

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3574 / April 4, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30446 / April 4, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15263

In the Matter of

**ZPR INVESTMENT
MANAGEMENT, INC. AND
MAX E. ZAVANELLI**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(e), 203 (f),
AND 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940 AND SECTION 9(b)
OF THE INVESTMENT COMPANY ACT OF
1940**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against ZPR Investment Management, Inc. (“ZPR”) and Max E. Zavanelli (“Zavanelli”) (collectively, “Respondents”).

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. Between October and December 2008, ZPR, through Zavanelli, distributed advertisements to prospective clients that omitted material information which would have revealed that the firm’s historical performance results were underperforming its

benchmark index rather than outperforming it. At the same time, these advertisements, and others that ZPR distributed to clients and prospective clients, misleadingly stated that the firm was in compliance with the Global Investment Performance Standards (“GIPS Standards”) for its performance results.

2. ZPR, through Zavanelli, also distributed advertisements that falsely claimed its performance results had been verified by a GIPS verification firm.

B. RESPONDENTS

1. ZPR is a Florida corporation with principal offices in Orange City, Florida. ZPR has been an investment adviser registered with the Commission since April 2006. Prior to then, ZPR was an investment adviser registered with the Commission from September 1981 until June 2001, when the firm’s assets under management fell below \$25 million and it filed an ADV-W.

2. Zavanelli is 66 and a resident of Deland, Florida. From 1994 through November 2011, Zavanelli was the president, chief operating officer and sole owner of ZPR. He also provided all investment advice to ZPR’s clients. In August 1987, the Commission instituted administrative proceedings against Zavanelli, individually, and doing business as Zavanelli Portfolio Research, for violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-1(a)(5) thereunder for making material misrepresentations and omissions concerning the firm’s investment results from 1979 through 1985. Specifically, the Commission alleged that Zavanelli reported fictitious results and distributed false advertisements to clients and prospective clients. Without admitting or denying the Commission’s allegations, Zavanelli settled to, among other things, a censure and a prohibition from soliciting or accepting new advisory clients for a period of 180 days. See In the Matter of Max Edward Zavanelli, et al., Rel. No. IA-1077 (Aug. 17, 1987).

C. MISLEADING ADVERTISEMENTS

Background

1. ZPR was operated by Zavanelli, its principal officer, and the firm has about 6 other employees. ZPR claims to have discretionary authority over approximately 105 client accounts, with assets under management valued at approximately \$125 million. The vast majority of ZPR’s clients are retail investors. The firm allocates clients’ assets in equities among several strategies, with the majority of the firm’s clients allocated to its Fundamental Small Cap Value composite (“Small Cap Composite”), a proprietary investment strategy.

2. Since at least 2007, ZPR has periodically advertised the performance returns for its various composites in several financial magazines that are geared towards retail clients, including *Smart Money* and *Barron’s*, in newsletters to clients, and on its website located at www.zprim.com.

3. In many of its advertisements, ZPR claimed compliance with the GIPS Standards for its performance results. The GIPS Standards are described as being a set of standardized, ethical principles that provide investment advisory firms with guidance on how to calculate and report their investment results to prospective clients. The GIPS Standards are voluntary and described as being based on the fundamental principles of full disclosure and fair representation of investment performance results. According to the GIPS Standards, the standardization of investment performance reporting gives investors the ability to compare and evaluate investment managers. The GIPS Standards were first released in 1999. The CFA Institute, a global association of investment professionals, created and administers the GIPS Standards.

4. The GIPS Standards require that all advertisements that include a claim of compliance with GIPS and present performance results must adhere to GIPS advertising guidelines. Specifically, the GIPS advertising guidelines, among other things, require that advertisements contain: (1) period-to-date composite performance results; and (2) composite results for either or both of the following time periods: 1-, 3-, and 5-year annualized composite performance returns with the end-of-period date clearly identified; or 5 years of annual composite performance returns. See GIPS at Appendix C, Section B: Advertising Guidelines (effective January 1, 2006); GIPS at Section III.A and III.B: Advertising Guidelines (revised effective January 1, 2011).

Misleading Magazine Advertisements

5. Although ZPR claimed in the advertisements that it complied with the GIPS Standards, several advertisements published in *Smart Money* magazine between October and December 2008 did not include, among other things, the composite's period-to-date performance returns as called for by the GIPS advertising guidelines. ZPR omitted to disclose this key information, which would have revealed that the firm's composite was actually underperforming the Russell 2000 Index ("Russell 2000") during a more recent time period. When ZPR stated that these advertisements were GIPS compliant, it became obligated to speak fully about any material facts on that subject whose absence would make the advertisements misleading. In this instance, by not disclosing the period-to-date returns in these advertisements, as required by the GIPS advertising guidelines, ZPR was able to conceal the fact that it was underperforming the market.

6. The following is an excerpt from a ZPR advertisement published in *Smart Money* magazine's October 2008 issue:

FINDING AN OPPORTUNITY IN A TOUGH MARKET

Performance Thru 6/30/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 10 Yr. Return	277.60%	71.21%	32.87%
Annualized	14.21%	5.52%	2.88%

Although ZPR claimed compliance with the GIPS Standards in this advertisement, it omitted to disclose ZPR's period-to-date performance returns, which would have shown that the firm was underperforming its benchmark index. This advertisement instead misleadingly showed only *compounded* returns for a 10-year period from July 1, 1998 through June 30, 2008 and compared that to the Russell 2000 and S&P 500 indexes. It also included a 14.21% figure which is only an annualized return of ZPR's 10-year compounded return. These performance figures showed the firm as outperforming the indexes over a long-term period. However, had ZPR included period-to-date returns in this advertisement, it would have been shown to be underperforming the Russell 2000 during a more recent time period. Specifically, ZPR would have reported a period-to-date return for the period from January 1, 2008 through June 30, 2008 of **-17.02%**. This compares to a return of **-9.38%** for the Russell 2000 for the same period.

7. The following is an excerpt from another advertisement published in *Smart Money* magazine's November 2008 issue in which ZPR again claimed compliance with GIPS, but omitted to disclose its period-to-date returns, which would have revealed that it was currently underperforming its benchmark:

FINDING AN OPPORTUNITY IN A TOUGH MARKET

Performance Thru 8/31/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 10 Yr. Return	415.14%	148.89%	57.93%
Annualized	17.81%	9.53%	4.68%

Similarly, this advertisement was misleading because it only included performance figures that showed ZPR was outperforming the market over a long-term period. Specifically, the advertisement showed *compounded* returns for a 10-year period from September 1, 1998 through August 31, 2008 and compared that to the Russell 2000 and S&P 500 indexes. In addition, it contained a 17.81% figure which was an annualized return of ZPR's 10-year compounded return. Here, had ZPR included the composite's period-to-date performance record from January 1, 2008 through August 31, 2008, it would have reported a return of **-12.70%**. This compares to a return of **-2.63%** for the Russell 2000 for the same period. Again, ZPR would have been shown to be underperforming during a more recent period.

8. The following is an excerpt from a ZPR advertisement published in *Smart Money's* December 2008 issue:

THINK LONG TERM

Performance thru 8/31/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 20 yr. return	1187.05%	509.76%	565.18%
Compounded 10 yr. Return	357.82%	111.99%	35.20%
Compounded 5 yr. Return	75.45%	47.92%	28.65%

Likewise, this advertisement was misleading because it omitted material information. In this advertisement, ZPR showed 20-year, 10-year, and 5-year *compounded* returns for the period ending September 30, 2008 and compared them to the Russell 2000 and the S&P 500 indexes.¹ However, had ZPR included period-to-date returns in the advertisement, the firm would have reported a **-18.42%** return for the period from January 1, 2008 through September 30, 2008. The Russell 2000's return for the same period was **-10.39%**. Again, ZPR would have been shown to be underperforming during a more recent period.

False Claims of Compliance with GIPS in Magazine Advertisements and Client Newsletters

9. The 2008 *Smart Money* magazine advertisements described above were also misleading because of ZPR's false claim that they were in compliance with the GIPS Standards. In addition to those advertisements, in the February and May 2011 issues of *Smart Money* magazine and a March 2011 issue of *Barron's* magazine, ZPR advertised performance returns for its "Global Equity" and "All Asian" composites while claiming compliance with the GIPS Standards. ZPR also falsely claimed that these advertisement where GIPS compliant, when in fact they were not. Specifically, these advertisements failed to include certain GIPS required information such as 3 and 5 year annualized returns or 5 years of annual returns.

10. In addition, during the relevant period, ZPR, through Zavanelli, distributed monthly newsletters to the firm's clients, and made these newsletters available through ZPR's website. Several of ZPR's newsletters disseminated in 2008 and 2009 made reference to the firm's GIPS compliance, but failed to include performance returns that complied with GIPS. For example, ZPR's April and December 2009 newsletters claimed compliance with GIPS. Yet, the performance results included in those newsletters did not include period-to-date returns.

¹ The performance returns in this advertisement actually reflect data through September 30, 2008. The reference to "8/31/08" in the heading of the first column of the advertisement is a typographical error.

False Statements Regarding its GIPS Verification Firm and the SEC's Investigation

11. ZPR, through Zavanelli, also advertised the performance returns for the Small Cap Composite in reports published by Morningstar, Inc.² These Morningstar reports were advertisements because they were made available to the public on Morningstar's website and ZPR referenced its Morningstar rating in its *Smart Money* and *Barron's* magazine advertisements. In a Morningstar report containing ZPR's performance figures for the period ending September 30, 2010, the firm stated that its results had been "audited for GIPS compliance for the period December 31, 2000 to the present" by Ashland Partners & Company, LLP ("Ashland"), its GIPS verification firm. This was a false statement. In fact, Ashland resigned as ZPR's GIPS verification firm in July 2010 and its last report attesting to ZPR's compliance with GIPS covered the period ending December 31, 2009.

12. Moreover, in that same Morningstar report and in a later one for the period ending March 31, 2011, ZPR falsely indicated in the disclosure checklist section of the report that it was not under a "pending SEC investigation" at the time.

D. VIOLATIONS

1. As a result of the conduct described above, ZPR willfully violated Sections 206(1) and 206(2) of the Advisers Act, which make it unlawful for any investment adviser: (i) to employ any device, scheme, or artifice to defraud any client or prospective client; and (ii) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

2. As a result of the conduct described above, Zavanelli willfully violated or, in the alternative, aided and abetted and caused ZPR's violations of Sections 206(1) and 206(2) of the Advisers Act, which make it unlawful for any investment adviser: (i) to employ any device, scheme, or artifice to defraud any client or prospective client; and (ii) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

3. As a result of the conduct described above, ZPR willfully violated, and Zavanelli willfully aided and abetted and caused ZPR's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5), promulgated thereunder, which make it unlawful for any investment adviser to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative, including publishing, circulating or distributing any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

² Morningstar, Inc. is a provider of stock market analysis and mutual fund and other financial instrument ranking services. Morningstar collects data through monthly surveys of the money managers in its database and makes this information available to the public on its website.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent ZPR pursuant to Section 203(e) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent Zavanelli pursuant to Section 203(f) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, civil penalties pursuant to Section 9 of the Investment Company Act;

E. Whether, pursuant to Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-1(a)(5) thereunder.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall each file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary