

# BADGLEY+PHELPS

WEALTH MANAGERS

## **FORM ADV PART 2A: FIRM BROCHURE**

### **Badgley Phelps Wealth Managers**

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March 31, 2021

Form ADV Part 2, which is comprised of Part 2A and 2B, is our "Disclosure Brochure" or "brochure" as required by the Investment Advisers Act of 1940, as amended. This brochure provides information about the qualifications and business practices of Badgley Phelps Wealth Managers.

Badgley Phelps Wealth Managers (hereinafter "Badgley Phelps") is a registered investment adviser. Registration as an investment adviser does not imply a certain level of skill or training. Please consider all information we provide you, including this brochure, as factors in your decision to retain us as your investment adviser and wealth manager.

If you have any questions about the contents of this brochure, please contact us at (206) 623-6172 or at [info@badgley.com](mailto:info@badgley.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Our brochure is available at any time upon request without charge. Please request our brochure by contacting our Chief Compliance Officer at (206) 623-6172 or by emailing us at [info@badgley.com](mailto:info@badgley.com).

Additional information about Badgley Phelps is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **Item 2 – Material Changes**

When specific material changes occur at our firm since the last annual update of our brochure, we are required to disclose these changes here.

This annual update of our brochure, dated March 31, 2021, includes an updated amount of our assets under management. General revisions were made elsewhere in our brochure. Specific changes since the last annual update filed on March 30, 2020 include the following:

Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss. This section is amended to include Disease Outbreak Risk.

Item 12 – Brokerage Practices: Research and Soft Dollars. This section has been updated to report changes in the payment of third-party research. We no longer have a soft dollar arrangement that pays for third-party research.

Item 14 – Client Referrals and Other Compensation. We no longer have agreements with other financial service firms to provide separate account investment management to clients of these firms.

Item 15 – Custody. This section has been updated to report that in certain situations when client checks are sent to our firm, we have custody of client funds under Rule 206(4)-2.

A complete copy of our brochure is available at any time upon request without charge. To request our brochure, contact our Chief Compliance Officer at (206) 623-6172 or email us at [info@badgley.com](mailto:info@badgley.com).

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#### Item 4 – Advisory Business

Badgley Phelps Wealth Managers was founded in 1966 in Seattle, Washington. Our firm offers personalized wealth and investment management services to individuals and families, and investment management services to corporations, retirement plans, endowments and foundations. Our approach is to help our clients establish goals and customize strategies to meet their financial objectives. We accomplish this through a disciplined investment management process built on equity, fixed income and alternative security selection methodology, financial planning, and with client-focused service.

Badgley Phelps has been 100% employee-owned since inception. Currently, Badgley Phelps has 35 full-time employees, of which 15 are also shareholders of our firm. Significant owners of Badgley Phelps are J. Kevin Callaghan and Steven C. Phelps.

Wealth managers at Badgley Phelps work with each client to develop an asset allocation which is aligned with the client's financial goals for each portfolio and/or client relationship. To determine the appropriate asset allocation, we work to develop a clear understanding of our clients' overall investment situation, risk tolerance, return objectives, tax circumstances and income needs. For most of our clients, this is done by preparing a financial plan. The concept of asset allocation, or spreading investments among several asset classes, is in the forefront of our strategy. Once we have concluded this review with our clients and determined the appropriate asset allocation, our investment process is implemented. Clients that wish to restrict investing in certain securities can do so by notifying their wealth manager. At our clients' request, we will also work with their other professional advisors, such as attorneys and accountants, to provide assistance regarding tax, estate planning and other issues that can impact our client's financial well-being.

Our investment management services include equity only, fixed income only, and balanced portfolio management. Brief descriptions follow:

**Equity management** utilizes fundamental/bottom-up research and analysis in our security selection process and focuses on identifying companies with either strong and consistent earnings growth or attractive valuation. Medium to large capitalization stocks and American Depositary Receipts ("ADRs") registered on the U.S. stock exchanges with a consistent growth or relative value bias are selected within the consistent growth and relative value portion of our clients' equity portfolios. We manage consistent growth and relative value portfolios using model portfolios which generally contain 30 to 40 stocks each. In addition, we seek exposure to small and mid-sized U.S. companies in our clients' portfolios by recommending a model portfolio consisting of mutual funds or Exchange Traded Funds ("ETFs"). We also recommend that our clients seek investment returns from non-U.S. markets, so we generally allocate a portion of a client's portfolio to international stocks by investing in a model portfolio of mutual funds or ETFs.

**Fixed income management** emphasizes a diversified portfolio of high-quality, short- and intermediate-term bonds. Our focus is on client specific solutions based on the client's tax rate and portfolio guidelines. In tax-exempt portfolios, we generally purchase U.S. government, governmental agency, and high-quality corporate bonds. For taxable portfolios, we typically invest in high-quality municipal bonds, depending upon the client's state of residence and tax status, and fixed income market conditions. Fixed income portfolios can also be structured to meet both short-term and long-term investment goals.

In addition to equity and fixed income securities, **alternative strategies** can be used to further diversify our clients' portfolios. If appropriate, we add an alternative strategy to a client's portfolio using a model comprised of mutual funds, ETFs and exchange traded notes ("ETNs"). Mutual funds, ETFs and ETNs can be used to enhance the risk-adjusted returns of our clients' investment portfolios by investing in securities that have, for example, a low historical correlation with the stock and bond markets. The goal of this "multi-strategy" process is to diversify the portfolio, help smooth returns, reduce volatility and decrease asset-class risks. Oftentimes, these securities focus on a shorter investment time horizon than our typical client portfolios. Generally, we allocate a smaller percent of a client's portfolio to alternative investments.

**Balanced portfolio management** combines equity, fixed income, and alternative investment management methodologies. For those clients who select balanced management, a target allocation between equity, fixed income, alternative assets and cash is determined at the onset of a client relationship based on the client's particular investment goals and requirements. Once this allocation is established, the portfolio is balanced to this target allocation ratio. Typically, accounts are reviewed for asset allocation rebalancing at least once every three months. The asset allocation target is periodically reviewed with our clients and may be revised to meet client goals and expectations.

Badgley Phelps manages client assets on a discretionary as well as non-discretionary basis. As of December 31, 2020, the market value of client assets managed on a discretionary basis was \$3,556,880,932 and \$261,498,866 for non-discretionary assets, for total regulated assets under management of \$3,818,379,798.

## Item 5 – Fees and Compensation

Badgley Phelps' standard advisory fee schedules for new accounts are as follows:

<b><u>Advisory Fee Schedule for Separate Accounts:</u></b>	<b><u>Portfolio Value at Market:</u></b>	<b><u>Annual Fee:</u></b>
Balanced	First \$5,000,000	0.90%
	Next \$5,000,000	0.60%
	Amount over \$10,000,000	Negotiable
Equity Only (*)	First \$5,000,000	1.00%
	Next \$5,000,000	0.75%
	Amount over \$10,000,000	Negotiable
<i>(*) Generally comprised of a minimum 80% equities</i>		
Fixed Income Only	First \$20,000,000	0.40%
	Amount over \$20,000,000	Negotiable

Each new client agreement with Badgley Phelps establishes the agreed-upon fee schedule. Fees are computed on the market value of assets less non-supervised assets. Clients are billed once every three months for wealth and investment advisory services. In any partial calendar quarter, fees are prorated based on the number of days in which the account is open during the quarter. Client portfolios are valued as of a specific pre-determined date to calculate the fee for that calendar quarter. Badgley Phelps requires a minimum investment portfolio(s) of \$1,000,000 per client household but this minimum can be waived under certain situations. Some clients might be billed at a fixed amount due to special circumstances including, but not limited to, the type of investment or financial planning work conducted by our firm.

Fee schedules and minimum account sizes are negotiable. Fees vary from the current fee schedules listed above due to the particular circumstances of the client, the type of investment or financial services provided, or as otherwise negotiated. Examples of these circumstances can include the account inception date, the existence of other accounts managed by Badgley Phelps, account size, minimum annual fee, and/or as otherwise negotiated. Discounts not generally available to our advisory clients are also offered to family members or associated persons of our firm.

Clients have the option to pay our invoices directly upon receipt. Additionally, with written client authorization, Badgley Phelps will deduct the advisory fee directly from the client's custodian account. Each fee payment deducted from the client's custodial account is reported on the client's account statement prepared by and sent from the client's qualified custodian. A copy of our invoice is sent to each client. Badgley Phelps urges our clients to verify the accuracy of each invoice since some custodians do not verify our fee calculation.

Accounts initiated or terminated during a calendar quarter will be charged a prorated fee. A client can terminate our services for any reason. We appreciate written notice when terminating. The client's final invoice is adjusted pro rata to the termination date with reimbursement to the client or the client's custodial account for any amounts due to be refunded. Any earned, unpaid fees will be due and payable at account termination.

Badgley Phelps' advisory fees are exclusive of brokerage commissions, custodial fees, transaction fees, regulatory fees, exchange fees, legal fees, accounting fees, and other related costs and expenses. Some examples of these fees include broker trade commissions, trust and custodial expenses, attorney and estate fees, accounting and tax preparation fees, settlement fees, sales charges, transfer taxes, foreign taxes, wire transfer and electronic funds transfer fees, and other fees and taxes on security transactions and custodial accounts. Additionally, mutual funds, exchange traded funds and exchange traded notes charge internal management fees which are disclosed in each fund's prospectus. All such charges, fees and commissions are exclusive of and in addition to Badgley Phelps' advisory fee. Badgley Phelps does not receive payment resulting from these commissions, fees, costs and expenses. See "Item 12 – Brokerage Practices" for additional information regarding Badgley Phelps' brokerage practices.

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

Badgley Phelps does not charge performance-based fees, which are fees based on a share of capital gains on, or capital appreciation of, the assets of a client.

#### **Item 7 – Types of Clients**

Badgley Phelps currently provides wealth and investment management services to individuals, trusts, estates, corporations, pension and profit-sharing plans, charitable institutions, foundations, and endowments. We require a minimum investment portfolio(s) of \$1,000,000 per client household but this minimum can be waived under certain circumstances.

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

Badgley Phelps' investment strategies encompass equity only, fixed income only and balanced portfolio management. Our Investment Policy Committee oversees the firm's investment strategies by determining the recommended allocation of the investments to each asset class and the underlying investment styles. The following is a review of these strategies.

## **EQUITY MANAGEMENT**

Equity management uses four different equity styles. These styles include Consistent Growth Equity, Relative Value Equity, Small/Mid Cap Equity and International Equity. Each equity style is managed by a team of research analysts within our firm that is responsible for stock selection and industry and sector weighting of the equity models. The equities that we consider for investment are securities that are listed on the major U.S. stock exchanges. When positioning a portfolio, our typical investment horizon is three to five years. For clients that prefer, we also manage equity portfolios that only contain Consistent Growth and/or Relative Value Equity securities.

### **Consistent Growth Equity**

Badgley Phelps' Consistent Growth Equity investment philosophy maintains that domestic large cap companies with strong and consistent financial characteristics generate competitive results over time. This philosophy is based on our belief that the price of a stock will, over time, parallel the trend of the underlying growth rate of the company's revenues, earnings and dividends.

We seek to invest in high-quality, established companies that consistently grow their revenues, earnings and cash flows faster than the broad market. These companies have a track record of outperformance versus their earnings estimates, maintain an attractive valuation and have dominance in their respective marketplace. Our largest weightings consist of companies that we perceive to have the strongest and most viable growth prospects. Sector and industry weightings are the result of our stock selection process.

From time to time, stocks are eliminated or trimmed from portfolios when the fundamentals of a stock deteriorate or when the valuation of the stock is excessive. To achieve optimal diversification, the Consistent Growth Equity strategy generally holds between 30 to 40 stock positions. The relative benchmark of this strategy is the Russell 1000 Growth Index

### **Relative Value Equity**

Our Relative Value Equity investment philosophy maintains that companies with attractive valuations – relative to past metrics and their peers – and companies with a catalyst for potential recognition in the marketplace will generate competitive results over time. We look for large cap domestic companies whose stock is selling at attractive valuations relative to their financial characteristics, to their competitors, or to the broader market. These companies could be trading at prices below their fundamental value because the market has not recognized the value of a new product introduction, restructuring opportunities, the generation and use of cash, or the skills of the company's management team.

As is the case with our Consistent Growth Equity strategy, we target industry and sector weightings such that the larger weightings are with companies we believe have the best prospects to grow their stock price. Stocks can be trimmed or eliminated when the valuation of the stock is excessive or when



the fundamentals of the stock deteriorate. The Relative Value Equity strategy generally holds between 30 to 40 stock positions and the relative benchmark is the Russell 1000 Value Index.

### **Small/Mid Cap Equity**

Our small/mid cap equity investment philosophy maintains that equity investment in a diversified portfolio of small to mid-sized companies generates long-term appreciation over time. Small/mid cap equities generally have higher earnings growth potential than large companies, are not as widely followed by Wall Street analysts and provide for participation in the merger and acquisition cycle. This strategy is currently implemented using ETFs which we believe to be an efficient method of achieving the desired allocation. As appropriate, mutual funds and other investments are incorporated within the Small/Mid Cap Equity strategy.

### **International Equity**

With respect to non-U.S. equity opportunities, we generally invest in ETFs and mutual funds to gain increased diversification and opportunities not available from the stocks of U.S. based companies. ETFs and mutual funds invested in international economies may focus on countries that have developed economies and countries whose markets are still emerging. It is our belief that these international investments could act to reduce portfolio volatility as their correlation to the U.S. stock market can vary. The addition of these investments also expands the opportunity set for our clients.

### **FIXED INCOME MANAGEMENT**

Badgley Phelps uses bonds in client portfolios to meet capital preservation, income and principal stability goals. Once investment objectives and constraints have been established, we select high quality bonds and focus on intermediate-term maturities in an effort to reduce market risk and maximize total return. For clients with large short-term cash positions, we can structure a fixed income portfolio based on the client's cash flow requirements using the same fixed income investment process.

Our commitment to high-quality investment grade bonds lowers credit risk to our clients since these bonds tend to exhibit a lower degree of price volatility and less default risk. Portfolios are structured around an average intermediate duration that ranges from 3 to 5 years. We believe that capital market history has shown that intermediate-term bonds generate total returns equal to those of long-term bonds, but with less volatility. Once a bond is purchased, we continue to monitor the soundness of the bonds we purchase using a combination of our research efforts, market data, rating agency services and industry publications.

Bond portfolios are structured to reflect our views on the economy, fiscal and monetary policy, political developments, credit fundamentals, and bond valuations as well as our experience in managing technical factors impacting the market. The core of our decision-making process is focusing our research and credit analysis on sector, issuer, security, quality and structure selection and not on factors

such as taking aggressive interest rate bets or excessive credit risks. We utilize a wide variety of research and publicly available information to guide our decisions.

We sell bonds from a portfolio if credit quality deteriorates, the ability of an issuer to service the debt declines, or other opportunities in the market develop that allow us to upgrade portfolio quality, yield and/or liquidity. Investment monitoring and rebalancing are ongoing aspects of our fixed income portfolio management process.

### **Taxable Bonds**

For clients with tax-exempt or tax-deferred portfolios, we invest in taxable bonds with intermediate-term maturities using a broad market strategy that emphasizes sector allocation and security selection. Investments primarily consist of U.S. Treasuries, governmental agencies and investment-grade corporate bonds. U.S. Treasuries generally consist of inflation protected (TIPS) and conventional Treasury bonds. Portfolio risk is managed within distinct tolerance bands for the following categories: duration, yield curve positioning, sector allocation and security selection.

### **Tax Exempt Bonds**

For clients with taxable portfolios, we invest in high quality municipal bonds with intermediate-term maturities. Generally, these are fixed-rate general obligation bonds, essential service revenue bonds, school enhanced issuer bonds, pre-refunded or escrowed bonds and select insured bonds with strong underlying credit ratings. Diversification in terms of municipal bond quality, coupon rate, and geographic location also reduces portfolio risk.

### **ALTERNATIVE INVESTMENT MANAGEMENT**

Badgley Phelps uses a liquid alternative investment strategy to further diversify client portfolios and dampen volatility. Based on market conditions, alternative investment management can include the investment in multiple strategies within this allocation. We believe that diversification into these alternative strategies helps to smooth returns, reduce volatility and decrease asset-class risks. For example, when using mutual funds, ETFs and ETNs, capital can be allocated and reallocated across strategies in response to various market opportunities, trends, events, and risks. Based on market conditions, this portion of a client's portfolio could invest in instruments designed to increase in value when the volatility of the stock market rises, purchase securities structured to rise as the stock market falls, invest in assets that have a low correlation with stocks and bonds, and focus on a shorter investment time horizon (i.e., concentrating on trends that are projected to persist for six to eighteen months). Some of the key areas that we consider as tactical opportunities include equity, fixed income, equity hedge instruments, commodities, real estate, and foreign exchange.

## **CASH**

Badgley Phelps generally maintains a small percent of each client portfolio in cash which is also part of the portfolio's asset allocation. This cash provides liquidity for client needs and distributions. It can also be used to take advantage of an investment opportunity. Cash is typically invested in a money fund or cash sweep account offered by the client's custodian which best meets the investment goals of the client's overall portfolio.

## **BALANCED PORTFOLIO MANAGEMENT**

Balanced portfolio management combines our equity, fixed income, alternative and cash investment management methodologies. Our philosophy is that a balanced strategy should maximize capital appreciation in rising markets with added protection in more volatile markets. The investment of a combination of equity, fixed income, alternatives, and cash generally affords Badgley Phelps the ability to provide a prudent, strategic asset allocation tailored to our clients' investment objectives, cash flow needs and risk profile.

As part of our investment discipline, we monitor client portfolios and rebalance the portfolios to their target portfolio asset class weightings. This discipline tends to force the sale of outperforming assets and the simultaneous purchase of less expensive investments.

## **RISK MANAGEMENT**

Risk management is an important matter for investors to consider. All investments have risks associated with them. Investment in any of the securities described above involves risk which could cause an investor to lose money. We do not warrant or guarantee any particular level of account performance or that the account will be profitable over time. We use our best judgment and good faith efforts in rendering services to our clients and we ask that our clients work with us in defining their individual tolerance for risk. And, while risk is unavoidable, we believe it can be managed using certain tools such as portfolio diversification.

Some of the material risks when investing in stocks include the possibility that stock prices will decline. For instance, stock markets tend to move in cycles, so it is possible that one of our equity investment styles could trail the returns of the overall stock market. Foreign stocks are subject to the possibility that world events and events in their home country (such as political upheaval, financial troubles or natural disasters) will adversely impact their price. Fluctuations in the foreign exchange rate of the U.S. dollar could also have a positive or negative impact on foreign stocks. The prices of foreign stocks and the prices of U.S. stocks have, at times, moved in opposite directions.

Bond investments are subject to interest rate risk. This risk is when changes in interest rates (in the U.S. or other world markets) may reduce or increase the market value of a bond. A fundamental

principal of bond investing is that market interest rates and bond prices generally move in opposite directions. Bonds are also subject to credit risk, which is the possibility that the bond issuer will be unable to make interest or principal payments, or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline. If a bond is callable, any price appreciation above the bond's call price could be lost, which could result in reinvesting the unanticipated proceeds at lower interest rates.

Another risk component that investors need to be prepared for is manager risk. This is the possibility that security selection or focus on securities in a particular sector, category, or group of companies could result in underperformance to relevant benchmarks or other securities.

The following list summarizes various types of investment risk:

- Capital Risk. The risk that the investor will not fully recover his/her entire investment. Speculative investments such as options have a high degree of this type of risk, while quality short-term investments such as Treasury bills typically have minimal capital risk.
- Selection Risk. The risk of choosing a security that will perform worse than other available securities.
- Timing Risk. The risk of buying or selling at an inopportune time, thus limiting profit or incurring a loss.
- Legislative Risk. The risk that future legislation will impact today's investment decisions. International, federal, state and local laws or regulations might change without notice, possibly impacting a security's performance.
- Liquidity Risk. The risk that the security holder will have a difficult time selling should there be a decline in the quality or the desire by the marketplace for this particular investment.
- Market Risk. The risk that the value of a security will decline due to factors that can impact overall market conditions, not by any fault of the issuing company.
- Credit Risk. The risk that the issuer becomes unable to pay interest and/or principal when due on fixed income securities. U.S. government securities are the least likely to default on payments, while "junk" bonds have a high degree of credit risk.
- Inflationary Risk. The risk that inflation will reduce the purchasing power of the U.S. dollar over time. Equity securities tend to provide the best protection against this type of risk, while bonds are more susceptible. Interest income earned by bonds is fixed, plus there also exists the possibility of long-term exposure to rising inflation for bonds with longer maturities.
- Interest Rate Risk. The risk that, as interest rates rise, a bond investor's holdings will decline as more attractive offerings enter the market. The longer the bond maturity, the greater the risk. Some stocks could also be susceptible to this type of risk if the company's borrowings are high. This will increase the company's interest expense costs which could decrease the company's stock price.
- Reinvestment Risk. The risk that a bondholder will be unable to reinvest interest payments at a rate equaling the yield-to-maturity.

- Call Risk. The risk that a bondholder will have their bonds called away by the issuer if prevailing interest rates decrease below what their bond is paying. At the time the bonds are called, the bondholder would likely be reinvesting in bonds that would not pay as much interest.
- Disease Outbreak Risk. Disease outbreaks that affect local, national or global economies may have material and adverse impact on a portfolio's investments. Disease outbreaks may lead to disruption, instability and volatility in the marketplace and within governments.

### **Cybersecurity Risk**

All businesses, including firms in the financial industry, are subject to cybersecurity risk. Businesses implement a number of routine business security operations to protect computer networks, systems, hardware and devices from being infiltrated by unauthorized persons and becoming the victim of security breaches. Despite the implementation of these security measures, systems can be breached or cyberattacked.

The risks associated with these security breaches or cyberattacks include the theft, loss or corruption of information such as client personal data, client investment information and internal business data. Unauthorized access directed at our firm or any of our client custodians or other service providers could result in financial losses to our clients and our firm, as well as disruption to daily business operations and communication functionality. Cybersecurity breaches affecting governmental and regulatory authorities, issuers of securities, exchange and other financial market operators could also result in market and government disruptions.

### **Item 9 – Disciplinary Information**

Registered investment advisers are required to disclose all material facts regarding any legal or disciplinary events that would be material to your evaluation of Badgley Phelps or the integrity of Badgley Phelps' management. There are no legal or disciplinary events related to Badgley Phelps and its supervised persons that are material to a client's or prospective client's evaluation of Badgley Phelps' advisory business or the integrity of its management.

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

Badgley Phelps is not actively engaged in business other than its wealth management and investment advisory practice.

## Item 11 – Code of Ethics

Badgley Phelps requires that its employees follow a Code of Ethics. This Code of Ethics incorporates certain general fiduciary principles, guidelines and procedures designed to prevent actual or potential conflicts of interest between our clients and our employees.

The guidelines included in the Code of Ethics require disclosure and annual reporting by our employees of certain personal security holdings. Additional requirements include pre-approval or pre-clearance procedures for certain security transactions, quarterly reporting of required security transactions, and the prohibition of certain types of security transactions. The Code of Ethics prohibits insider trading and participation in initial public offerings. It also establishes guidelines regarding investment clubs, participation in limited or private offerings, plus other standards of business conduct including the acceptance of gifts and entertainment and pre-approval to serve on the board of public companies. All employees of Badgley Phelps must annually acknowledge the terms of the Code of Ethics.

For purposes of this policy, employees are not required to report security investments that include securities issued by the U.S. government, certain open-end mutual funds, and certain other short-term debt securities such as bankers' acceptances, bank certificates of deposit, and commercial paper. All other securities which our employees wish to purchase or sell, including the same securities we recommend to our clients, must be transacted under certain guidelines. Accordingly, we have adopted the following policies and procedures to prevent conflicts of interest arising from our employees' personal trading practices and the security recommendations and transactions we place on behalf of our clients:

**Pre-clearance of Securities Transactions.** Advance clearance is required for security transactions (as defined under this policy) in which an employee has beneficial ownership. This request is approved or disapproved based on the compliance criteria outlined in the Code of Ethics. Factors considered include the type of security transaction, whether the security is on the firm's buy list, whether the security transaction is for a new or existing security holding, and the timing of the transaction in relation to certain client transactions. Certain transactions are prohibited. These include, but are not be limited to, initial public offerings, certain private placements, and certain short-term trades.

**Disclosure and Annual Reporting of Personal Securities Holdings.** Employees of Badgley Phelps are required to disclose, upon commencement of their employment and on an annual basis thereafter, all their personal securities holdings as defined by the Code of Ethics.

**Quarterly Reporting of Securities Transactions.** Each employee of Badgley Phelps must submit a report detailing (a) all security transactions which were executed during the current calendar quarter for their personal account or any account in which they have a beneficial

interest; and (b) whether the employee opened a new brokerage account during the quarter. This report is submitted for review no later than ten days after the end of the calendar quarter.

**Restricted Security Transactions.** Certain restrictions regarding the timing of certain security transactions apply to our firm's employees. Employees who wish to purchase or sell securities which are also being bought and sold for clients of the firm will not always be able to execute this transaction. From time to time, "black out" time periods are announced on certain anticipated client transactions which would restrict employees from trading in these securities.

Badgley Phelps employees can, from time to time, buy or sell securities for themselves that are also being transacted or recommended to our clients and these transactions must be approved in advance as described above. Additionally, the firm's employees can enter into personal transactions of securities which are not deemed appropriate for our clients. Badgley Phelps' Code of Ethics has been adopted to prevent potential conflicts of interest or the appearance of a conflict of interest between our firm's clients and our employees' personal transactions. A copy of our Code of Ethics is available to our clients and prospective clients upon request without charge.

## **Item 12 – Brokerage Practices**

### **Broker Selection and Trading Process**

Unless the client directs us to execute transactions with a broker of preference, Badgley Phelps selects brokers for client transactions.

When executing client transactions, Badgley Phelps allocates equity and fixed income trades to brokers after making a good-faith judgment that the transaction will be executed in the best interest of the client. The criteria used for selecting brokers includes the quality and reliability of the execution of each trade. It also includes a determination that the commissions paid for these transactions are reasonable in relation to the value of the brokerage and research services provided to our clients and our firm. For instance, execution capability, promptness of execution, complexity of the trade, research coverage, financial responsibility of the broker, administrative resources and broker responsiveness are some of the factors we consider when evaluating and selecting a broker. These are factors we consider in addition to commission rates.

Badgley Phelps reviews and, in some cases, negotiates the commission rates offered by each broker we select to execute client trades, and we evaluate whether these rates are reasonable in relation to the value of the research and brokerage services provided, including best execution. We believe that the brokerage fees paid by our clients should represent fair payment for execution capability and the value of the research provided which might not otherwise be available if a broker was selected solely

on the basis of commission costs. We base our transaction placement decisions on an evaluation of the factors noted above and maintain a record of transactions placed by us on behalf of our clients.

Security orders are placed separately or are aggregated with other client trades. When client trades are aggregated, or combined, with other client trades of the same security, this is done for the purpose of achieving a better commission and/or better execution for the clients. Clients in an aggregated trade should pay the same commission rate and receive the same price per share or unit, whereas clients that have directed brokerage to a specific broker might pay a different commission and receive different execution. Additionally, if more than one price is paid for a security in an aggregated trade, each client will receive the average price for that trade. If aggregated trades are only partially filled, the trades are allocated to each client account on a prorata basis based on the original size of the client's order. In addition, if an aggregated trade that is only partially filled is executed in more than one lot at different prices, an average price would be calculated such that all client accounts participating in the aggregated trade would receive the same execution price.

When purchasing bonds for clients who do not have broker-directed arrangements or whose broker-directed accounts permit bonds to be traded with other brokers, offers are sought from brokers who have a particular bond or appropriate inventory, either directly or through an electronic bond trading platform. Depending on the type of bond, comparisons are made between the bond being offered and bonds with similar characteristics currently trading in the market. Characteristics which could be evaluated include credit name, coupon, maturity, call/put options, underlying credit rating, credit enhancement, and corporate or municipal sector. The offer is then evaluated and either accepted or rejected.

When selling bonds, Badgley Phelps attempts to obtain several bids, as is reasonably possible, from brokers or through electronic bond trading platforms. Factors taken into consideration when selling the bond include current market conditions, the characteristics of the bond, any client instructions regarding the sale of the bond, and the broker's price bid.

For bond purchases and sales in broker directed accounts, the bond trade is placed with the client-designated broker. In this circumstance, the bond purchased may or may not be from the broker's inventory and the trade price of the bond sale or purchase may or may not be in line with the institutional bond market.

### **Trading Errors**

If Badgley Phelps is responsible for a trading error, it is our policy to correct the error and cover the cost of the error. When a trading error occurs, we will correct the trade in a manner dependent on the facts and circumstances associated with the error at the time we discover the error.



In most cases, we will correct trade errors through the broker-dealer's trade error desk which effectively cancels the original trade in the client's account and replaces it with the correct trade. If there is a cost associated with correcting the trade error, Badgley Phelps pays these costs. In some cases, an error can result in a gain. Depending on the circumstances of the error and the policies of the broker dealer's trade error desk, the client might retain the gain or the broker dealer might donate the gain to charity. If the broker-dealer's trade error desk does not permit the client to retain the gain, the gain is distributed per the policies and procedures of the broker-dealer.

It is also possible to correct a trade error directly in our client's account by placing a new trade instead of cancelling the original trade as described above. If this results in a gain, such gain is retained by the client since the error correction occurs directly in the client's account. In this situation, the client is responsible for any taxes associated with the transaction. On the other hand, if the trade correction results in a loss, we would reimburse the client directly for the costs arising from this error.

#### **Client-Directed Brokerage**

Most clients that select Charles Schwab or Fidelity as their custodian also direct Badgley Phelps to use Schwab or Fidelity as their directed broker. In this case, Badgley Phelps clients pay commissions and other trading costs that Schwab and Fidelity offer to the clients of Badgley Phelps. Badgley Phelps is also able to aggregate trades with the trades of other clients that are custodied at Schwab and Fidelity.

For those clients who wish to direct their transactions to another broker, Badgley Phelps will maintain this client-broker relationship so long as the client directs us to do so. In this situation, Badgley Phelps will not be able to negotiate commissions on the client's behalf and/or will not be able to aggregate trades with the trades of other clients. It is possible that the client who directs Badgley Phelps to trade with a specific broker will not receive best execution since directed brokerage could result in higher commissions, greater spreads, less favorable net prices and less favorable execution prices.

Some clients of our firm are engaged in wrap fee arrangements with certain independent consultants or financial service firms whereby, in consideration of a fee paid by the client, the consultant will provide services to the client which may include custody, brokerage, investment management and/or performance measurement.

#### **Agency Cross Transactions**

Badgley Phelps does not enter into agency cross transactions for any of its client accounts.

### **Research and Soft Dollars**

Our firm uses both proprietary and third-party research services and products.

Proprietary research is research created and provided by certain brokerage firms. This research includes economic, industry, corporate strategy, fundamental and technical reports and analyses. We have no pre-planned agreements or understandings with brokers regarding the amount of brokerage required to procure proprietary research.

Third party research services are also used by and paid for by our firm. This is research that originates from an entity separate from a brokerage firm. These research products and services can include electronic security research systems, portfolio risk management and fundamental analysis tools, security pricing, indices reporting services, and performance measurement services.

We do not have any soft-dollar arrangements that pay for third-party research services.

### **Item 13 – Review of Accounts**

Most investment advisory accounts are formally reviewed by the client's wealth manager once every three months while other accounts may be reviewed monthly or at other than three-month intervals as established from time to time with the client. As part of the review process, advisory accounts are routinely rebalanced to target portfolio asset allocations previously agreed upon with our clients.

Badgley Phelps currently has a total of eighteen wealth, investment and financial planning professionals who are responsible for reviewing our clients' investment advisory accounts. Some investment advisory accounts are reviewed by more than one wealth manager.

In the event there is adverse news on a particular security or one of our investment teams makes a decision regarding security selection, all accounts owning that security may be reviewed even though a formal review is not scheduled. Wealth managers are expected to restrict their security purchase recommendations to the approved security buy list/model portfolios and to follow approved firm investment philosophy and strategy within the framework of the client's needs and circumstances. From time to time, a client may own a security that is not on our approved buy list. This security may continue to be held in the client's portfolio and the wealth manager will determine whether the security will be managed on a supervised or non-supervised basis.

Portfolio review reports are prepared and sent to clients on a scheduled basis, typically once every three months. These reports generally consist of: (1) a portfolio commentary and review letter which summarizes recent market developments and provides summary information regarding financial

planning and recent transactions; and (2) portfolio summary and appraisal reports which detail the individual securities held in each portfolio and include summary information of each asset class held in the portfolio, plus portfolio performance and recent transactions. Clients may also request other reports such as realized and unrealized gain and loss reports, or income and expense reports. Reports are available to clients monthly, quarterly and/or annually, based on the clients' needs or preferences. Financial plans may be reviewed and updated at various times, depending upon the nature and terms of our clients' needs and financial circumstances. In addition, clients receive periodic brokerage statements from their broker custodian which provides an independent accounting of portfolio assets.

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

### **Sub-Advisory Agreement**

Badgley Phelps has entered into a sub-advisory agreement with Barwick & Partners, Inc. ("Barwick"), a registered investment adviser located in Seattle, Washington, to provide investment advisory services for Barwick client accounts. Prior to allocating any client accounts to Badgley Phelps, Barwick determines that the client accounts are suitable for investment advisory services in accordance with our investment advisory strategy. As sub-adviser, Badgley Phelps provides services to these accounts as directed by Barwick, including investment advisory, reporting, administrative and supervisory services. Under the sub-advisory agreement, Badgley Phelps is paid a negotiated fee directly from these clients. This fee is computed on the market value of assets less non-supervised assets, and the clients are billed once every three months. Badgley Phelps' sub-advisory fee represents a portion of the total fee paid by these clients since the client also pays a separate fee to Barwick.

### **Referral Agreement**

Badgley Phelps has signed an Investment Manager Service Agreement with Charles Schwab & Co., Inc. to participate as an investment manager in the Schwab Adviser Network program. From time to time, Schwab representatives identify and refer potential clients to Badgley Phelps who may wish to hire Badgley Phelps as their wealth manager. Under this agreement, Badgley Phelps will pay a referral fee to Schwab for those clients that hire Badgley Phelps. The fee paid by Badgley Phelps is either a percentage of the investment advisory fee or a percentage of the value of those assets in the client's account. These clients are notified in writing of the referral agreement between Badgley Phelps and Schwab in accordance with applicable securities regulations. These clients do not pay Badgley Phelps a higher fee than they would otherwise pay as a result of the Schwab Agreement.

### **Other**

From time to time, we receive referrals from existing clients as well as other professional service providers, such as accountants and attorneys. We do not have formal referral agreements with these individuals and do not formally compensate these individuals for the referral. We are aware that reciprocating the referrals we receive from these professional service providers could lead to a conflict of interest. When asked for referrals to professional service providers, we refer our business and that of our clients in as unbiased a way as possible by providing multiple names, when available, for each referral.

### **Item 15 – Custody**

If a client requests that we recommend a broker for the safekeeping of securities, we base our recommendations on the compatibility of services needed by and provided for the client, the financial strength of the broker, and the factor of confidentiality for the client. In all cases, we require that our clients select a qualified custodian. We recommend to most of our clients that they use Schwab Institutional or Schwab Private Trust Services as the custodian for their investment accounts. We base this recommendation on Schwab's capacity to provide reliable custody and trust services as well as efficient trading capabilities. Other factors considered include Schwab's demonstrated ability to provide efficient servicing and consistent reporting, handle routine as well as complex trading requirements and provide our clients with low-cost custody options and competitive lending services. Based on suitability, we also refer clients to Fidelity. Ultimately, it is up to the client to decide the custodian for their accounts.

The qualified custodians send quarterly, or more frequent, account statements directly to our clients. For those custodians that can deliver account statements electronically or via paper, it is up to each client to select the preferred delivery method. The custodian sends a copy of these statements to Badgley Phelps and may also electronically transmit daily transactions to us which are used to update and reconcile our portfolio reporting system. Badgley Phelps urges our clients to carefully review the qualified custodian statements and compare them to the account reports that we send to them. Our reports may vary from our clients' custodial statements due to a difference in accounting procedures, reporting dates or valuation methodologies and pricing sources. We encourage our clients to contact us and their custodian if they identify any discrepancies between the custodian's statements and our account reports. For tax purposes, the custodian statement is the official record of the client's accounts.

Both Schwab and Fidelity make available to us additional products and services that benefit our firm and improve our ability to service our mutual client accounts. These products and services include investment research, as well as technology that allows us to electronically access client account data, facilitates trade execution and the allocation of aggregated trade orders for multiple client accounts plus the processing of client fee payments. Other services made available to us include pricing and access to market data. Schwab also provides services intended to help manage and further develop

our firm's compliance program, business consulting, training, publications and conferences on practice management, succession planning, marketing, operations, and trading. Schwab may arrange payment for certain conferences and has also invited employees to occasional business entertainment events. As discussed elsewhere in this document, we participate in Schwab's new business referral program.

Badgley Phelps does not act as a qualified custodian for client assets, but under certain circumstances (such as when client checks or assets are sent to our firm), we may be deemed to have custody of client funds or securities as defined in Rule 206(4)-2 of the Investment Advisers Act (Custody Rule). Accordingly, we are subject to an annual surprise examination by an independent public accountant. The accounts that are in this category are included in a pool of accounts from which the independent public accountant selects its sample to audit. Badgley Phelps has retained an independent public accountant to conduct the Custody Rule surprise audit and the results of this audit are reported annually to the SEC on Form ADV-E.

Badgley Phelps is also deemed to have custody of client funds when a client signs certain standing letters of authorization directing the client's custodian to accept the authorization of Badgley Phelps to process certain securities and funds transfer requests on behalf of the client. Additionally, as described above under "Item 5 – Fees and Compensation," we have custody when clients give written authorization to Badgley Phelps to deduct our advisory fee directly from the clients' custodial account.

Several of our wealth managers have been appointed trustees of accounts in which the wealth manager has a personal or family relationship with the beneficiary, decedent or grantor of the trust. Additionally, certain client custody agreements, of which Badgley Phelps is not a party to, may grant our firm certain authority which may be interpreted as granting us custody over client assets. Badgley Phelps disclaims and rejects such authority.

## **Item 16 – Investment Discretion**

Badgley Phelps usually receives discretionary authority from the client at the outset of an advisory relationship to select the specific securities and the quantities that are bought or sold. In all cases, however, such discretion is to be exercised in a manner consistent with the stated investment objectives or asset allocation for the particular client account. If the client prefers, Badgley Phelps may also manage client portfolios on a non-discretionary basis. Under a non-discretionary investment management arrangement, Badgley Phelps makes investment recommendations to the client and the client makes the decisions with respect to the investment of the account.

When selecting securities and determining transaction amounts, Badgley Phelps observes the investment policies, limitations and restrictions of the clients that we advise. We prefer that all investment guidelines and restrictions be provided to Badgley Phelps in writing. We also request that

our clients notify us promptly of any changes in their financial circumstances, investment objectives or tax status.

### **Item 17 – Voting Client Securities**

Badgley Phelps has adopted Proxy Voting Policies and Procedures to guide proxy voting on behalf of the clients for whom we vote proxies. The guidelines are not exhaustive and do not cover all potential voting issues because proxy issues and the circumstances of individual companies are varied. As a result, there may be circumstances when proxy votes cast by Badgley Phelps on behalf of our clients are not in strict adherence to these guidelines. Nevertheless, proxy voting is generally cast in adherence to the guiding principles of the proxy policy. Badgley Phelps has established a Proxy Committee which is responsible for proxy voting. Proxy votes cast on behalf of our clients should be cast by us in a manner consistent with the best interests of our clients. Badgley Phelps has established the following guiding principles to assist in analyzing each proxy issue and in providing a framework for decision-making:

- Promote accountability of a company's management and Board of Directors to its shareholders;
- Align the interests of management with those of the shareholders; and,
- Increase disclosure of a company's business and operations.

It is anticipated that the Proxy Committee evaluate proxy issues using information from diverse sources, including Badgley Phelps' wealth managers and research analysts, company management, shareholder groups, and independent sources. To further promote both the Proxy Policy and these voting guidelines, Badgley Phelps has established voting principles for certain matters likely to come to a vote.

Badgley Phelps will vote proxies or a certain proxy for clients when directed in writing to do so by the client. If the client is subject to ERISA and the plan has not specifically withheld the proxy voting responsibility to a named fiduciary, Badgley Phelps will vote the proxies. To facilitate the voting of client proxies, Badgley Phelps uses the ProxyEdge electronic voting service which manages the process of voting, tracking, reporting and maintaining the records of our firm's proxy voting guidelines and principles.

If Badgley Phelps is not directed to vote client proxies, the client's qualified custodian or transfer agent will send proxy statements directly to the client or as per the client's direction. If there is a question regarding a particular proxy solicitation, clients may contact their wealth manager to review this matter.

Clients may obtain a copy of Badgley Phelps' proxy voting policies and procedures upon request. Clients may also request information from Badgley Phelps regarding how we voted any proxies for their particular account(s).

#### **Item 18 – Financial Information**

Registered investment advisers are required in this Item to provide certain financial information or disclosures about Badgley Phelps' financial condition. Badgley Phelps has no financial requirement that impairs its ability to meet contractual and fiduciary commitments to clients, and has not been the subject of any bankruptcy proceeding.