

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 75319 / June 29, 2015**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4132 / June 29, 2015**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 31699 / June 29, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16657**

**In the Matter of**

**WELHOUSE &  
ASSOCIATES, INC., AND  
MARK P. WELHOUSE,**

**Respondents.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
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 United States Securities and Exchange Commission (the “Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), 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 Welhouse & Associates, Inc. (“Welhouse”) and Mark P. Welhouse (“Mr. Welhouse”) (collectively, “the Respondents”).

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. SUMMARY**

1. From approximately February 2010 to January 2013 (the “relevant time period”), Mark P. Welhouse, the sole owner of Welhouse & Associates, Inc., an investment adviser registered with the State of Wisconsin, engaged in fraudulent trade allocation – “cherry-picking.”

Mr. Welhouse executed his cherry-picking scheme by unfairly allocating options trades in an S&P 500 ETF called SPY. He disproportionately allocated those trades that had appreciated in value during the course of the day to his personal and business accounts, while allocating trades that had depreciated in value during the day to the accounts of his advisory clients. He did this by purchasing the options in an omnibus account and delaying allocation of the purchases until later in the day, after he saw whether the securities appreciated in value.

2. By virtue of their conduct, the Respondents willfully violated Section 10(b) of the Exchange Act [15 U.S.C. §§78j(b)] and Rule 10b-5 [17 C.F.R. §§240.10b-5] promulgated thereunder, and Sections 206(1) [15 U.S.C. §80b-6(1)] and 206(2) [15 U.S.C. §80b-6(2)] of the Advisers Act.

## **B. RESPONDENTS**

3. **Welhouse & Associates, Inc.**, is a company with its principal place of business in Appleton, Wisconsin and has been registered with the State of Wisconsin as an investment adviser since 1999. According to the most recent Form ADV filed in January 2013, Welhouse had approximately 72 accounts and a total of \$4.8 million under management. Welhouse is wholly owned and controlled by Mr. Welhouse. Welhouse's clients are individuals and families.

4. **Mark. P. Welhouse**, age 58, resides in Appleton, Wisconsin. Mr. Welhouse is the owner, principal, and CCO of Welhouse, which he formed in 1999.

## **C. RESPONDENTS' CONDUCT**

### ***Mr. Welhouse Claimed That His SPY Trades Were Allocated Pro Rata***

5. During the relevant time period, Mr. Welhouse and Welhouse's clients had their accounts in custody at a brokerage firm ("the broker"). To execute options trades, Mr. Welhouse made trades in a master account at the broker and later allocated the trades to either his or his clients' accounts.

6. Mr. Welhouse was interviewed by the Commission staff on January 28, 2014. Mr. Welhouse agreed that the interview could be recorded, and the staff recorded the interview. During that recorded interview, Mr. Welhouse claimed that to allocate a trade, he needed to manually create a spreadsheet with the trade allocation and then submit the spreadsheet on the broker's trading platform. Mr. Welhouse said his practice was to submit the trade allocation for each account to the broker before 5:00 p.m. on the date the trade was made. Mr. Welhouse stated that he used one master account for trades in his four personal accounts and a different master account for his clients' trades. Despite this statement, Mr. Welhouse also stated that there were times when he allocated SPY options trades from the client master account to his personal accounts. Mr. Welhouse called these allocations "mistakes" and stated that the broker called many times and expressed concern about his allocating SPY options from the clients' master account to his personal accounts.

7. Mr. Welhouse said that during the relevant time period, in investing his clients' funds, he followed four investment models: conservative, moderate, aggressive, and options. Mr. Welhouse said that the options model traded only SPY options, but that he also traded SPY options in the other models.

8. Mr. Welhouse stated that he allocated all trades pro rata across all accounts for a particular model (including pro rata across Mr. Welhouse's own accounts and his clients' accounts that were on the same model). Mr. Welhouse also stated that Welhouse's January 2012 Form ADV Part 2A's reference to fair and equitable trade allocation is a reference to Mr. Welhouse's pro rata allocation across a model. Additionally, Welhouse's firm brochures on Form ADV, which the Respondents were required to provide to clients, stated that Welhouse did not trade for its own account and that it restricted the trading of employee's accounts. Welhouse's firm brochures did not disclose that Mr. Welhouse invested in, or bought and sold, the same securities that he recommended to clients, failed to discuss the conflicts of interest such trading presents, and did not disclose how Welhouse addresses the conflicts posed by personal trading, as required by Form ADV. Accordingly, parts of Welhouse's Form ADV, Part 2A were false or misleading. In addition, the Respondents did not otherwise disclose the facts underlying the material conflict of interest posed by Mr. Welhouse's purchase and sale of SPY options for both himself and his advisory clients.

9. Welhouse's written policies and procedures for trade allocation state: (1) "[a]ll clients are assigned to a model portfolio. . ."; and (2) "[w]hen a trade is put on the trade is purchased by the model portfolio and automatically allocated to the clients account" on a pro rata basis. The Welhouse trade allocation policies and procedures also state: "We do not have written order tickets or spreadsheet documents reflecting allocations of orders. Our model portfolios have been in use for over 10 years. Our trade allocations are built into our model portfolios."

#### ***Welhouse's SPY Options Trades Were Not Allocated Pro Rata***

10. Contrary to Welhouse's policies and procedures and its Form ADV statements, Mr. Welhouse, on behalf of Welhouse, did not allocate SPY options trades pro rata. During the relevant time period, Mr. Welhouse allocated a disproportionate number of profitable SPY options trades to favored accounts (accounts belonging to Mr. Welhouse or another person with the last name Welhouse), while allocating unprofitable SPY options trades to client accounts. Mr. Welhouse did so by trading securities in a master account, typically using a day-trading strategy, and then delaying the allocations until later in the day when he could determine whether trades had appreciated or declined in value. During the relevant time period, approximately 58% of SPY options trades occurred before 11:00 a.m. while about 58% of SPY options trades were allocated to accounts after 2:00 p.m. Moreover, approximately 47% of SPY options trades were allocated to accounts after 3:00 p.m., during the last hour of regular market hours for options trading. This delay allowed Mr. Welhouse to selectively allocate profitable trades to his personal accounts.

11. For trades that increased in value on the day of the purchase, Mr. Welhouse often day-traded by selling the option on the same day he purchased it, allocating a disproportionate share of those profitable day trades to his personal accounts. For trades that decreased in value on the day of the purchase, Mr. Welhouse often did not sell the option on the day of purchase; he

allocated a disproportionate share of these trades to his clients' accounts.

12. According to the broker's internal compliance notes, an employee of the broker told Mr. Welhouse in April 2010 that the broker was monitoring his trade allocations. During this conversation, Mr. Welhouse agreed to separate his personal and client trading in different accounts. Following the April 2010 conversation, the broker's trade allocation surveillance system flagged Mr. Welhouse's joint account nine times between May 2011 and September 2012. In February 2012, another employee of the broker called Mr. Welhouse again because he seemed to be making preferential trade allocations from his clients' master account to his personal account. Mr. Welhouse returned the employee's call, and, during the recorded telephone call, the employee reminded Mr. Welhouse to keep his personal trading separate from his clients' master account and Mr. Welhouse agreed he would do so. Then, in June 2012, another employee of the broker called Mr. Welhouse and told him that he was continuing to allocate trades to his personal account from his clients' master account, which had the appearance of preferential trade allocation. The employee reminded Mr. Welhouse of the two prior conversations on the same issue, and the employee told Mr. Welhouse that the broker would consider blocking allocations from a master account to his personal accounts if the practice continued. In September 2012, the broker flagged Mr. Welhouse's trade allocation a ninth and final time. In December 2012, the broker terminated its relationship with Mr. Welhouse.

13. Mr. Welhouse stated that he had allocated from the clients' master account to his personal account several times and that the broker had spoken to him about this practice numerous times before it ceased. Mr. Welhouse stated that any allocations from the clients' master account to his personal account were "mistakes." To support his claims that he had allocated trades pro rata, Mr. Welhouse described how, based on his memory, the performance of his clients' SPY options trades during the period 2009 to 2013 was similar to that of his own SPY options trades.

#### ***Mr. Welhouse Reaped Substantial Profits From His Cherry-Picking Scheme***

14. Commission staff in the Division of Economic and Risk Analysis ("DERA") analyzed first-day profits and one-day returns for both Mr. Welhouse's personal accounts and his clients' accounts. To do this, DERA first classified all SPY options trades as either day trades or multi-day trades. Day trades are those where both the purchase and sale occur on the same day. All other trades are multi-day trades. DERA analyzed only the first-day return of both day trades and multi-day trades because it is only on the day of purchase, when Mr. Welhouse allocated the trade, that he had the opportunity to cherry-pick the profits.

15. During the relevant time period, Mr. Welhouse allocated 496 SPY options trades to his personal accounts and 1,127 to his clients. The total cost of these trades was \$7.25 million for Mr. Welhouse's personal accounts and \$8.46 million for his clients' accounts. Mr. Welhouse's total first-day profits on these 496 trades was \$455,277. In contrast, Mr. Welhouse's clients suffered a total first-day loss of \$427,190. The average first-day return for the trades Mr. Welhouse allocated to himself was 6.28%, while his clients' average first-day return was -5.05%. Combined, the first-day return for all SPY options trades was \$28,087, for an average first-day return of 0.18%. In other words, if Mr. Welhouse had allocated all SPY options' first-day

returns on a pro rata basis, every SPY options client (including Mr. Welhouse and all his clients who owned SPY options) would have had made a first-day return of 0.18%. By comparing Mr. Welhouse's actual first-day returns of 6.28% to the overall average of 0.18%, DERA concluded that Mr. Welhouse reaped \$442,319 in ill-gotten gains.

16. The following chart summarizes the profitability of the SPY option trading:

SPY-Options	Investment	1-Day Profits	1-Day Return	N	Average Profit Per Trade
<b><u>Panel A: All Trades</u></b>					
Welhouse Accounts	\$7,248,754	\$455,277	6.28%	496	\$918
Non-Welhouse Accounts	<u>\$8,463,500</u>	<u>-\$427,190</u>	<u>-5.05%</u>	<u>1,127</u>	<u>-\$379</u>
All Accounts	\$15,712,254	\$28,087	0.18%	1,623	\$17
<b><u>Panel B: Day Trades</u></b>					
Welhouse Accounts	\$5,622,098	\$560,883	9.98%	334	\$1,679
Non-Welhouse Accounts	<u>\$3,913,718</u>	<u>\$139,194</u>	<u>3.56%</u>	<u>487</u>	<u>\$286</u>
All Accounts	\$9,535,815	\$700,077	7.34%	821	\$853
<b><u>Panel C: Multi-Day Trades</u></b>					
Welhouse Accounts	\$1,626,657	<u>-\$105,606</u>	<u>-6.49%</u>	162	<u>-\$652</u>
Non-Welhouse Accounts	<u>\$4,549,782</u>	<u>-\$566,384</u>	<u>-12.45%</u>	<u>640</u>	<u>-\$885</u>
All Accounts	\$6,176,439	<u>-\$671,990</u>	<u>-10.88%</u>	802	<u>-\$838</u>

17. The difference between Mr. Welhouse's first-day profit and that of his clients is highly statistically significant. To test whether the first day profitability of trades allocated to Mr. Welhouse's personal accounts was significantly different from that of those allocated to his clients' accounts, a simulation was run one million times. The simulation tests the possibility that although Mr. Welhouse's accounts were very profitable, he simply selected a lucky combination of trades by chance. Mr. Welhouse's \$455,277 profit was substantially higher than every one of the one million random simulations. These results show that there is only an

infinitesimal likelihood of achieving by chance a profit like Mr. Welhouse's. Finally, when comparing the proportion of profitable trades allocated to Mr. Welhouse's accounts to the proportion of profitable trades allocated to Mr. Welhouse's clients' accounts, the likelihood of Mr. Welhouse's personal accounts receiving such a high proportion of profitable trades by pure random chance is less than one in one trillion.

***Welhouse's clients were not aware of the cherry-picking scheme***

18. Mr. Welhouse's clients were not aware that he was trading options in their accounts, or that he was using those accounts to further his own interests by cherry-picking profitable day trades. The Commission staff interviewed three Welhouse clients who experienced significant investment losses on SPY options trades, including unprofitable first day returns. In each instance, the client considered himself or herself to be an inexperienced investor seeking a conservative approach in managing his or her accounts. None of the clients was aware that he or she had invested in options on the S&P 500 Index, and two of the clients did not know what options were. Each of the clients' practice was to review the total account value in a periodic account statement, and these clients did not review the performance of underlying account holdings. Although these reviews could have revealed Mr. Welhouse was trading options, they could never have revealed the cherry-picking scheme. One of the clients recalled significant account losses. When the client asked Mr. Welhouse about the losses, Mr. Welhouse told the client that he had experienced the same losses in his personal accounts. Mr. Welhouse did not reveal that he was selectively allocating trades to client accounts.

**E. VIOLATIONS**

19. By knowingly or recklessly allocating profitable trades to Mr. Welhouse's own accounts at the expense of advisory clients and making false and misleading statements to clients concerning trade allocation and trading for Mr. Welhouse's own account, Mr. Welhouse and Welhouse willfully<sup>1</sup> violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and, in the alternative, Mr. Welhouse willfully aided and abetted and caused Welhouse's violations. Section 10(b) of the Exchange Act makes it unlawful for any person to use or employ, in connection with the purchase or sale of any security any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. Rule 10b-5 under the Exchange Act makes it unlawful for any person, directly or indirectly, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

20. In addition, through this cherry-picking scheme and by failing to disclose the scheme, Mr. Welhouse and Welhouse willfully violated Sections 206(1) and 206(2) of the

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<sup>1</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Advisers Act, and, in the alternative, Mr. Welhouse willfully aided and abetted and caused Welhouse's violations. Mr. Welhouse and Welhouse also violated Sections 206(1) and 206(2) by making false or misleading statements to clients in Part 2 of Welhouse's Form ADV and by not otherwise disclosing the facts setting forth their conflicts of interest. Section 206(1) of the Advisers Act prohibits any investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client, and Section 206(2) of the Advisers Act prohibits any investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that 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 Respondents pursuant to Sections 203(e) and 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act, including disgorgement pursuant to section 9(e) and civil penalties pursuant to section 9(d); and

D. Whether, pursuant to Section 21C of the Exchange Act and 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 Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act, whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act.

### 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 either of the Respondents fail to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against him 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.

Brent J. Fields  
Secretary