

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

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4502 / August 25, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17498**

**In the Matter of**

**J.J.B. HILLIARD,  
W.L. LYONS, LLC**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against J.J.B. Hilliard, W.L. Lyons, LLC (“Respondent” or “Hilliard Lyons”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

**III.**

On the basis of this Order and Respondent’s Offer, the Commission finds<sup>1</sup> that:

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<sup>1</sup> The findings herein are made pursuant to Respondent’s Offer and are not binding on any other person or entity in this or any other proceeding.

## Summary

1. This matter arises from misstatements made by registered investment adviser Hilliard Lyons to certain of its advisory clients, including clients with separately managed accounts invested in F-Squared Investments, Inc.'s ("F-Squared") strategy. Hilliard Lyons advertised the strategy by negligently relying on F-Squared's materially inflated, and hypothetical and back-tested, performance track record that F-Squared misrepresented.

2. AlphaSector is a sector rotation strategy based on an algorithm that yields a signal indicating whether to buy or sell nine industry exchange-traded funds ("ETFs") that together made up the industries in the S&P 500 Index. Between December 2011 and September 2013, Hilliard Lyons offered the AlphaSector strategy to its clients.

3. From November 2011 to October 1, 2013, in reliance on F-Squared's false statements, Hilliard Lyons's AlphaSector advertisements falsely stated that the track record had significantly outperformed the S&P 500 Index from April 2001 to September 2008. In fact, F-Squared miscalculated the historical performance of AlphaSector from April 2001 to September 2008 by incorrectly implementing signals in advance of when such signals actually could have occurred. Hilliard Lyons took insufficient steps to confirm the accuracy of F-Squared's historical data and other information contained in the materials. In addition, Hilliard Lyons did not obtain sufficient documentation that substantiated F-Squared's advertising claims in the materials. As a result of this inaccurate compilation of historical data by F-Squared, Hilliard Lyons advertised the AlphaSector strategy by using hypothetical and back-tested historical performance that was inflated substantially over what performance would have been if F-Squared had applied the signals accurately.

4. As a result, Hilliard Lyons violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by publishing, circulating, and distributing advertisements that contained untrue statements of material fact. Hilliard Lyons likewise did not make and keep true, accurate and current records or documents necessary to form the basis for or demonstrate the calculation of the performance or rate of returns that it circulated and distributed, as required by Section 204(a) of the Advisers Act and Rule 204-2(a)(16) thereunder.

## Respondent

5. **J.J.B. Hilliard, W.L. Lyons, LLC** (SEC File No. 801-23120) is an investment adviser and broker-dealer registered with the Commission since 1984 (as an investment adviser) and 1985 (as a broker-dealer) and is headquartered in Louisville, Kentucky. A predecessor entity was registered with the Commission beginning in 1972 (as an investment adviser) and 1973 (as a broker-dealer). Hilliard Lyons and its predecessors have been operating since 1854. As of

October 29, 2015, Hilliard Lyons had regulatory assets under management of more than \$6.1 billion.<sup>2</sup>

### **Other Relevant Persons**

6. **F-Squared Investments, Inc.** (“F-Squared”) (SEC File No. 801-69937) is an investment adviser that was registered with the Commission from March 2009 until January 2016, and is headquartered in Wellesley, Massachusetts. In October 2008, F-Squared launched its first AlphaSector index. F-Squared sub-licensed its approximately 75 AlphaSector indexes to unaffiliated third parties who managed assets pursuant to these indexes. On December 22, 2014, the Commission instituted a settled fraud action against F-Squared in which F-Squared admitted, among other things, to making the materially false claims that (a) the signals that formed the basis of the AlphaSector index returns had been used to manage client assets from April 2001 to September 2008; and (b) the signals resulted in a track record that significantly outperformed the S&P 500 Index from April 2001 to September 2008. *See In the Matter of F-Squared Investments, Inc.*, Admin. Proceeding No. 3-16325 (Dec. 22, 2014).

7. **Howard Brian Present** (“Present”), age 55, resides in Wellesley, Massachusetts. In 2006, Present co-founded F-Squared and was the President and CEO until his separation in 2014. On December 22, 2014, the Commission filed a civil complaint alleging fraud charges against Present in the United States District Court for the District of Massachusetts, which is pending. *See SEC v. Present*, No. 1:14-cv-14692 (D. Mass. filed Dec. 22, 2014).

### **Facts**

#### **Hilliard Lyons’s Relationship With F-Squared**

8. In 2011, a due diligence provider retained by Hilliard Lyons recommended F-Squared’s AlphaSector strategies to Hilliard Lyons. Hilliard Lyons began considering whether it would enter into a model manager agreement with F-Squared whereby Hilliard Lyons would establish an investment product based on F-Squared’s AlphaSector sector rotation strategy. F-Squared marketed AlphaSector to Hilliard Lyons as an ETF sector rotation strategy that was based on an algorithm that yields a “signal” indicating whether to buy or sell nine industry ETFs.<sup>3</sup> If the algorithm produced buy signals for three or fewer sector ETFs, the AlphaSector strategy provided for some or all of the assets to be invested in cash equivalents.

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<sup>2</sup> Regulatory assets under management include the securities portfolios for which Hilliard Lyons provides continuous and regular supervisory or management services.

<sup>3</sup> F-Squared created several AlphaSector strategies and sub-licensed approximately 75 AlphaSector indexes. The AlphaSector indexes that are the subject of this matter, including the AlphaSector Premium Index and the AlphaSector Rotation Index, are based on investments in U.S. equity ETFs. As with all indexes, the performance of the AlphaSector Premium Index and AlphaSector Rotation Index is inherently hypothetical in the sense that the indexes do not purport to reflect the performance of any particular client or account. However, the AlphaSector Premium Index and AlphaSector Rotation Index were advertised as being based on a strategy that had been in place since 2001 and therefore the

9. F-Squared described the strategy falsely to Hilliard Lyons by, among other things, representing that: (a) the AlphaSector strategy had been used to manage client assets from April 2001 to September 2008, often calling it a “live” track record; and (b) the track record had significantly outperformed the S&P 500 Index from April 2001 to September 2008. In reality, no assets tracked the strategy until 2008 and the back-tested track record was substantially overstated. F-Squared’s AlphaSector sales and marketing materials shared with Hilliard Lyons claimed that clients actually achieved these performance returns for the April 2001 to September 2008 time period. In turn, another service provider retained by Hilliard Lyons took portions of F-Squared’s advertisements, including claims concerning the significant outperformance claim, which Hilliard Lyons disseminated in its own advertisements to its clients and prospective clients without having a reasonable basis to conclude that F-Squared’s exceptional performance claims were true.

### **Hilliard Lyons’s Advertisements Contained Misstatements**

10. From November 2011 to October 1, 2013, Hilliard Lyons, in advertising its own advisory services, disseminated AlphaSector performance advertisements for its own separately managed account strategies that substantially overstated the performance of the back-tested track record during this period based on the false information provided by F-Squared. Hilliard Lyons typically distributed these advertisements to its clients and prospective clients, largely during in-person client meetings. In February 2012, Hilliard Lyons added the following disclosure to some of its advertisements: “*Returns illustrated are hypothetical performance that an investor may have obtained had they invested in the strategy; the performance returns are not based on a composite or actual client returns. Returns are based on an Index that follows the F-Squared Alpha-Sector Premium Strategy.*” (Emphasis in original.) Revised disclosures were sent to all existing clients, but the advertisement continued to contain the substantially overstated performance calculation and never disclosed that the hypothetical performance also was back-tested. In its Form ADV, Hilliard Lyons separately disclosed that it used a third-party due diligence provider, and that “neither Hilliard Lyons nor its due diligence service independently verifies the money managers’ performance information.” In October 2013, Hilliard Lyons removed the references in its advertising materials to any performance information of F-Squared for periods prior to September 2008. On October 28, 2013, Hilliard Lyons discontinued accepting new accounts with F-Squared. The last client assets were withdrawn in March 2014, and Hilliard Lyons replaced F-Squared with another provider entirely. Hilliard Lyons disclosed these changes to its advisory clients at those times.

### **Hilliard Lyons Failed to Have A Reasonable Basis to Believe the Accuracy of the Performance and Performance-Related Claims in the Advertisements**

11. Hilliard Lyons knew or should have known that it did not have a reasonable basis to believe that AlphaSector’s advertising claims were accurate. Hilliard Lyons knew or should

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performance of these indexes was advertised as “not backtested” when in fact the performance *was* back-tested.

have known that F-Squared's AlphaSector strategy purported performance contained in Hilliard Lyons's advertising materials was exceptional over the 2001-2008 period in that it significantly outperformed the S&P 500 Index. Hilliard Lyons also knew or should have known that F-Squared claimed that the performance involved actual results notwithstanding that the AlphaSector strategy was not launched until 2008. Hilliard Lyons and the due diligence providers it retained relied on documents making performance claims that were prepared and provided by F-Squared without any other substantiation. Having taken insufficient steps to confirm the accuracy of the AlphaSector performance data and not having obtained sufficient documentation that would have substantiated F-Squared's advertised performance and performance-related claims in Hilliard Lyons's advertising materials, Hilliard Lyons failed to have a reasonable basis to believe that AlphaSector's performance was accurate when included in its own advertisements for clients considering the strategy.

### **Hilliard Lyons Failed to Maintain Adequate Books and Records**

12. Hilliard Lyons was required to make and keep true, accurate and current records or documents necessary to form the basis for or demonstrate the calculation of the performance or rate of return that it circulated or distributed to ten or more persons. In marketing its own advisory services, Hilliard Lyons circulated and distributed the 2001-2008 historical performance of the AlphaSector strategy in client presentations and marketing materials and other communications to numerous clients, investors, and potential investors. However, Hilliard Lyons failed to keep sufficient records or documents to form the basis for or demonstrate the calculation of the historical performance or rate of return of the AlphaSector strategy.

### **Violations**

13. As a result of the conduct described above, Respondent violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which make it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act to, among other things, directly or indirectly publish, circulate, or distribute an advertisement which contains any untrue statement of material fact, or which is otherwise false or misleading. A violation of Section 206(4) and the rules thereunder does not require scienter. *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992).

14. As a result of the conduct described above, Respondent violated Section 204(a) of the Advisers Act and Rule 204-2(a)(16) thereunder. Section 204(a) of the Advisers Act requires investment advisers to make and keep certain records as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204-2 under the Advisers Act requires investment advisers registered or required to be registered to make and keep true, accurate and current various books and records relating to their investment advisory business, including all accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(k) of the Advisers Act, Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 204(a) and 206(4) of the Advisers Act and Rules 204-2(a)(16), and 206(4)-1(a)(5) thereunder.

B. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty of two hundred thousand dollars (\$200,000) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Hilliard Lyons as the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Jeffrey B. Finnell, Assistant Director, Asset Management Unit, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5010.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such

a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary