by this arrangement. "CCP" and the Separate Accounts product of Pengra Capital Management, Inc. have different investment objectives, investment styles, and suitability standards, and "CCP" may utilize strategies which differ from those employed in the Separate Accounts product. The Separate Accounts product trades primarily in large to mid cap stocks, whereas "CCP" has no restrictions with regard to market capitalization and employs other differentiating strategies. The Separate Accounts product may or may not transact in the same securities as would be placed in "CCP". To the extent the two entities invest in the same securities, they may be bought and sold at different times for different reasons and utilizing different valuation parameters and investment considerations. Under no circumstances will any trade be "crossed" between the two entities. There is no guarantee that a situation will not arise where a transaction takes place in one entity proximate to one in the other entity which contributes to price displacement and disadvantages the other entity as to the price it receives, however, in practice, the size of trades done by PCM and CCP does not have market impact. When purchasing a security for both entities on the same day, PCM is under no obligation to combine the trades as a block, although it may do so. It is likely that Separate Accounts trades will usually be executed where those accounts are custodized, and "CCP" trades at that entity's prime broker. The fee levied by each Prime Broker for trades done at another broker offset any fractional amount saved on execution. Investors in either "PCM" or "CCP" should assume that trades done at the same time in both entities at separate brokers may contribute to displacement which disadvantages one or the other.**



**EXHIBIT – M**  
**BEST PRACTICES LETTER**

November 11, 2008

Dear Client:

Every year at this time, you receive a letter which discusses an aspect of the Disclosure Statement which you receive with every performance report.

No action is required on your part, and these letters are sent as a "Best Practices" standard.

As you are aware, I started a new fund on December 1, 2007, Cohassett Capital Partners ("CCP").

The Disclosure Statement for Pengra Capital ("PCM") clients was amended at that time to reflect the formation of this fund and to disclose potential conflicts of interest. The Disclosure Statement will be sent both to clients of PCM and Limited Partners of CCP.

The main potential conflict relates to trades done in the same security in both entities. The Disclosure Statement states that to the extent any security is purchased or sold in both entities, it is possible that one entity will receive a price in that security which differs from that received by the other. This does not apply when both entities' trades are done as one block at one or the other of PCM's prime brokerage firms, and then allocated out of that block into both the Separate Accounts and The Fund. In that case, both entities receive the same price.

The Disclosure Statement states that in practice, trades will most likely be done separately for each entity at its custodial broker. In this case, there will be a price differential such that one entity may pay less on a purchase or receive less on a sale than does the other entity.

I do not consider these execution price differentials to be relevant with regard to the different objectives of the entities or material to the investment success of either.

If you have any questions or concerns, please let me know. There are a lot of reasons why it makes sense to trade at each entity's respective prime broker, although some trades are executed as blocks at one or the other.

**Email Policy:** Remember that all requests for wire transfers must be made in writing and include account name and number, amount to be transferred, and signed by you. A request to buy or sell a security may be made directly over the phone. Email requests

cannot be processed, although either a letter or telephone call can be backed up with an email.

This policy is designed to protect your account from fraudulent use.

**Privacy and Account Security:** Please do not include your Social Security number in any email communication with us. We do not keep your Social Security Numbers and Taxpayer Identification numbers on file either electronically or on paper, and may have to ask you once in awhile to provide these numbers again. I apologize for the inconvenience, but these numbers result in the worst problems in the event of document theft.

**Soft Dollar Arrangements:** Neither PCM or CCP have any soft dollar arrangements with any broker, bank, or other entity.

**Uncompensated Referrals:** To the extent that I have facilitated your relationship with any competitor of this firm, including various hedge funds and money management firms, neither PCM or I personally have received any compensation, commissions, fees, or in-kind considerations for such facilitation either from those entities or from you or your advisors. My role in these facilitations has consisted solely of attempting to match you with the right type of money manager for your needs and, in some cases, requesting that those managers lower their required account minimums to accommodate you, since some of the managers serve institutions only and have high minimums which most individual investors cannot meet.

**Death of Principal:**

As mentioned in previous letters, procedures are in place to assist you in transferring or liquidating your accounts in the event of my death or incapacitation. These procedures and documents are reviewed regularly.

Enclosed please find a list of reports available to you which describe compliance policies.

Please do not hesitate to call with questions.

Best regards,

Molly Pengra

**EXHIBIT – N**  
**BEST PRACTICES LETTER**

February 20, 2008

Dear Client:

Enclosed please find a copy of our Privacy Statement, e-Mail Policy, the List of Reports to Clients, and revised Disclosure Statement.

Please do not hesitate to ask if you would like to receive any of the reports on the List of Reports to Clients again.

You are entitled to receive free of charge a copy of the firm's ADV-Part II.

You receive with every performance report throughout the year a copy of the Disclosure Statement.

In earlier annual letters to clients regarding compliance issues, I have discussed issues involving the security of your account. Most attempts by third parties to take money out of accounts at brokerage firms and banks are made by persons who have worked for the account holder in his home or office. It is a good idea to change your passwords into your computer and into any specific accounts or screens any time an employee leaves.

As you know, Pengra Capital is now the General Partner of a new fund, Cohassett Capital Partners, L.P. Most of you have discussed this with me, and if you have not, I welcome any questions or concerns you may have about potential conflicts of interest. Such potential conflicts exist for all firms which manage more than one investment product or fund.

There has never been such a high proportion of cash in the portfolios. It has served us well as far as keeping the accounts stable throughout the derivatives and subprime debacle. The worst is not over, and from a valuation standpoint, it is reasonable to expect the markets to go through a pattern similar to that which preceded the start of the bull market in 1982, which was one of the four great buying opportunities of the twentieth century. We are about to see one very much like it, but patience is required for awhile longer. There is a pretty clear set of things which has to happen in the bond, commodity and other markets before this is over. We may see the cyclically-adjusted price earnings multiple on equities back around 10X before this is all over.

I think we can do relatively well through what is left of the bear market, but make no mistake, that is what this is. Index funds will do particularly poorly, while certain sectors and special situations should do well.

Sincerely,

Molly Pengra

**EXHIBIT – 0**  
**BEST PRACTICES LETTER**

January 20, 2007

Dear Client:

Enclosed please find the following documents which we are required to send clients on an annual basis.

1. Privacy Disclosure Statement.
2. Disclosure Statement.
3. List of reports about your account you should expect to receive from PCM and the custodial broker on a monthly, quarterly, or annual basis.
4. Client Suitability Standards for this product.

With regard to suitability, it is important that you review the suitability document and ask yourself if your goals may have changed since you last described them to me and since you originally signed the advisory agreement.

The Disclosure Statement which you receive with every performance summary and tax summary includes information about our policies regarding best execution, soft dollar issues, allocation, investment style, and other “Best Practices”.

This letter also includes a discussion of what you need to know in the event of my death or incapacitation, as well as what you can expect in the event of a natural disaster or terrorist attack which impedes communications within the financial services grid.

Many of you have asked over the years for assistance in choosing other money managers to meet your need for diversification. I am happy to provide this service, and have directed you only to established, sophisticated institutional money managers. If you are clear on your financial goals and have an estate attorney and C.P.A. you are well advised not to introduce middle man fees to choose managers.

For now, some of you use these managers in addition to Pengra Capital, as part of a diversified strategy to employ different asset classes and investment styles. However, there may come a time when I am unable to serve in my current capacity, and you will want to be prepared with an idea of which managers we have discussed would be suitable for you to use instead of Pengra Capital.

I am available on an ongoing basis to discuss this, and ask that you review your goals and the information I have given you over the years regarding other managers or mutual

funds in suitable style categories, and verify with me that you feel comfortable about what you would do in the event I were incapacitated. As we have discussed, the procedure for transferring your account from its current custodial brokerage arrangement at Schwab Institutional or other firms is simple, and your newly appointed manager would facilitate the ACATS transfer with help from this office. Should you not want to select a new manager or mutual fund immediately, you can easily transfer the account to your bank until you decide what fiduciary relationship you want to establish. In selecting new managers or, in some cases, mutual funds, remember that a stockbroker (or private wealth management firm, as many now call themselves) is not a legal fiduciary. The reason I have suggested money management firms over the years, not stockbrokers or private wealth managers, is that if corporate Defined Benefit plans governed under the ERISA laws, and endowments, place assets to be managed on a discretionary basis with money management firms, not with brokerage firms, so should you.

The managers I have suggested for each of you, depending upon your goals, are selected by virtue of having been vetted by major institutional investors who, as fiduciaries of ERISA-governed Defined Benefit Plans and other entities such as public trusts and endowments, are obligated to adhere to strict selection criteria. Always be sure to verify that any firm you hire reports performance in conformity with CFA Institute® (formerly AIMR®) performance presentation standards, and that their style suits your risk tolerance and goals.

I will be reviewing again with each of you what the procedure for such a transfer is, and whether the manager list you have is still suitable for your goals. You should meet regularly with your estate attorney and C.P.A. to be sure that your estate plan and will are in good order. A financial planner is not a substitute for the above professionals.

By way of disclosure, Pengra Capital has no entwinements or agreements with any firm whereby it will be compensated in any way, either through direct financial compensation or soft dollar arrangements, for referring business to them. PCM has no soft dollar relationships and no cross-referral agreements with any firm. PCM has never accepted any form of compensation from any client for assisting in placing assets with a competitor. One of the biggest deterrents to wealth creation is the introduction of middle man fees, as investors who bought into brokerage firm wrap programs in the 1970's discovered. PCM has never had any arrangement with any brokerage firm whereby we placed trades with a brokerage firm or directed clients to them in exchange for referrals or consideration of any kind.

It is advisable that you consider all of your securities portfolios to be illiquid in the event of a natural disaster or terrorist attack. This may not actually turn out to be the case, but planning for the worst case makes sense. You should have adequate cash on hand in your home, car, and checking account to get you through a long period following a natural disaster or terrorist attack. Again, I do not recommend that you count on being able to access your account in the event of a major disaster, as it is conceivable that problems could occur throughout the communications technology grid or the financial system which will cause funds you attempt to wire not to reach your destination bank account.

You all know that I do not believe it makes sense from an investment or technical standpoint to start moving money around should there be technical impediments to communication between entities in the financial system. Realistically, no one has probably foreseen or provided for certain eventualities during a natural disaster or terrorist attack in executing trades, communicating the information to third parties, settling trades, and wiring funds. Money managers are required to test alternative ways of conducting business during a disaster and to have a disaster preparedness plan. Should the landline phone service be destroyed in the event of earthquake or terrorist attack, the only remaining way to access a trading desk is through cell phone. I have no intention of placing equity or bond trades over cell phones given the potential for interruption and error, and the possibility of the trading desk being unable to confirm the trade should they be unable to reach the cell phone number. Online trades would not be advisable in that the stock prices may have declined precipitously by the time the online trade is able to be processed by the receiving broker, and there would be no certainty that the receiving brokerage firm would be able to confirm back the trade either electronically or by telephone. It is possible that days could pass before it was clear what trades had been executed. Selling securities into this kind of an extreme crisis does not make sense. I have no intention of attempting to liquidate the accounts during a disaster, and urge you to take this into account when looking at your overall financial plan and long term needs.

You may have noticed that we are carrying uncharacteristically high cash levels the past year. While this is frowned upon by the institutional pension consultants and financial planners, it does not represent an attempt to time the market. It is partly a reflection of the reality of today's geopolitical risks, as well as having to do with strategic concerns enumerated in the November 2006 Strategy Letter. There is great pressure in this industry to engage in group-think and formulaic approaches to managing money. Common sense tells us one thing, and the consultants and planners and others who stand between money managers and their clients tell us another. Since I am the legally responsible fiduciary, I have to do what I think is best, and I am holding more cash than the backseat drivers want us to hold. The financial planners and consultants will not be here to take ownership of what has gone wrong for clients when we have done it their way, anymore than they were willing to take the consequences for recommending that clients sell stock in 2002 or substitute money center bank stocks for certain investment banking stocks in July 2002. The entity which has to take the consequences as a fiduciary should be allowed to make the decisions. The previous paragraph describes a worst-case way of regarding a disaster, and the take-away is that you need to keep cash at home and on your person and not depend on this account; and that you cannot expect that we will sell equities into a panic, both for technical and investment reasons, but we will have cash on hand to take advantage of the situation after the dust settles.

It makes sense for you to assume the worst case -- that the financial system will not work reliably, and that you need to keep adequate cash in a safe in your home, and with you at all times, and not to depend on accessing your bank and brokerage accounts, either here or anyplace else.

Please do not hesitate to talk to me about how you would be served in the event of my incapacitation. The goal is for you to know exactly what you would do to transfer your assets and continue your investment program and ability to access your funds.

You are entitled to receive at no charge every year a copy of SEC Form ADV.

Best Regards,

Molly Pengra

**EXHIBIT – P**  
**BEST PRACTICES LETTER**

January 15, 2006

Dear Client:

Enclosed please find your 2005 Annual Performance Summary prepared in conformity with AIMR<sup>®</sup> performance calculation guidelines, and your 2005 Realized Gain and Loss Statement and Unrealized Gain and Loss Statement.

Also enclosed are a Since-Inception Withdrawal and Contribution Summary, an Expense Report, and an Income Report.

A copy of SEC–Form ADV–Part II is available upon request, at no charge.

You will also find the following:

1. Privacy Disclosure Statement
2. Disclosure Statement
3. List of reports about your account you should expect to receive from PCM and from the custodial agent on a monthly, quarterly, or annual basis.
4. Client Suitability Standards for Concentrated Theme Product

The following PCM Policy Statements are available upon request and will be sent automatically in any year when a significant revision has occurred:

1. Best Execution and Soft Dollar Policy
2. Proxy Statement
3. Code of Ethics
4. E-mail Policy

It is particularly important that you read the Disclosure Statement which is enclosed and is also attached to all quarterly and annual performance reports, interim performance reports, and strategy letters.

I want to reiterate to you the point made in my letter to you dated September 2, 2004, which discussed ways that clients can protect their personal information, account numbers, and Social Security or Taxpayer Identification numbers. It is of critical importance that you keep your documents in locked files, shred documents you are discarding, and use complex passwords on your computer and other electronic access (a complex password should be at least seven digits long and employ both numbers and letters so that it cannot be guessed by someone who might know you or work for you).

The strategy letters which I send you periodically discuss the Firm's composite gross-of-fee investment performance, as is the custom in such strategy letters where certain institutional recipients of the letter may use the Composite performance in comparison



with composite returns for other managers whose fee structure may be different than ours. The performance for your individual account is always presented to you showing both gross-of-fee and net-of-fee performance, and your account's performance may differ significantly from the Composite or from any other single account of the Firm. Any client may request at any time to know how his account's performance differs from that of the Composite. An account with high cash withdrawal patterns, changes in investment goals, or style-deviation may differ significantly from the Composite in portfolio structure and performance.

I want to remind everyone that successful investing entails a probabilistic process, not a predictive one. Integrity of investment process and self-consistency of investment style are the key drivers of investment success. Process is outcome. Investors who engage in reactive or tactical behavior at the expense of style adherence and integrity of process do not achieve good outcomes over time. Simply put, they usually "flip" when they should "flop". A common mistake investors make is attempting to "become more conservative" during recessions and bear markets. This ploy often adds valuation risk, while reducing fundamental risk. Any midcourse deviation from the pre-set investment strategy and style increases the risk of failure. Reactive style changes do not serve investors well, and investors who are prone to change styles frequently or reactively may not be suited to using the services of a style-adherent, institutional money manager.

I urge you to read the enclosure, Client Suitability-Concentrated Theme Equity Product, reviewing what your goals are now relative to what you may have represented them to be upon becoming a client of PCM.

Do not count on being able to make securities transactions or wire funds in the event of a natural disaster or terrorist attack. We make no representation that this will be possible, and believe that all transactions attempted under disaster circumstances are unadvisable both from an investment and technical standpoint. If you are counting on "business as usual", or are expecting to live off your portfolio in the early days of a disaster, you should rethink the amount of money you need to have in your possession. No one can predict whether securities exchanges, banks, or custodial brokers will be operational in the event of a major disaster.

Federal Anti-Money Laundering regulations require that each client have one bank account of record to which he wires funds from his managed account. We are unable to allow clients to wire funds out of the custodial broker to accounts other than the destination bank account of record, the owner of which must be the client himself. No client may wire funds directly into any account managed by PCM not owned by him. Incoming wires must originate at an account owned by client at a bank or custodial broker.

Sincerely,

Molly E. Pengra

**EXHIBIT – Q**  
**BEST PRACTICES LETTER**

January 20, 2005

Dear Client:

Enclosed please find your 2004 Annual Performance Summary prepared in accordance with AIMR<sup>®</sup> performance calculation guidelines, and your 2004 Realized Gain and Loss Statement and Unrealized Gain and Loss Statement.

Also enclosed are a Since-Inception Withdrawal and Contribution Summary and an Expense Report.

A copy of SEC – Form ADV – Part II is available upon request.

You will also find the following:

5. Privacy Disclosure Statement
6. E-mail Policy
7. Disclosure Statement
8. Client Suitability Standards for Concentrated Theme Product
9. List of reports about your account you should expect to receive from PCM and from the custodial agent on a monthly, quarterly, or annual basis.

The following are available upon request:

5. PCM Policy Statements: Best Execution and Soft Dollar Policy, Proxy Statement, and Code of Ethics. These will be sent automatically in any year when a significant revision has occurred, and are provided to all new clients at least 48 hours before advisory documents are signed.

It is particularly important that you read the Disclosure Statement which is enclosed and is also attached to all quarterly performance reports, interim performance reports, and strategy letters.

I want to reiterate to you the point made in my letter to you dated September 2, 2004, which discussed ways that clients can protect their personal information, account numbers, and Social Security or Taxpayer Identification numbers. It is of critical importance that you keep your documents in locked files, shred documents you are discarding, and use complex passwords on your computer and other electronic access (a complex password should be at least seven digits long and employ both numbers and letters so that it cannot be guessed by someone who might know you or work for you).

The strategy letters which I send you periodically discuss the Firm's composite gross-of-fee investment performance, as is the custom in such strategy letters where certain

institutional recipients of the letter may use the composite performance in comparison with composite returns for other managers whose fee structure may be different than ours. The performance for your individual account is always presented to you showing both gross-of-fee and net-of-fee performance, and your account's performance may differ significantly from the composite or from any other single account of the Firm. Any client may request at any time to learn how his account's performance differs from that of the composite. Portfolios with high cash withdrawal patterns or changes in investment goals may deviate significantly from the composite.

I want to remind everyone that successful investing entails a probabilistic process, not a predictive one. Integrity of investment process and self-consistency of investment style are the key drivers of investment success. Process is outcome. Investors who engage in reactive or tactical behavior at the expense of style adherence and integrity of process do not achieve good outcomes over time. Simply put, they usually "flip" when they should "flop". A common mistake investors make is attempting to "become more conservative" during recessions and bear markets. This ploy often adds valuation risk, while reducing fundamental risk. Any midcourse deviation from the pre-set investment strategy and style increases the risk of failure. Reactive style changes do not serve investors well, and investors who are prone to change styles frequently or reactively may not be suited to using the services of a style-adherent, institutional money manager.

I urge you to read the enclosure, Client Suitability-Concentrated Theme Equity Product, reviewing what your goals are now relative to what you may have represented them to be upon becoming a client of PCM.

Do not count on being able to make securities transactions or wire funds in the event of a disaster. We make no representation that this will be possible, and believe that all transactions attempted under disaster circumstances are unadvisable both from the investment and technical standpoint. If you are counting on "business as usual", or are expecting to live off your portfolio in the early days of a disaster, you should rethink the amount of money you need to have in your possession."

Best regards,

Molly Pengra

MEP:cdh

## **EXHIBIT – R STRATEGY LETTER**

**November 16, 2006**

### **The Flip Side of The Productivity Coin: Inflation Risk and Valuation**

The time to be wildly bullish was October 2002. Here is what we will be doing to make money from now on.

We know that one thing is highly probable. Growth will begin to outperform value across the market capitalization spectrum. For over eight years, Value worldwide has outperformed Growth. Anomalies such as this cannot last forever – mean reversion is the one thing we can count on in finance. In an environment of slowing GDP growth, markets award a premium valuation to companies which show above-market growth. Volatility, too, is due to increase. The 30-Year average volatility on the market is 15%, and for the past three years, it has been running at 8% which is about equal to bond market volatility. As the valuation anomalies described in this letter -- between Value and Growth, and between control and liquidity – begin to resolve, volatility will increase, creating opportunities. The wild card in all this is how the derivatives markets exacerbate imbalances in the markets. These markets have only been in existence during a period of low interest rates and rising productivity. The derivatives markets are like a house of mirrors, and the number of moving parts is about to increase. No one knows how they will behave, and uncertainty tends to create volatility. When derivatives first came into use, they were used to hedge against certain risks on a primary basis. They are now used by speculators as well – hedge funds and private equity funds. There are so many partially dependent variables here and so little transparency that it is hard to tell who owns the risk at any given moment, and who will get the last chair when the music stops.

Stocks are expensive on normalized earnings. While P/E multiples on current earnings are around 16X (below the average 30-Year P/E of 18X), the earnings growth rate is currently two standard deviations above trendline and due to revert to the mean. The P/E based on long term, normalized earnings is 24X. Were the current environment similar to that of the 1990's with rising productivity and low inflation, this valuation would represent a plateau in a step-function market. Today, however, the earnings growth rate is peaking, productivity is slackening and inflation risk is rising, so the 24X looks pricey, especially with mean reversion in the earnings growth rate imminent. As mentioned frequently to clients over the past year, the rate of GDP growth has been expected to decline from 5% to a more sustainable level, perhaps 2.95% or below – not a recession, but a slowdown in the rate of growth. Indeed, this has occurred. With the earnings growth rate falling and inflation risk rising due to falling productivity growth, a P/E multiple expansion is not likely. Never have there been the particular confluence of variables we are seeing now that a recession has not followed. Those variables include the rate of decline in housing starts and permits, double digit production declines in the auto industry, the flat to inverted yield curve, and the rate of debt accumulation in the REIT industry. Normally, a Fed easing would be expected to offset these pressures, but

with productivity slackening, flooding the system with money again may not be an option. Inflation is a monetary phenomenon, not a byproduct of growth per se, so the current opposing pressures may not be as simple to resolve as some think.

Valuation does not predict the direction of the market, nor the timing or precise magnitude of any move in the market. It simply describes risks relative to alternatives. This letter attempts to enumerate some of the specific risks facing the market. Your investment well-being is not contingent on our predicting the timing or direction of a market move, and willingness to hold a portion of the portfolio in cash suggests that there is a probability that events specific to individual names on the equity list will give us the opportunity to redeploy cash at better valuations than now exist. The portion of the portfolio in large cap equities with strong balance sheets, including Berkshire Hathaway, AIG Corporation\*, and IBM should generate good relative performance in most environments. The valuation parameters are not a predictive tool. They are a statement about risks we are not willing to take, even if avoiding those risks sacrifices short term performance.

Holding cash gives us the flexibility to purchase certain names at opportunistic valuations and make a meaningful, cycle-long impact on performance, rather than floating with the P/E cycle and enduring mundane performance for the entire cycle. If earnings are not peaking now, they are close to it, and common sense dictates that since productivity was the most important variable in driving sixteen years of inflation-free growth, a slackening in productivity is not going to bode well for inflation-free growth now. Roger Bootle, the author of "The End of Inflation," published in 1996, and founder of the London firm Capital Economics, has cautioned that while globalization can be expected to offset inflationary pressures over time, current variables conspire to push inflation upwards if central banks do not act. As a practical matter, companies whose shares make it into the portfolio must have the ability to pass along cost increases to the consumer. There are not a lot of names which pass muster on EV/EBITDA, and in the environment described in this letter, free cash flow yield is going to get a lot of attention.

The high cash position has precluded outperformance year-to-date. The large cap growth stocks which comprise the portfolio are doing very well on a fundamental basis, but the cash position is holding back performance. Cash is a residual. That is, it was not raised by way of timing the market, but rather arose as a result of the sale of certain stocks. Specifically, the investment banks (Merrill, Morgan Stanley, Goldman Sachs, JP Morgan) were sold profitably, but early. Common sense concerns about the effects of a hedge fund or derivatives market debacle on their back offices rendered them overvalued (high risk) at 2X book. Since much of the performance since inception has been attributable to a high concentration in financials, it was a bit uncharacteristic of this firm's style to let go of them before they reached 2.4X book. As mentioned in earlier notes to clients, a hedge fund debacle seemed likely, and when it came in the form of Amaranth, it did not wreak much damage to the brokerages. That does not mean it was wrong to protect against that risk, or that there are not more such problems lurking.

\*[AIG was sold November 2006]

Goldman Sachs and Lehman were raising their Value-at-Risk parameters at a time when risk was increasing on the proprietary trading desk and in the Credit Default Swaps, Collateralized Debt Obligations, and Constant Proportion Debt Obligation markets. The valuation discipline simply describes acceptable risk levels. In the case of JP Morgan, exposure to Credit Default Swaps and other derivative products; subprime lending; and the adjustable rate mortgage market raised red flags. These firms claim that securitization (the selling off and redistribution of risks) reduces risk to their balance sheets, but this is a zero sum game in the end. Better early and safe than sorry later.

We are not finding the stocks we want to own at the valuations we want to own them on EV/EBITDA or other metrics. When the opportunity to own certain names on the equity list arises, it will probably come abruptly, perhaps in the form of a correction induced by a liquidity event in the derivatives markets. Forced to guess, I would say that such an event might resemble the world debt crisis of November 1998. Or it may be a reaction to further information about productivity and inflation. It will be necessary to act quickly to take advantage of such opportunities to buy some of the many names in high growth industries which will not be fundamentally compromised by the risks described in this letter. The bulk of outperformance over any cycle occurs over very short periods (over the past cycle, most of PCM's Composite performance accrued during the period of poorest performance for Large Cap Growth as a sector. We were willing to pay for operating leverage during the worst of the crisis in late 2002, and became more cautious recently as most investors became willing to pay up on Price-to-Earnings-Growth-Rate for linear growth.

Dale Jorgensen, an economist at Harvard whose work on productivity for The Federal Reserve has been cited in letters to clients for many years, has hinted for some months that there were signs of slowing in productivity. The Conference Board survey points to a poorly educated work force with inadequate math and grammar skills, and poor work ethic. No amount of capital spending on innovative technologies can offset a workforce not poised to use it. Falling productivity constrains inflation-free growth.

The last thing the U. S. economy needs in the face of massive debt levels and falling productivity is a hostile regulatory environment which limits potential returns on capital. The effects of Sarbanes-Oxley can best be seen in the rise to competitive advantage of the London Stock Exchange. There is no reason for many companies to list on U. S. exchanges when the LSE has made it so easy. Capital gravitates toward returns, and as the regulatory environment here raises the cost of doing business and makes it more difficult for American companies to attain competitive cost advantages, the potential for returns fades. There are several industries where the "central planning" mentality of the regulators prevents capital from rising to its natural return. Don't get me started on the history of wireless spectrum.

The U. S. has been in a six year real estate investment cycle. Concerns about the residential housing market, housing starts, and building permits are well known. What is more interesting is the institutional real estate arena. While it is early to conclude that the rising use of debt in institutional real estate is going to end the cycle soon, it is worth

noting from a capital markets perspective that leverage is as high as 70% in some REITS. At the same time, cap rates (net operating income divided by the value of a property, expressed as a percentage) are compressing. This drives down returns and renders it more difficult to reinvest profitably. The difference between purchase cap rates and ten-year Treasuries has converged below 250 basis points. Why does this matter to equity investors? Asset classes are valued relative to each other (that is, markets are opportunity-cost driven). As capital flows out of institutional real estate, it will most likely flow into what, at first glance, appear to be a less overvalued asset class – large cap equities. This will provide some support for the large cap stocks we own, albeit with inflation percolating and rate increases possible, lower P/E's are likely, so there is already a damper on this asset class. It is important to remember the effect a real estate binge has on the economy. Investors who went through the tech bubble feel that they have seen the worst that can happen. Yet it makes sense to reflect on how strong the recovery was from mid 2002 on. This was because the economy itself was resilient due to the health then of the money center banking system. As mentioned in a strategy letter the first week of October 2002, loan loss reserves plus equity at the banks was at an all time high, just as investors were becoming the most panic-stricken about the markets, believing that a Japan-style deflation was afoot. Reserve coverage of nonperforming loans in late 2002 was 200% (it had been 85% during the money center bank crisis in 1991). Now we are starting to see risk increasing on the bank balance sheets, and at a time when ROE and ROIC in the economy may be falling. Remember that a real estate binge, unlike one in technology, does not leave behind residually higher ROE, ROIC, or productivity. Japan's real estate boom in the 80's saw productivity growth of just 1.2%, versus 2.4% during the U. S. technology spending cycle of the 90's. ROE grew to 25% during our tech boom, from 14% in 1991, whereas the Japan real estate boom engendered peak ROE for the TSE nonfinancial firms of just 8%. Real estate depreciates very slowly, whereas technology depreciates rapidly. This does not bode well for extreme optimism about bank balance sheets or returns in the overall economy.

A friend observed recently that this is the first time in many years that control was valued more dearly than liquidity. Just as productivity was the dearest commodity of the last cycle, liquidity is seeing its day now as can be seen in the rising P/E's awarded Large Cap Growth. Control was also valued at a premium during the LBO craze of the 80's. We now have too many private equity funds chasing too few deals, desperate to get invested before the money is taken away from them, and bidding up for the privilege. This is analogous to the late stages of a momentum-driven stock market where investors fear underperforming if others are participating and they are not, something which drives portfolio managers to pay too much for stock during times such as 2000. The average hurdle rate for corporations to invest is just over 13%, a bit below the hurdle rate for LBO funds. Weighted-average-cost-of-capital is rising. When control is overvalued, a liquidity crisis often ensues. As investors pay up for liquidity, Large Cap Growth should continue to do better than other categories of domestic equities. While Small Cap Value appears headed for mean reversion, there are still opportunities in Small Cap Growth, but liquidity needs point toward Large Cap as the dominant sector.

Large Cap stable growth is being driven by three factors which are primarily technical. The first is that when the earnings growth rate at the average company is expected to decelerate, momentum investors and others pay up for consistency and visibility of the earnings growth rate. They may pay high multiples on Price-to-Earnings-Growth-Rate, and high P/E's relative to the market P/E. Large Cap in general is being driven by the fact that investors are willing to pay up for liquidity now. When we see investors in the derivatives markets, specifically in Constant Proportion Debt Obligations, Collateralized Debt Obligations, and Credit Default Swaps, take on more leverage and demand less return for risk, there is high probability of a liquidity crisis should there be an unexpected event. Large cap stocks are cheaper than real estate as an asset class and private equity – in private equity, investors are paying up for control of the asset. This is all to say that Large Cap Growth relative to alternatives is appealing. **This type of market move is not, however, as sustainable or valuable as one driven by an internal profitability shift.** Falling productivity, rising unit labor costs, and low capital spending due to high hurdle rates of return on new investment do not suggest that ROIC will be shifting upward anytime soon. It may be the case that the semiconductor cycle is due to lengthen again to its longer term, three-year duration. This is important in that the productivity resurgence of the late 90's and early 00's was partly fueled by a turnaround time in semiconductor design-to-market of two years. On an individual stock basis, most companies look as though they are operating at peak ROE, and, as described in the previous paragraph, the banking system does not show the resilient qualities it did four and five years ago when everyone wanted to sell stocks and buy overvalued Treasuries and even-more-overvalued blue chips trading at high Price-to-Earnings-Growth and peak ROE. Free cash flow yield will be a useful metric in the current environment just as it was in the 80s.

The cure for falling productivity is capital spending on productivity-enhancing technology. So, is this similar to the early 90's when The Fed was walking the inflation-recession tightrope? That period was followed by the productivity surge of the late 90's which was driven by high and increasing levels of capital spending on productivity-enhancing technologies and improved productivity, both for the users of technology and within the semiconductor industry itself as a producer of productivity-enhancing technology. Or, given the causes of the current decline in productivity, is stagflation possible? My job is to focus on internal profitability metrics, not macroeconomic forecasting, but in doing the bottom-up work on individual companies, it is tough not to come to the conclusion that this environment is a bit tougher than that in the early and mid 90's. I think that an opportunistic, “wait for the ball to come to you” approach will work better than buying linear growth and floating with the P/E cycle. **I think that a lot of money will be made by those who behave opportunistically.** Your investment well-being is not contingent on forecasting macroeconomic events, but on describing and limiting your risk through a consistent valuation discipline. Self-consistency of investment style and valuation discipline are the process that drives successful outcomes. Our returns over time are driven by a focus on fixed navigation points and the patience to take the opportunities on our own terms, not to sputter around trying to “catch up” with momentum moves. Just as it is hard to recapture cycle-long performance if one is out of the market for the best ten days of market performance early in a recovery (as investors



who tried to time the market in late 2002 found out), it is helpful to mute the worst few days late in the cycle by having some cash during periods when desirable opportunities are expensive relative to normalized earnings. Look at a chart of November 1998 if you think we are “too far behind” the market this year due to cash holdings to keep our One, Three and Five-Year performance in tact.

The bright spot in all this is that as unit labor costs rise (particularly if Congress increases the minimum wage), business will find a way to use less labor and more capital. It is the marginal rate of substitution of capital for labor which sets off capital spending booms, and corporations are rich with cash and able to spend. So, high quality technology will be a good place in which to redeploy cash, particularly that area of technology discussed below.

The largest positions in the Composite are the following large cap names: **Legg Mason, Berkshire Hathaway, IBM, Corning, T. Rowe Price, WisdomTree Large Cap Dividend-Weighted ETF, American International Group, [AIG was sold in November 2006], Sprint Nextel, Alltel, and Xilinx.** You will probably see in the portfolio a number of OEM’s which sell into the financial services industry – application software and transactions-processing and trade-settlement technologies. The Fed is telling the industry to improve back office settlement, transactions-processing, clearing, and reporting, and it is always a good idea to get in the way of what The Fed is telling the industry to do.

The portfolios are positioned for stability and liquidity now, and the strategic emphasis on valuation, free cash flow, and opportunistic positioning will drive performance over the long term. That is, performance will be a by-product of stability and liquidity when volatility increases.

## EXHIBIT – S STRATEGY LETTER

MAY 2007

The Composite is up 6.907% gross (6.576% net) year-to-date through May 15, 2007. Cash comprises 25.016% of the Composite and is a residual. The S & P 500 has returned 6.64% over that interval.

The annualized gross Composite performance for the Five-Year interval ended April 30, 2007 is 13.087% (11.977% net).<sup>\*</sup> The S & P 500 returned 8.54% annualized for the comparable period.

The largest holdings other than cash equivalents are **Berkshire Hathaway** at 10.163% of the Composite (average cost \$3,014), **Legg Mason** at 9.211% (average cost \$57.10), **Corning** at 6.649% (average cost \$12.08), and **WisdomTree Large Cap Dividend-Weighted ETF** at 6.447% (average cost \$53.11). **Sprint Nextel** (average cost \$7.785) comprises 6.169% of the Composite and **Alltel** (average cost \$22.09), 5.154%.

WisdomTree Large Cap Dividend-Weighted ETF will outperform as volatility increases, as will most high-quality, large cap, liquid stocks in stable-growth businesses.

The equity portion of the Composite is working hard to offset the high cash position. Investors often forget to risk-adjust their returns, and if we can continue to outperform while protecting against the risk of a compression in price-to-earnings multiples, no one will be sorry for the cash position. By holding cash and allowing for a multiple-compression in our valuation methodology, we are building in a margin of safety.

The investment style entails a high level of concentration in terms of individual names. It should be noted that while most consultants place this product in their Large Cap Growth category, they do not distinguish between concentrated-style managers and conventionally diversified managers who hold the requisite thirty-three to one-hundred equity names. There are not many other domestic equity managers who run only ten or fifteen names.

As outlined in the November strategy letter, P/E multiples seem stretched unless one assumes that the 25 bp Fed easing which is priced into the market is really going to occur this year and be followed with another 25 bp early next year. Inflation-free growth at high levels of capacity utilization in the last decade was driven by rapidly rising productivity and asynchronous global recessions. Neither condition is present now. Cyclically-Adjusted Price-to-Earnings (based on long term normalized earnings growth) is high. It is prudent to leave some margin of safety by valuing stocks such that the Fed remaining on hold for a long period, or even tightening, is implicit in the models.

Many investors are counting on an expansion in price-earnings multiples. Interest rates troughed in 2003 and therefore, price-earnings multiples probably peaked. The multiple-expansion which has driven the bull market the past 26 years has ended. Multiple-expansion as a component of returns is receding relative to dividends and reinvestment, cash flow, and earnings.

Stock prices historically continue to rise long after they reach overvaluation on the Fed Model, notorious examples being 1987 and 2000. The earnings yield on stocks is still higher than the bond yield, so this could go on for awhile, but such exogenous structural risks as those posed by credit derivatives combined with high valuations on a cyclically-adjusted basis render this a perilous time. The market is pricing in a 25 bp rate cut in the second half, followed by a second cut early in 2008. Betting on a multiple-expansion market is a high-risk strategy. There is no margin of safety in the PEG based on ten-year normalized earnings if these rate cuts do not materialize. Again, inflation-free growth is rendered possible by rising productivity and, in the past, by recessions elsewhere.

Valuation does not predict the timing or direction of market moves. It simply describes a level of risk relative to other alternatives. The market is in a high-risk, late-cycle, liquidity-driven phase. Good investors make a point of distinguishing between growth that is secular and growth that is cyclical. It costs a lot to buy secular growth at this stage of the cycle, and there is no margin of safety should the Fed stay on hold longer than expected or, worse yet, tighten. An “episode” in the credit derivatives markets is not unlikely.

Not since the LBO craze of the late 1980’s has control been valued so dearly relative to liquidity. As mentioned in previous letters, a greater fools game is being played with companies which are potential targets of private equity firms by virtue of having high free cash flow yield. They trade at unusually high P/Es relative to those of Large Cap Growth, as well as a high PEG. If interest rates were to increase, they will experience sharper declines than large cap, liquid, lower price-to-earnings stocks. Investors in many of the small and midcap companies with high price-to-earnings ratios will quickly forget that they are “waiting for the company to be taken out”. While absolute return strategies which focus on shareholder yield rather than relying on multiple expansion will continue to do well as long as liquidity persists, volatility in the markets will increase. As mentioned in the November letter, volatility has been running at bond-market levels of about 8% the past three and a half years. The displacements described in these letters will cause it to revert to historically normal rates of 15%.

Cash as a residual will be deployed as some of these valuation anomalies resolve.

May 17, 2007

\*See Footnote 3 on Disclosure Statement enclosed.

## **EXHIBIT – T STRATEGY LETTER**

October 10, 2007

### **THIRD QUARTER 2007**

The year-to-date Composite gross return through September 30, 2007 is 12.18% (11.09% net), versus 16.43% for the S & P 500.

Cash equivalents comprise 32.857% of the Large Cap Growth Equity Composite. Berkshire Hathaway at 11.48% of the Composite is the largest holding, followed by Legg Mason, Corning, Sprint Nextel, Streettracks Gold, General Electric, Apollo Group, and American International Group.

The Composite remains highly concentrated as always, with the eight largest holdings comprising 75% of the Composite.

The Five Year gross annualized return through September 30, 2007 is 22.93% (21.73% net), compared to 15.44% for the S&P 500. The Large Cap Growth category average gross return for the interval was 9.11% (source: Lipper).\*

The Three Year gross annualized return through September 30, 2007 is 14.97% (13.87% net), compared to 13.13% for the S&P 500. The Large Cap Growth category average gross return for the interval was 10.68%.

Strategy letters to clients over the past year have posited that price earnings multiple expansion will no longer be the driver of investment performance as it has been for most of the past twenty-seven years. As previously mentioned, productivity growth is falling, and the productivity numbers for the past three years have been revised downward. This puts a significant damper on inflation-free growth, and renders rate increases likely. Corporate profits as a proportion of GDP are at a 40-year high, so current P/E is probably not a reflections of cheapness.

Earnings growth which is driven by the weak dollar fueling export business is not as “high quality” as earnings growth driven by such strong absolutes as productivity growth and new product cycles. It should not be awarded the same price earnings multiple as quality growth.

Investors may quibble about whether the housing market will cause a recession, or whether the bigger risk is inflation – or, as mentioned in the November 2006 strategy letter, whether we will get the worst of both worlds through stagflation – but in any of those cases, valuations on almost all asset classes are stretched. There is no margin of safety in the valuation of most stocks or any other asset class.

Inflation is a monetary phenomenon, not a growth phenomenon. Many argue that the monetary base is stable, and that appears to be true if one looks only at M2 and M3. Taking the value of securitized loans and derivatives and adding them to the conventionally defined monetary base paints a different picture.

The most ominous variable right now is that we are at the tail end of a real estate boom, and the hangover from a real estate boom is quite different than that from a technology boom. Leverage in some REITS is higher than 70%, and cap rates are converging on the Treasury rate. A real estate boom does not impact ROE across the corporate sector, and it does not leave behind residually higher productivity. It does leave behind weakened bank balance sheets and, in the current case, problems in the derivatives markets. A technology boom improves ROE. I am not suggesting that the situation in the U.S. is as bad as that in Japan in 1990. It is not, as there is no comparison between the health of U.S. bank balance sheets now and the precariousness of banks in Japan and the U.S. in 1990. But from a fundamental standpoint, the overall economy is not as well off as it was after the tech bubble burst in 2000, resulting in one of the shallowest recessions on record, even though the markets behaved as though we were going into a Japan-style deflation (in fact, inflation was percolating). Unlike 2002, productivity is falling now, and there has not been a capital spending cycle since that leading up to Y2K. It is of concern that corporations are not spending the cash hoards on their balance sheet. The Fed could end up pushing on a string in its quest to deal with the housing market and derivatives crisis, all the while fueling inflation. There is no doubt that the next big sector move will be in technology, but I do not believe that that move has begun in earnest.

In the November 2006 letter, I mentioned that the market had been trading at bond market volatility of 8% for several years, and would revert to the normal 15%. It has done that. Volatility should continue as investors listlessly migrate back and forth between different asset classes across the globe. As predicted, the favored asset class right now is Large Cap Growth which is finally, after an eight year hiatus, taking the lead over Value and Small Cap. But with quality of earnings at these large, multinational companies questionable given the dependence on the weak dollar to drive export business, and the PEG being high, this does not have the same force it would if the rally were being driven by growth in return on capital fueled by capital spending and innovative product cycles, beginning from reasonable PEG rates. Investors are simply looking for relative cheapness. If interest rates rise, those price earnings multiples of 22X are not going to look reasonable. And the price earnings multiples are higher than they look in that the Ten Year normalized earnings growth rate is much lower than the current growth rate on which price earnings multiples are based.

The purpose of asset allocation across the different asset categories is to achieve “non-correlation,” so that an investor does not see all asset classes he hold decline at once. In fact, high correlation between asset classes has existed in recent corrections suggesting that most asset classes are at bubble valuations. Risk is not being properly priced. The only non-correlated asset class has been cash. The cash in the Composite is a residual, not an attempt at market-timing, although I believe that all asset classes are overvalued

and that any correction which occurs will again show high correlation between asset classes. Most stocks fall into one of two categories with regard to valuation. Either they show above-market earnings growth rates which look to be sustainable for a reasonable time, but are valued at premium PEG rates, or they show seemingly reasonable price earnings multiples with earnings that are at a peak for the cycle. Stocks are valued at “momentum” investor levels. There is no margin of safety should any macro variable move against equities. That is, either recession or inflation with rising rates would cause a severe decline in stock prices.

Molly Pengra

## **EXHIBIT – U STRATEGY LETTER**

November 6, 2007

### **OCTOBER 2007**

The PCM Large Cap Growth Composite is up 10.06% gross (9.18% net) year-to-date through October 31, 2007, versus 10.95% for the S & P 500. Cash is the largest holding at 46% of the Composite.

With the exception of Legg Mason, the portfolio held up well in the October turmoil (1.36% gross or 1.31% net, versus 1.64% for the S & P 500).

Cash represents 46% of the Composite, followed by Berkshire Hathaway, Corning, Apollo Group, Streettracks Gold Trust, Sprint Nextel, General Electric, Legg Mason, and Clearwire. The strongest performers year-to-date have been Berkshire Hathaway, Corning, Apollo Group, Streettracks Gold Trust, and General Electric.

The Five Year gross annualized return through October 31, 2007 is 18.95% (17.79% net), versus 13.85% for the S & P 500.

The Three Year gross annualized return is 13.55% (12.45% net), versus 13.17% for the S & P 500.

These Three- and Five-Year returns are significantly ahead of the average return for our style category, Large Cap Growth.

As mentioned many times over the past seventeen years in letters to clients, valuation does not predict the direction of the market; rather, it describes risk. Investors might lament their opportunity cost in holding cash (the year-to-date performance would be significantly ahead of the index had we not held so much cash). Successful investing is probabilistic, not predictive. The observations made in these letters about risk are just that. This is not about being “right” about any macroeconomic outcome (no one can solve for a large number of partially dependent variables, and the best investors tend to be bottom-up, not macro-oriented), but about being conscious of risk such that there is some margin of safety in the valuations we pay. If you ask what I think, we are well into a slowdown in GDP growth rate, followed by inflation and possibly stagflation, but what I believe is not really very important as far as what drives risk-adjusted returns. Process is outcome in this business, and self-consistency of investment style is essential to outcome. The investment well-being of clients over long periods is not hinged to any particular macroeconomic scenario, although does depend on certain secular growth themes playing out, since the Composite is always concentrated in a few secular themes.

The cash is a residual in that it does not reflect an attempt to time markets, but is an indication of how much trouble I am having finding stocks at valuations I want to pay

after selling many of our names at peak profitability. You can almost divide up the investment universe into two categories – those companies in fundamental distress with no signs of a margin expansion in sight, and those companies doing well and turning out consistent, visible, and linear growth rates which trade at high PEG's. There are not many companies on the verge of a shift upward in ROIC cycle-over-cycle which do not trade at vulnerable price earnings multiples. One of the best ways to make money is to invest in sectors where there has been underinvestment for a number of years. Infrastructure is such a sector, and most of these companies are trading at valuations which price in peak ROE. It's always fun to own companies which show up well on EV/EBITDA screens during periods when cost of capital is very low and LBO or private equity funds are out looking (the late 80's and the past couple of years). However, the easy money in this category has been made, and equities as an asset class are not cheap regardless of how you look at balance sheets. Cost of equity capital is rising and WACC is rising. There is no place to hide. As mentioned many times in letters over the past year, price earnings multiple expansion as a component of return on domestic equities is receding. The earnings will have to do the heavy lifting, and it will be heavy indeed once The Fed stops printing money. The money supply is growing rapidly now (and is larger than conventional M2 and M3 measures indicate if you count the percentage of GDP in derivatives and securitized loans as part of the money base). Inflation is a monetary phenomenon, not a growth phenomenon, so a slowdown in GDP growth does not necessarily cause inflationary pressures to abate.

We will not be buying "cheap companies in distress" and calling them "value stocks" any time soon. There is more to come in the securitized loan and derivatives arena. All asset classes with the exception of certain areas of distressed debt are overvalued. It is not yet time to buy distressed debt for the most part, although that will be one of the next opportunities once GDP growth has slowed. It can be lucrative to focus on high debt-adjusted ROE in industries driven by major regulatory and technological change as volatility spikes and credit spreads widen. The only non-correlated asset class in the last few corrections was cash, hence the large cash position. Investors have not seen the benefits of diversification they were promised by many "asset allocators" and trust companies, as was predicted in recent letters. It is possible for all asset classes to become overvalued, and that has happened, so best to hold cash and depend on opportunistic investing to generate returns.

If I had to guess, I would still say that the probable outcomes described in November 2006 letter will play out – and much of it already has. That is, problems in subprime and derivatives will continue to pose major risks to some banks and mortgage lenders (it is reasonable to believe that there are more problems to be revealed at several banks and Countrywide); GDP growth will deteriorate at the same time inflationary pressures increase; The Fed may print more money for awhile, thus fueling money supply growth and inflationary pressures; and, ultimately, inflation, if not stagflation will become a big problem for P/E multiples. Distressed debt will be one opportunity on the horizon, with select reindustrialization names (including vocational education companies such as Apollo Group) and technology being the best opportunities as valuations improve.



We will continue to make concentrated investments in a few secular growth themes, particularly those driven by regulatory change and technological improvement. There are a number of names in infrastructure and OEM's which service the financial services industry on the equity list which I would expect will become more attractive in 2008.

Corporate profitability is at a record proportion of GDP, and this is reverting, as posited in November 2006. Small cap is due to revert, however the small and micro names we own as a small percentage of the portfolio (Epoch Holding, Clearwire, and Anadigics) were bought at fairly low valuations with the express intention of holding them as beneficiaries of certain secular growth and regulatory change themes for the long term. Having bought Clearwire at around \$19, I have no intention of trying to time its cyclical ebbs and flows, and am focusing on earning power three years out as a function of secular changes in the regulatory environment, market structure as it relates to spectrum accessibility and use, and technology. Similarly, Epoch Holdings will see its assets under management drop in a market decline which will hurt revenue growth for a bit. Given its management, self-consistent investment style, and Lipper rankings, it should continue to see rapid growth in institutional accounts. Epoch has grown AUM from zero to over \$6 billion in a few years, and is known for its rigorous quantitative investment process and the experience of its management team (a group of University of Chicago grads, most of whom were at BEA, one of the top quant firms on Wall Street, in the 1980's).

I do not mean to belabor a point made many times over the past year in these letters, but real estate cycles tend to end with more structural damage to the system than do technology cycles. The latter leave behind residually high ROE at most corporations and do not leave behind weakened bank balance sheets. Weak bank balance sheets presage deflation, an unthinkable outcome given current debt levels. Japan's massive deflationary spiral was caused by a real estate cycle ending badly. As commercial real estate cap rates converge ever closer to the Treasury rate and leverage peaks, the offsetting factor is the potential for a capex cycle which would improve productivity and ROE. This puts the Fed under pressure to continue to ease, as corporations are unwilling to commit if a recession is in the offing. Again, The Fed is fighting a two-front war between inflation and recession. It makes no sense to pay price earnings multiples which are high on a cyclically-adjusted basis. The P/E is not 17X if you look at the Ten Year normalized earnings growth rate as the denominator. It is closer to 23X, not adjusted for inflation! This cyclically-adjusted or Ten Year Normalized P/E, unlike The Fed Model, is predictive of direction of market, though worthless as a timing indicator (as is everything else). Cash is paying us well. Should there be opportunity cost to holding it, its opportunistic deployment in a correction over the next couple of years will more than offset it discounted back to the start of 2007. Just as productivity and innovation were the dearest commodities of the early 90s, and those which propelled us back to competitive advantage in the global arena, liquidity is the dearest commodity now. The liquidity to be found in Large Cap Growth equities may not be the panacea it usually is at peaks in the earnings cycle, since PEG's are high and distressed hedge funds will sell what they can (large cap, liquid stocks), not what they should. The quality of earnings at many of the large multinationals is dependent on the export business being driven by the

degraded dollar, and therefore not as high quality as growth driven by productivity improvements and strong product cycles. A cheap dollar does not cause ROIC to shift upward. Liquidity for now means cash – cash not as a default option, but as a preferable asset class to many large cap growth names which boast as their main virtue “liquidity” while trading at high PEG’s.

Molly Pengra

## **EXHIBIT – V STRATEGY LETTER**

January 8, 2008

### **WHY SO MUCH CASH?**

Year-to-date 2008 PCM Composite performance is (1.95% gross) versus the S&P 500 (3.52%) and the Russell 100 Growth at (4.21%).

The largest holding is Cash at 47% of the Composite.

The largest holdings remain Berkshire Hathaway Class B, Streettracks Gold, and Apollo Group.

Tremendous pressure exists in the money management industry to remain fully invested at all times. After all, if investors expect to command the long-term return on domestic equities which academics peg at approximately 6.5% (or the underlying growth in corporate profits which is assumed to be around 5.7%), they have to remain in equities all the time. Market timing tends to cause investors to flip when they should flop. No institutional investor has ever risen to prominence employing market-timing ploys or hinging his performance to macroeconomic forecasting.

In fact, a study by John Bogle, the former head of the vaunted Wellington Management and founder of Vanguard Funds, shows that the typical individual investor only garnered 5% CAGR over the 1990's, while the average institutional investor return was around 10%. This can be explained by the fact that individual investors tend to chase returns in high performing asset classes or investment style categories at tops and to sell at bottoms. Additionally, individual investors tend to pay higher fees in the form of mutual fund loads and other intermediary charges. They attempt to engage in "rebalancing" which often tends to remove them from any given manager's process just as the best returns are about to occur.

So why do we hold so much cash? This is not a market-timing ploy. Cash is a residual. That is, as many of the names we own reached what we considered to be peak profitability or peak ROE last year, we sold them. The names on the "wish list" do not trade at valuations which make sense. Investment performance is not a function of any particular forecast about inflation or recession bearing out. Rather, it is a function of avoiding certain types of risk which are currently visible. When professional investors talk about valuation, they are quantifying risk. It is difficult to name a time when bank balance sheets have been under duress that deflation was not a risk. When deflation is a risk, The Fed has no choice but to ease, and when they ease, by definition, there is greater risk of inflation (inflation is a monetary phenomenon, not a growth phenomenon). Yet the cyclically-adjusted price earnings multiples, and the price of the stocks relative to their underlying earnings growth rate, demand that we assume that earnings continue to grow at the rate they have been; Total Factor Productivity grows at the rate it grew in the

late 90s; economic growth in the U.S. is decoupling from that in the rest of the world; and that inflation remains low and stable. No one can predict the future, but no prudent person can assign a high probability to those variables meeting the assumptions inherent in the valuations. I do not need to know much of anything except that bank balance sheets are frayed, and not for the reasons most frequently given by the popular press (subprime and housing), but having more to do with the derivatives markets and cap rates in commercial properties. I am not predicting any particular outcome, but stating, and to some degree, quantifying, a risk I am not willing to take.

Common sense tells us that it is not early in a cycle. Cyclical beginnings are characterized by the ability of banks to lend; consumers to borrow; companies to meet their hurdle rates and to take on debt to grow ROE. Most of these conditions are not present, so there is low probability that holding cash will create opportunity cost.

I cannot emphasize enough the points made in recent letters about the impact to bank balance sheets of a real estate cycle unwinding, as opposed to a tech cycle. Again, a real estate cycle does not leave behind residually higher ROE in the economy. Real estate depreciates slowly, whereas tech depreciates rapidly. We have not yet seen the impact to bank balance sheets around the globe of commercial lending rising as a proportion of banks' overall lending.

Most of the outperformance of the PCM Composite the past five years accrued early in the cycle at which time it was appropriate to take risk. The S&P 500 was up 8.44% and the Russell 1000 Growth was up 7.14% in the Fourth Quarter of 2002 while the PCM Composite was up 20.2%, bank balance sheets were in pristine condition, so it was appropriate to take risk. The time to be wildly bullish was October 2002, not January 2008. As banks and investments banks saw their price to book multiples rise to levels which are considered speculative, we began liquidating these names. The book value is a moving target now given what is going on in the derivatives markets. Those who claim it is time to "bottom-fish" many of the financials are in for a rude awakening. As mentioned in the November 2006 strategy letter and several since, it is magical thinking to believe that banks can "take risk off their balance sheets and redistribute it over a broader base" without the risk still being in the system. The risk has not yet settled and is not accounted for.

Markets are opportunity-cost driven. When investors want to know how to think about the relative valuation across the broad array of asset classes and investment styles, they can do worse than to listen to Jeremy Grantham, the founder of GMO in Boston which presides over \$150 billion in tactical asset allocation funds for various endowments and ERISA plan sponsors. Grantham has talked about the current environment as an overall asset bubble in The Financial Times and other venues. There is not a lot of opportunity cost now in holding cash. PCM outperformed all but five other large cap growth separate account managers in the Pensions & Investments rankings provided by Morningstar for the five year intervals ended September 30, 2007 and June 30, 2007, and the way to create further outperformance is to be patient now. The opportunities which will arise

over the next year as derivatives risk “settles” (or gets “repriced”, as those who like to skip a step, call it), will be accretive to performance.

This is not a sector rotation style, and paying high PEG for Coca Cola and other great companies is certainly a good way to insure good relative performance, but not a way to give long-term torque to the portfolio. Such torque accrues as a result of shifts upward in ROIC created by new product cycles, innovation, spending on productivity-enhancing technology.....It is not a function of strong export business fueled by the noise of a cheap dollar.

As mentioned in earlier letters, I do not believe the capital spending on tech has begun in earnest. While such spending is the solution to the inflation threat, companies with high hurdle rates are reluctant to commit. Ann Mulcahy of Xerox has made this point recently, as have others. One has to ask if perhaps fiscal policy which includes investment tax credits for spending on productivity-enhancing technology would be more effective than monetary easing. The problem in front of us (subprime and housing) is not the problem that is going to bite us. Productivity is the solution to most possible outcomes here, and perhaps The Fed should dwell on an area where it can get positive results, rather than one which merely patches up one negative force (liquidity crunch and bank balance sheets) while fueling a potentially worse one. Technology will be a major emphasis in the portfolios, but not yet.

Molly E. Pengra

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