

## DISCLOSURE BROCHURE

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# PENN DAVIS MCFARLAND, INC.

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Dallas, TX 75229  
214-871-2772

February 1, 2021

This brochure provides information about the qualifications and business practices of Penn Davis McFarland, Inc. If you have any questions about the contents of this brochure, please contact us at 214-871-2772. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about Penn Davis McFarland, Inc. also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **Item 2 - Material Changes**

As of February 1, 2021, the firm purchased John McFarland's shareholder interest. John remains an active contributor to the firm as Senior Vice President.

If you would like another copy of this Brochure, please download it from the SEC website ([www.advisorinfo.sec.gov](http://www.advisorinfo.sec.gov)), or you may contact our Chief Compliance Officer Robert Felty at 214-871-2771 (or e-mail [robertf@pdavis.org](mailto:robertf@pdavis.org)).

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## Item 4 - Advisory Business

### Our History

Penn Davis McFarland, Inc. (PDM) was founded in 1977 by Fred M. Penn, John H. Davis, and John S. McFarland. We offer asset management services through separately managed accounts. Our typical account owners are individuals, retirement and pension plans, trusts, and limited partnerships.

PDM has full discretionary investment authority over the vast majority of its client accounts. See Item 16 - Investment Discretion below.

PDM invests its client's assets primarily in publicly traded stocks and bonds; however, we may occasionally purchase and sell other assets for your account, including but not limited to those described below in Item 8-Methods of Analysis, Investment Strategies and Risk of Loss. We generally seek to make investments that provide, in our judgment, a reasonable expected rate of return relative to the risk of loss. We use primarily fundamental analysis when assessing the merits of investment opportunities. As part of our due diligence process to vet potential investments, we review regulatory filings, sell side research reports, newspapers and other trade journals, as well as rely on our own experiences and conversations with individuals engaged in the particular business we are evaluating, including a company's customers, suppliers and competitors. Once we have identified what we deem to be an attractive investment, we then consider each client's risk tolerances, cash needs, and any other criteria our clients have asked us to consider when determining whether or not that particular investment is appropriate for that specific client.

Each client account is managed on the basis of that client's individual financial situation, investment objectives and instructions. In other words, we tailor our advisory services to the individual needs of our clients and we allow clients to impose restrictions on investing in certain securities or types of securities.

As of January 31, 2021, our discretionary assets under management were \$592,441,647. Our total discretionary and non-discretionary assets under management including non-discretionary infrequently priced assets some of our clients hold and we advise them on (such as investments in private partnerships) were \$596,397,559.

### Our Principals

**R. Van Ogden - Principal** - has been with the firm since 1986 and became a partner in 1993. He is a CFA charterholder\* and holds a Masters in Business Administration from Southern Methodist University. Prior to joining the firm, Van served as a personal trust officer with a large Dallas Bank, now a part of Bank of America. While at the bank, he gained extensive experience in managing trust, real property, and financial assets, as well as estate and tax planning. Van is President of PDM, and his primary responsibilities are portfolio management, client relations and managing operational aspects of the firm. He is a member of our Investment Committee.

**Jeffrey (Jeff) W. Helfrich - Principal** - joined the firm in May 2010 and became a partner in 2020. He graduated magna cum laude from Harvard University with an A.B. in Economics and is a CFA charterholder\*. He has been an equity research analyst with the Janus Capital Group. Prior to joining Penn Davis McFarland, Inc. Jeff was a research analyst for Perot Investments, the private investment company for the Perot family in Dallas. (October 2008 – May 2010). Jeff also worked as a Managing Director at Matador Funds L. P. in Dallas (May 2008 – September 2008) and was a Principal and Senior Research Analyst at Independence

Capital Asset Partners, LLC in Denver (August 2005 – March 2008). Jeff is Senior Vice President of PDM and his primary responsibility is investment research and portfolio management. He is a member of our Investment Committee.

## **Our People**

**John S. McFarland - Founder** - graduated from Southern Methodist University with a Bachelor of Arts and Business Administration degree. John became a Securities Broker with Goodbody & Co. From there he was a founder of Southland Trust Company and later, Penn Davis McFarland, Inc. John is a lifelong Dallasite and has served on many civic boards, including Bryan's House, Dallas Mental Health Association, President of the Boys and Girls Clubs of Dallas, the Board of Meadows School of the Arts at Southern Methodist University, and was co-chairman of The SMU Meadows School Capital Campaign. John is a member of Saint Michael and All Angels Episcopal Church. John is Senior Vice President and Secretary-Treasurer of PDM. He focuses on client relations and operational aspects of the firm.

**Robert E. Felty** joined the firm in November 2012. Prior to joining Penn Davis McFarland, Robert worked for over 30 years with Bank of America, serving as a U.S. Trust client relationship manager. He has extensive trust, estate, private foundation, investment and banking experience. He also held trust department management positions with the bank. He holds both BBA and MBA degrees from Midwestern State University. Robert is Vice President and Chief Compliance Officer of PDM and his primary responsibilities for the firm are client relations and new business development.

**Charles L. Norton** joined the firm in May 2015. Previously, Charles managed multi-asset class portfolios as a senior portfolio manager at Wells Fargo Private Bank, where he also served as a senior analyst on the national equity research team covering consumer stocks. For 11 years prior, Charles was a founding principal of a long/short equity investment management firm, where he was responsible for portfolio management and investment research for all of the company's managed assets. Previously, he was an analyst at a NYC-based hedge fund firm and a health care investment banker at Smith Barney. Charles is a CFA charterholder\* and has a BSM degree from Tulane University's A.B. Freeman School of Business. Charles' primary responsibility is investment research and portfolio management, and is a member of our Investment Committee.

**Kenni L. Hamilton** joined the firm in March 2005. Prior to joining Penn Davis McFarland, Inc., Kenni was a portfolio administrator for a Dallas investment firm for 9 years. Her primary duties include the ongoing accounting for client portfolios, firm receptionist, administrative support for the principals and client relations.

**Frances (Fran) D. Jenkins** joined the firm in 2004. Fran is a native Dallasite. Prior to joining Penn Davis McFarland, Inc., she was a licensed Agency Trader for a brokerage firm for seventeen years. Fran's primary responsibilities include the ongoing accounting for client portfolios.

**Stacy L. Wulf** joined the firm in February 2007. Prior to joining Penn Davis McFarland, Inc., Stacy was the accountant for a family owned business and worked with special needs children in the Mesquite Independent School District. Stacy oversees the daily accounting needs of the firm's clients who utilize our "Family Office" services.

## **Our Retired Founders**

**Fred M. Penn - Founder – (In Memoriam)** was a native Dallasite with a life-long interest in finance and the stock market. Fred graduated from Southern Methodist University where he

majored in Banking and Finance. After 17 years at the First National Bank in Dallas, he became one of the founders of Penn Davis McFarland, Inc. In addition to being a retired Commander in the U.S. Naval Reserve, Fred was past President of the Boys and Girls Club of Dallas, the Dallas Summer Musicals, the American Heart Association (Dallas Chapter), and participated in many other civic aspects of the community. Fred passed away in August 2020. He is missed.

**John H. Davis - Founder** - graduated from Texas Christian University with a Bachelor of Arts and Sciences degree in Economics and English. He was subsequently employed by the First National Bank in Dallas, where he served as portfolio manager for a variety of trusts, as well as manager of two pooled equity funds. In 1973, John was a founder of Southland Trust Company and became Head of Investments. He left Southland Trust to form Penn Davis McFarland, Inc. in 1977. John retired January 31, 2020.

\*To become a Chartered Financial Analyst® (CFA) charterholder, a candidate must satisfy the following requirements:

Complete the CFA Program (mastery of the current CFA curriculum and passing three six-hour examinations).

Possess a bachelor's degree (or equivalent) from an accredited institution. Have four years of qualified work experience (or a combination of education and work experience acceptable by the CFA Institute).

Become a member of the CFA Institute and apply for membership to a local CFA member society.

Adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct.

Independent of any other requirements for becoming a charterholder, the CFA Program takes an average of four years for candidates to complete.

## Item 5 - Fees and Compensation

### How We Are Paid

We are paid based on a percentage of our client's assets under management. Our fee is computed quarterly (the quarterly fee percentage is  $\frac{1}{4}$  of the annual fee percentage). The fee is calculated based on assets under management on the final day of the preceding quarter and is billed quarterly in advance. The fee is due upon receipt of our invoice. We deduct all fees from the subject accounts, except a few IRA fees which are deducted from the clients' taxable accounts. Clients do have the choice to pay their fees via some means other than a deduction from their account. If an account is terminated, the fee is prorated and the unearned portion is returned to the client.

### Annual Fee Schedule

One and one-quarter percent (1.25%) of the first \$1,000,000 of assets under management;

One percent (1.00%) of assets from \$1,000,000 to \$4,000,000;

Three quarters of one percent (0.75%) of assets from \$4,000,000 to \$10,000,000;

One-half of one percent (0.50%) on assets \$10,000,000 and above.

While fees are generally not negotiable, the firm has in some instances negotiated a fee with clients opening several accounts (e.g. a family). Your account may also be charged for custodian fees, brokerage fees, and other customary third party fees charged based on the assets we invest in (e.g. fees related to and/or charged by ADRs, ETFs, or mutual funds). You have the choice to keep your account at a bank or at a broker such as Charles Schwab & Co., Inc. ("Schwab"). You will generally incur custodian fees if your account is held by a bank. These charges run from 0.08% to 0.375% of the market value of the account and are deducted by the custodian from your account.

Accounts held at Schwab are not charged a custodial fee, but because we may trade these accounts through a third party brokerage firm, higher brokerage fees for the purchase and sale of securities may be charged by the broker. We tend to recommend that clients use Schwab for their managed account with us when our clients have an existing account there or when an account is less than \$500,000. The accounts held at Schwab are usually traded through Schwab, which currently does not charge a commission per trade.

PDM currently pays brokerage firms a commission of five cents (\$0.05) per share of stock traded, except when trades are executed at Schwab. See Item 12-Brokerage Practices for more information about our use of brokerage firms.

We prefer that clients hold their managed accounts at one of three institutions for trading efficiency and to take advantage of negotiated custody fees. Our preferred custodians are Bank of America, Frost Bank, and Schwab.

Neither PDM, nor any of our employees receive any compensation for the sale of securities or other investment products, other than the generation of soft dollars as discussed below under Item 12-Brokerage Practices.

### **Additional Compensation**

PDM performs some "family office services" for 13 of our clients. These services include bill paying and reporting, insurance placement, the payment of salaries/withholding and reporting for employees and other complementary business services. We bill for these services on a quarterly basis. Our fees for family office services are negotiated individually with clients and range from \$1,250 to \$12,500 a quarter depending on the amount of work performed.

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

PDM does not charge Performance Based Fees.

## **Item 7 - Types of Clients**

### **Our Clients**

The majority of our clients are high net worth individuals. We also offer our services to pension plans, foundations, trusts, and partnerships.

### **Minimum Account Size**

PDM prefers a minimum account size of \$1,000,000, but has accepted smaller accounts under certain circumstances.



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

### **Our Investment Strategies**

Our primary investment strategy is to invest in common stocks, bonds, and cash and cash equivalents which in our estimation offer attractive return potential relative to the risk of permanent loss. We evaluate each investment on a case by case basis using primarily fundamental analysis.

Fundamental analysis is a type of analysis where one evaluates a range of quantitative and qualitative factors with respect to a business in order to ascribe a fair value to that business. In conducting such analysis we will frequently review regulatory filings such as annual reports (e.g. SEC form 10-K or 20-F), quarterly reports (e.g. SEC form 10-Q), proxy statements (e.g. SEC form DEF 14A), registration statements (e.g. SEC form S-1 or F-1), and current reports (e.g. Form 8-K). In addition we may refer to macroeconomic statistics from third party research providers and/or government agencies. We frequently read articles about a particular business or industry we are researching in newspapers and trade journals and/or magazines. We often read research reports on companies or macroeconomics provided by third parties such as brokers. We may try to contact people who have worked in a particular industry we are evaluating to draw on their experiences to better understand the practical realities of the specific business we are trying to evaluate. We quantitatively try to evaluate the historic and potential for future cash flow and earnings as well as the soundness of a specific company's balance sheet. We qualitatively evaluate the business in terms of its strengths, weaknesses, opportunities for growth, and threats to the existing business as well as many other qualitative factors dictated by the circumstances of the specific company we are evaluating. Once a value has been ascribed to a business as a whole, we can then evaluate the capital structure of the company and determine a fair value for the various securities issued by the company.

From time to time we may evaluate technical factors (e.g. review the stock chart, moving averages, historic trading volume) when considering whether the timing is favorable to enter or exit an investment.

If we find that a particular security is trading at a significant discount in the market to our estimate of fair value and the timing seems appropriate, we may choose to pursue it as an investment for clients who have the appropriate risk tolerance and who have surplus cash relative to their immediate needs. We generally take a long-term view (i.e. years not months) when evaluating potential investments. We sell our investments when we believe the likely returns no longer justify the potential for permanent loss of capital. We typically run a concentrated portfolio of investments, as we believe truly good investments are difficult to find and, thus, when one is found it should represent a meaningful portion of one's assets. A typical investment position is 3-4% of a client's account. Most client accounts have fewer than 40 positions. Position sizes generally range from 0.5% of client assets up to 15% of client assets depending on the situation. Sometimes exceptions to these size ranges may occur, but we would expect it to be very rare. We may also invest in foreign securities, ADRs, ETFs, preferred stock, warrants, options, private placements, and other securities that we deem to offer attractive returns relative to the risk of permanent loss of capital. We have occasionally engaged in the short sale of options (often covered calls) and common stocks. All of our investment strategies involve a substantial degree of risk and the potential for loss. Some securities, such as foreign securities, involve special risks due to economic, political and legal developments, including favorable or unfavorable changes in currency exchange rates. Some strategies, such as the short sale of a common stock, can result in losses that are theoretically infinite and are appropriate only for investors that have the appropriate risk tolerance for such risky investments.

## Cash Management

Cash is generally invested in a taxable or tax-exempt money market fund offered by the custodian that the client has chosen. For accounts at Schwab, a Schwab Bank sweep deposit is usually utilized for cash management. Alternatively, we may invest in short-term Treasury bills as a cash alternative in order to achieve a higher yield.

## Risk

Investing in securities involves the risk of loss. While our ultimate goal is to provide attractive absolute returns over a long period of time (several years at a minimum), there can be no assurance we will achieve this goal. Clients' portfolios have historically and will almost certainly experience losses in the future over certain periods of time.

### Investment Risks

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**Concentration Risk.** Investments in your account are not required to be diversified, and it is possible that your holdings could be concentrated in only a few issuers, industries, sectors, companies, geographic regions or asset classes. This limited diversification could expose your account to losses disproportionate to market movements in general and could have a significant adverse effect on your account.

**Illiquidity.** We may invest in securities and other assets which are subject to legal or other restrictions on transfer or for which no liquid market exists. Market prices, if any, for such investments tend to be volatile and may not be readily ascertainable. In addition, we may not be able to sell illiquid investments when we desire or to realize what we believe to be fair value in the event of a sale. The sale of restricted and illiquid assets often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in over-the-counter markets.

**Market Conditions.** Our strategies may be materially affected by conditions in the financial markets and economic conditions throughout the country and the world, including interest rates, availability of terms of credit, inflation rates, economic uncertainty, changes in laws, trade barriers, commodity prices, currency exchange rates and controls, and national and international political circumstances.

**Short Selling.** Our strategy for your account may include occasional short selling. Short selling involves selling securities which may or may not be owned and borrowing the same securities for delivery to the purchaser, with an obligation to replace the borrowed securities at a later date. Short selling allows an investor to profit from declines in market prices to the extent that such decline exceeds the transaction costs and the costs of borrowing the securities. A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying security

could theoretically increase without limit, thus increasing the cost of buying replacement securities to cover the short position. There can be no assurance that the necessary securities will be available for purchase. Purchasing securities to close out a short position can itself cause the price of the securities to rise further, thereby exacerbating the loss.

**Reliance on PDM Management.** PDM's success will depend in large part upon the skill and expertise of our professionals. There can be no assurance that any particular professional will continue to be associated with PDM. The ability to recruit, retain, and motivate such professionals is dependent on our ability to offer attractive incentive opportunities. Should any of these professionals join or form a competing firm, become incapacitated or in some other way cease to participate in PDM investment activities, our performance could be adversely affected.

**Equity Securities.** We primarily recommend investments in equity and equity-linked securities. The value of these securities generally will vary with the performance of the issuer and movements in the equity markets in general. As a result, your account may suffer losses if we invest in equity securities of issuers whose performance diverges from our expectations or if equity markets generally move in a single direction and we have not hedged your account against such a general move.

**Foreign Securities.** We may occasionally invest in securities of companies domiciled or operating in one or more foreign countries. Such foreign securities may involve considerations and risks not typically encountered by domestic securities. These may include government instability, possible expropriation, limitations on the use or removal of funds or other assets, currency risk, domestic or foreign administration, economic, or monetary policy changes, or changed circumstances between nations. Foreign tax laws or confiscatory taxation may also affect foreign security investments. Currency conversions and foreign brokerage commissions may cause foreign security investments to be more expensive than domestic investments. Foreign securities markets also may be less liquid, more volatile, and subject to less governmental supervision than in the United States (e.g., a lack of uniform accounting, auditing, and financial reporting standards, and potential difficulties in enforcing contractual obligations).

**Fixed Income Securities.** We may invest a portion of your account in fixed income securities, including bonds, notes, and debentures issued by corporations, municipalities or the U.S. government; debt securities and commercial paper. Fixed income securities pay fixed, variable or floating rates of interest. Fixed income security values will vary in response to interest rate fluctuations. Changes in perceptions of creditworthiness, political stability, or soundness of economic policies can also cause value fluctuations. Also, fixed income securities are subject to the possibility of an issuer's inability to meet principal and interest payments on its obligations (i.e., credit risk). They are also subject to price volatility due to factors like interest rate sensitivity, perception of issuer creditworthiness, and general market liquidity (i.e., market risk).

## **Item 9 - Disciplinary Information**

Neither PDM, nor any employee of the firm or management person of PDM, has been involved in any disciplinary proceedings since our inception.

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

PDM does not have any material relationships with other financial industry participants. We do not refer clients to other investment advisors and we do not receive any compensation from other financial industry participants, other than soft dollar credits. We receive soft dollar credits from Goldman Sachs, which are used to pay for investment research that benefits all of our clients, including some of those who execute trades only through other brokers. This is discussed in more detail under Item 12-Brokerage Practices below.

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

### **Code of Ethics**

We have adopted a Code of Ethics that complies with SEC rule 204A-1. Our Code of Ethics states that we have a fiduciary duty of care, loyalty and good faith to our clients. Our employees have an obligation to act solely in the best interests of clients, and to make full and fair disclosure of all material facts, particularly where the clients' interests may conflict with the interests of the firm or our employees. A thorough knowledge and understanding of our Code of Ethics by all of our employees assists in promoting a "culture of compliance" that is crucial to fulfilling our fiduciary responsibility.

The fiduciary principles that govern personal investment activities of employees are, at a minimum, the following: (1) the duty at all times to place the interests of clients first; (2) the requirement that all personal securities transactions be conducted in a manner that is consistent with Rule 204A-1 of the Advisers Act and in such a manner so as to avoid any actual or potential conflict of interest, or any abuse of an individual's position of trust and responsibility; and (3) the fundamental standard that personnel providing services to clients should not take inappropriate advantage of their positions. Our policy is that the interest and privacy of our clients always comes first and all employees will conduct themselves in accordance with the highest standards of integrity, honesty and fair dealing. Our Code of Ethics is available to anyone upon request.

Our Code of Ethics also contains policies and procedures with respect to personal trading. Our principals and employees may invest in the same securities (or related securities e.g. warrants, options, or futures) that we recommend to our clients. This creates a potential conflict of interest because we may have an incentive to favor our own portfolios, in which we have a direct financial interest, over other client portfolios. To address this potential conflict, our policy is to finish trading a security for our client accounts before we allow our principals or employees to trade in the security. We do not permit principal transactions with client accounts or agency cross transactions.

### **Personal Trading**

Employees of PDM frequently purchase the same stocks that are recommended for client accounts; however, employees may not trade for themselves until all applicable client accounts have completed their transactions. Employees are prohibited from trading on any insider (material non-public) information, and PDM will not purchase any investments for client accounts in which an employee has a material financial interest.

Employee security transactions are reported on a quarterly basis and reviewed by Robert Felty, the Chief Compliance Officer.

## **Item 12 - Brokerage Practices**

### **In General**

Our investment management agreement with you grants us the authority to select the brokers through which your trades are executed and to determine the commission rates to be paid to these brokers. Most of the brokers that we use to execute trades on behalf of our clients' accounts are currently paid five cents (\$0.05) per share. In the case of low-priced stocks, we may negotiate this rate lower. PDM considers several factors when selecting brokers to execute trades, including the quality of executions; the commission rates charged by the broker; the research services provided by the broker; and the broker's execution policies and commitment to providing best execution. We are not required to weigh any of these factors equally. Since commission rates in the United States are negotiable, selecting brokers on the basis of considerations which are not limited to applicable commission rates may at times result in higher transaction costs than would otherwise be obtainable.

The accounts held at Schwab are usually traded through Schwab, which currently does not charge a commission per trade.

Schwab does not charge a custody fee so we feel it is a financial benefit for some clients to custody at Schwab although those clients do not participate in the bulk executions through the other brokers we use such as Goldman Sachs or Jefferies & Company, Inc. ("Jefferies").

### **Research and Soft Dollar Benefits**

Goldman Sachs offers PDM a soft dollar credit of a portion of the commissions that PDM directs to their firm. PDM uses this soft dollar credit to purchase investment research products and services for the firm. The soft dollar credit provides a benefit to PDM, because otherwise PDM would be paying for the same services with our own resources. This may create a conflict of interest with our clients because we may direct trades to Goldman Sachs to generate soft dollars to purchase investment research despite the fact that Goldman Sachs may charge our clients more in commission than they might be able to pay another broker offering comparable execution service, but not offering PDM soft dollar credits.

We use Goldman Sachs or Jefferies for trading most client accounts; however, client accounts held at other brokers may trade through those brokers; if requested by the client. All of the accounts managed by PDM benefit from the research purchased with soft dollars provided by trades routed to Goldman Sachs or Jefferies, and we make no attempt to allocate soft dollar benefits to client accounts proportionately to the soft dollar credits the accounts generate.

PDM uses a Financial Information Exchange – a "FIX" connection to engage in electronic trading and allocation through NYFIX. We have a FIX connection with Goldman Sachs, Jefferies and Schwab for trading. With Schwab, we also use FIX for allocating trades to each account, which reduces manual labor in our back office. PDM does not benefit financially from this association but it does make our operations smoother. PDM still pays a fee to NYFIX for use of their services. However NYFIX charges additional fees for each connection to a broker. Goldman Sachs, Jefferies and Schwab pay for the FIX connection with PDM, a cost we would otherwise bear. As a result of our FIX connection we may be more likely to conduct business with Goldman Sachs, Jefferies and Schwab.

PDM only uses soft dollars for research services (including investment recommendations) within the safe harbor of section 28(e) of the Exchange Act as defined below. The research services obtained with soft dollar credit in the last year are Bloomberg, Intercontinental



Exchange Holdings, Options Price Reporting Authority, Rosenberg Research & Associates, Telemet America, Thompson Financial, Ullink Net and Value Line Publishing.

We are authorized to pay higher prices for the purchase of securities from or accept lower prices for the sale of securities to brokerage firms that provide us with investment and research information or to pay higher commissions to such firms if we determine those prices or commissions are reasonable in relation to the overall services provided. Accordingly, we may be deemed to be paying for research and other services with "soft" or commission dollars. Such investment and research information may be internally generated by the brokerage firms we use or be obtained from third parties by the brokerage firms. Research services furnished by brokers may include written information and analyses concerning specific securities, companies or sectors; market, financial and economic studies and forecasts; statistics and pricing or appraisal services; discussions with research personnel; and invitations to attend conferences or meetings with management or industry consultants.

Section 28(e) of the Securities Exchange Act of 1940, provides a "safe harbor" to investment managers who use commission dollars generated by their advised accounts to obtain investment research and brokerage services if the manager determines in good faith that the commission is reasonable in relation to the value of the brokerage and research services provided. Conduct outside of the safe harbor afforded by Section 28(e) is subject to the traditional standards of fiduciary duty under state and U.S. federal law. Notwithstanding a good faith determination that the amount of commissions paid is reasonable in relation to the value of brokerage research services provided, to the extent that we determine to use commission dollars to pay for products and services that provide administrative or other non-research assistance, such payments may not fall within the safe harbor of Section 28(e). Nevertheless, we intend to use commission dollars generated by our clients' brokerage accounts to obtain only such investment research and brokerage services or products as permitted under the safe harbor afforded by Section 28(e)

### **Brokerage for Client Referrals**

We do not direct brokerage business to brokers in exchange for client referrals.

### **Directed Brokerage**

We allow clients to choose their custodian and brokers at the beginning of our relationship; however, we may offer them some guidance on what we expect to be the most cost effective configuration for the client. Most of our clients choose to defer to us regarding brokerage and custody decisions, in which case we generally recommend setting up custody at a bank, which allows us to use brokers to execute transactions that are not affiliated with the custodian. Some clients, however, choose custodians like Schwab that waive their custodial fee in exchange for brokerage business, and in order to get this waiver the clients direct us to conduct all trades through that broker. Other clients direct us to trade through a specific brokerage account with a broker they have chosen. However, clients who direct us to use a specific broker may not get best execution because we may not be able to aggregate orders to reduce transaction costs and they may receive less favorable prices. See Order Aggregation below.

We sometimes pay higher commissions to full service brokers for research or, in the case of Goldman Sachs, for soft dollars we can use to purchase research and research-related services. In addition we cannot be sure we are directing the trade to the broker that will get the best execution. Therefore, clients who defer to us regarding brokerage decisions may end up paying more in commission than other clients.

## **Order Aggregation**

Our preferred practice is to aggregate orders, which we believe contributes to best execution. Our practice is to first execute bulk orders on behalf of clients who defer to us regarding brokerage decisions, and then to proceed to execute transactions on behalf of our clients who direct us to use a specific broker, as we want to avoid having our clients bid against each other in the marketplace. It should be noted that clients sometimes get different executions as a result of this practice and, indeed, clients not participating in aggregate orders may get a worse (or better) execution depending on market fluctuations during the time between when aggregate and other orders are executed.

In the event of partial fills for aggregate orders, our practice is to allocate trades to the least invested accounts first in the case of a buy and the most invested accounts first in the case of sells. If several accounts are similarly invested we may then choose to allocate by custodian for the sake of convenience.

## **Item 13 - Review of Accounts**

Accounts are monitored on a daily basis by the members of our investment committee (R. Van Ogden, Jeffrey W. Helfrich and Charles L. Norton) for market and economic factors that might dictate a change or redirection of assets. The entire investment committee meets at least once a month (via telephone or in person) and often more frequently than that as the committee meets at any time it is deemed necessary. Large withdrawals or additions of cash may prompt an adjustment of the portfolio holdings.

Monthly statements are mailed to clients from PDM and at least quarterly statements are mailed from all Custodians. See Item 15 - Custody below.

We seek to meet with our clients on a quarterly basis to review their portfolios, performance, risk tolerance, investment goals, and cash needs. We meet with some clients more frequently than quarterly and some less frequently as the client so chooses.

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

We do not pay for client referrals.

## **Item 15 - Custody**

PDM uses qualified third party custodians and clients will receive a statement from their custodian at least quarterly. Clients will also receive a monthly statement from PDM. All statements should be carefully reviewed and the two separate statements compared for accuracy. For tax and other purposes, the custodial statement is the official record of your account and transactions.

## **Item 16 - Investment Discretion**

The Discretionary Investment Management Agreement executed between a client and PDM contains a Power of Attorney which grants PDM full discretion with respect to the investment

and management of a client's portfolio. The Power of Attorney also appoints PDM as the client's Attorney in Fact for the purpose of placing all brokerage orders for the account.

PDM will maintain full discretion over all assets in a client's portfolio unless otherwise directed by the client. Clients may impose restrictions on the type of securities we buy for their account.

## **Item 17 - Voting Client Securities**

Proxies for securities held in clients' discretionary management accounts are forwarded to PDM by the custodian banks or brokers holding the securities. PDM votes all proxies in a prudent and timely manner in accordance with our Proxy Voting Procedures outlined in our Compliance Manual unless the client has requested either to vote the proxy personally or to have it voted in a specific manner. A copy of our Compliance Manual and Proxy Voting Procedures is available to any client or prospective client upon request. Information on how votes were cast is also available to any client upon request.

While PDM votes based on the specific circumstances we believe to be in our clients' best interest, we will generally vote FOR:

1. Election of directors nominated by the current directors, where no corporate governance issues are in question;
2. Selection of independent auditors recommended by management;
3. Increases in authorization for the issuance of or reclassification of common stock;
4. Management recommendations adding or amending indemnification provision in charter or by-laws;
5. Changes in board of directors recommended by management;
6. Outside director compensation recommended by management;
7. Proposals that maintain or strengthen shared interests of shareholders and management;
8. Proposals that maintain or increase shareholders' influence over issuer's board of directors and management;
9. Proposals that maintain or increase rights of shareholders;
10. Management proposals for merger or reorganization if the transaction appears to offer fair value.

PDM will generally vote AGAINST:

1. Shareholder resolutions that consider non-financial impacts of mergers;
2. Anti-greenmail provisions.

All proxies will be voted in a prudent and timely manner and only after a careful evaluation of the issues presented on the ballot. PDM will provide adequate disclosure to clients if any



substantive aspect of foreseeable result of the subject matter to be voted upon raises an actual or potential conflict of interest between PDM and its clients. Details concerning the possible conflict will be provided and the client will be asked to either vote the proxy personally or to indicate a voting response.

Any client may obtain information as to when and how a vote is cast for their account by making an oral or written request for such information.

## **Item 18 - Financial Information**

We offer certain clients “family office” services, which include payment of client bills. Some of these clients give us check writing authority over their accounts. Thus, we may be deemed to have custody of certain client checking accounts. The checks are generated by one PDM employee and signed by two others. We have a monthly reconciliation prepared by a fourth employee and signed off by the original two check signors. The monthly reconciliation is also mailed to the client and to their CPA if requested. All funds are held in a separate checking account for each client with the bank acting as an independent qualified custodian. Because PDM supplies this service, the client funds of which we have custody are verified by actual examination at least once a year by an independent public accountant (also known as a surprise audit).

We are not aware of financial condition that would impair our ability to meet our contractual commitment to our clients. PDM has always been financially solvent.

Clients with accounts held at Schwab can authorize PDM to direct the distribution of money from their account to the client; however, a separate authorization must be signed by the client for PDM to direct a distribution from the account to a third party. Client accounts at custodial banks can also authorize PDM to direct the distribution of money from their account to the client; however, the custodial banks allow PDM to direct payments from the client’s custody accounts to third parties, often for the payment of legal or accounting fees, without a separate agreement from the client. In all cases, the client receives a statement from the custodian and from PDM to review all transactions and holdings on a regular basis.

John McFarland acts in his individual capacity as Trustee for two testamentary trusts whose assets are managed by PDM and one irrevocable trust whose assets are not managed by PDM. In his role as Trustee, he has discretionary control over the trust assets.

Van Ogden acts in his individual capacity as Co-Trustee for one irrevocable grantor trust and one revocable grantor trust whose assets are managed by PDM.

Neither Mr. McFarland nor Mr. Ogden accepts compensation for their roles as trustees of the above referenced accounts.

Van Ogden also serves as Independent Executor of an estate whose assets are managed by PDM. Van Ogden may receive compensation from the estate. The beneficiaries of the estate all receive a statement from the custodian and from PDM to review all transactions and holdings on a regular basis.

## ***Brochure Supplement***

### **Item 1 - Cover Page**

This brochure supplement provides information about our supervised persons who either (i) formulate investment advice for our clients and have direct client contact or (ii) have discretionary authority over a client's assets, even if the supervised person has no direct client contact. These persons include:

- **John S. McFarland**
- **R. Van Ogden**
- **Jeffrey (Jeff) W. Helfrich**
- **Robert E. Felty**
- **Charles L. Norton**

For the business address and telephone number of each of our supervised persons, please see the cover page of our brochure.

### **Item 2 - Educational Background and Business Experience**

Please see Item 4 - Advisory Business of our brochure and additional required information below:

John S. McFarland - Born 1936. John has worked for PDM for each of the prior five years.

R. Van Ogden - Born 1957. Van has worked for PDM for each of the prior five years.

Jeffrey (Jeff) W. Helfrich - Born 1980. Jeff has worked for PDM for each of the prior five years.

Robert E. Felty - Born 1957. Robert has worked for PDM for each of the prior five years.

Charles L. Norton - Born 1974. Charles has worked for PDM for each of the prior five years.

### **Item 3 - Disciplinary Information**

Please see Item 9 - Disciplinary Information of our brochure.

### **Item 4 - Other Business Activities**

None of our supervised persons are engaged in any investment-related or other business or occupation, other than activities for PDM.

**Item 5 - Additional Compensation**

None of our supervised persons receives any additional compensation or economic benefit for providing advisory services, other than their regular salary and other compensation from PDM.

**Item 6 - Supervision**

John McFarland, Robert Felty and Charles Norton are supervised by Van Ogden, President of Penn Davis McFarland, Inc. (214-871-2772). Mr. Ogden speaks with John, Robert, and Charles daily (except on days he is out of the office) about any contact they have with clients to stay informed regarding the quality of advice they are providing. As principals of the firm, Van Ogden and Jeff Helfrich report to each other with respect to the advice clients receive.