



# ADV Brochure, Part 2A

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**Palouse Capital Management, Inc.**  
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This brochure provides information about the qualifications and business practices of Palouse Capital Management, Inc. If you have any questions about the contents of this brochure, please contact us at (509) 624-5591 or (800) 624-3833. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

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

## II. Summary of Material Changes

Palouse Capital Management, Inc.'s (PCM) most recent annual update to Part 2 of Form ADV was completed March 2017. Material changes to PCM's business activities since the time of that update: None

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## IV. Advisory Business

PCM provides discretionary investment advisory services primarily for individuals, corporations, public and private pension plans, endowments, and foundations. Discretionary client portfolios may invest in equities, fixed income, open or closed end mutual funds, exchange traded funds (ETFs) or a combination of the above depending upon the PCM investment strategy selected by the client. A portion of the client's portfolio may also be invested in short term instruments (such as cash equivalents or money market funds) as a result of the normal buying and selling discipline in the portfolio management process (taking into account prevailing market conditions and the PCM investment strategy discipline).

Discretionary clients deposit account assets with their selected custodian and then they typically work with their financial consultant to determine an investment strategy based on personal circumstances, objectives, and risk tolerance. Clients choosing PCM to provide investment advisory services sign an investment advisory agreement giving PCM the authorization to effect security transactions on behalf of their portfolio. Portfolio Managers at PCM provide investment advice specific to assets placed under management and the strategy selected. Within the Investment Management Agreement, the client must provide specific financial information as well as their desired investment strategy. PCM permits discretionary clients to impose restrictions on the types of securities purchased for their accounts.

The discretionary portfolios are individually managed and monitored based on subjective and objective analysis of fundamental and technical factors. In addition, cyclical analysis is used to determine what may appear to be appropriate investments based upon economic and industry business cycles. Account positions are monitored continuously and portfolio changes are made as deemed appropriate. Because accounts are managed individually, portfolios with the same or similar investment objectives may differ as to securities held and performance achieved.

In some cases, PCM has been retained as an investment manager under a so-called "wrap-fee" arrangement for separately managed account programs sponsored by certain unaffiliated broker-dealers (the "Program Sponsors"). Under such wrap-fee arrangements, Program Sponsors may recommend that a client retain PCM as an investment advisor, pay investment advisory fees on behalf of the client (a percentage of which are shared with PCM as compensation for its services), monitor and evaluate PCM's performance, execute the client's portfolio transaction without commission charge, and provide custodial services for the client's assets, all for a single fee paid by the client to the Program Sponsor. Wrap-fee arrangements generally involve the client entering into an investment advisory agreement with the Program Sponsor while PCM enters into a sub-advisory agreement with the Program Sponsor. The wrap programs and the sponsor in which PCM currently provides services are: Masters Investment Consulting Services (Masters) and Diversified Managed Allocations (DMA) through Wells Fargo Advisors, LLC.

For more information regarding any of the wrap-fee programs offered by any of the Program Sponsors in which PCM participates, please see Schedule D of each Program Sponsor's Form ADV Part 1A as well as Appendix 1 of their Form ADV Part 2A. PCM manages wrap-fee clients in the same manner that it manages non-wrap-fee clients.

In addition, PCM has entered into agreements with other financial firms (Model Program Sponsors) to provide model portfolio investment recommendations. These Model Program Sponsors use the information supplied by PCM to provide investment management services to their clients. The Model Program Sponsors retain discretion to accept, modify, or reject PCM's recommendations and are responsible for executing any trades. The Model Program Sponsors' clients are not PCM clients.

PCM is not responsible for certain functions typically completed by or with a broker/custodian, (i.e., calculation of required minimum distribution, referring of other financial solutions such as life insurance, annuities, other financial planning, etc., processing of deposits and withdrawals, wiring of funds, custodial address-of-record changes, calculation of breakpoint discounts for mutual fund investments, tax reporting, initial selection of money market funds, asset allocation studies, SIPC or account protection coverage, etc.); this list is in no way meant to be all-encompassing. Clients should review the financial stability and insurance carried by their chosen custodian. PCM carries no liability for any loss resulting from any financial instability, insolvency of the custodian, or acts of the employees of the custodian. Insurance carried by the custodian may or may not provide full protection for losses. Clients should contact their financial consultant with questions regarding their custodian.

PCM does not offer or provide tax, legal, or accounting advice, nor is PCM responsible for tax reporting for clients. Dividends, interest, and capital gains generated in a Client's account may be subject to taxation. Implementation of, or a change to the investment strategy may create a taxable event for the client. Cost basis (as provided by the client) information provided in PCM's quarterly reports (as applicable) is provided for information purposes only and should not be used for tax preparation. All tax or legal related inquiries should be directed to a qualified tax professional or legal counsel.

Clients should always deposit securities or funds directly with their respective custodians, not with PCM.

PCM, formerly Ken Roberts Investment Management, Inc., was founded in 1991 and became registered with the SEC as an investment adviser in 1994, is currently owned equally by Barry Menne and Bryn Harman. (*SEC registration does not imply a certain level of skill or training.*). As of December 31, 2017 PCM managed approximately \$347.9 million in discretionary assets on behalf of approximately 713 accounts. In addition, the assets that participated in the previously described Model Programs as of December 31, 2017 were approximately \$4.7 million. For the Model Programs, PCM only offers non-discretionary model portfolio investment recommendations and has no control over the implementation of investment decisions or trading authority for these assets.

## V. Fees and Compensation

### Management Fees-General Conditions

See appropriate section below for information specific to the type of Managed Account Program

PCM's fee for managing portfolios is paid every three months, generally in advance based on the value of the account on the last business day of the preceding calendar quarter. Fees can be negotiated and may be offered by PCM at lower rates depending upon the circumstances and size of the account. Lower fees for comparable services may be available from other sources. PCM does not combine or household the balances of multiple accounts belonging to any one client for the purpose of calculating management fees.

#### SMALL/MID VALUE

<u>Annual Fee</u>	<u>Account Value</u>
0.85% of the first .....	\$10 Million
0.80% of the next .....	\$15 Million
Negotiable over .....	\$25 Million

#### LARGE-CAP VALUE

<u>Annual Fee</u>	<u>Account Value</u>
0.75% of the first .....	\$5 Million
0.50% of the excess over .....	\$5 Million

#### LARGE-CAP VALUE TOTAL RETURN

<u>Annual Fee</u>	<u>Account Value</u>
0.75% of the first .....	\$5 Million
0.50% of the excess over .....	\$5 Million

#### DIVERSIFIED INCOME & BALANCED

<u>Annual Fee</u>	<u>Account Value</u>
0.60% of the first .....	\$5 Million
0.40% of the excess over.....	\$5 Million

#### ALL-CAP TILT

<u>Annual Fee</u>	<u>Account Value</u>
0.75% of the first .....	\$5 Million
0.50% of the excess over.....	\$5 Million

#### ETF MODEL PORTFOLIO

<u>Annual Fee</u>	<u>Account Value</u>
0.75% of the first .....	\$5 Million
0.50% of the excess over.....	\$5 Million

Either party may terminate the Investment Management Agreement at any time upon written notice. Termination of the agreement does not affect or preclude the consummation of any transaction initiated prior to termination. In the event of termination, a pro-rata management fee will be calculated based on the date of notification to PCM or in the case of a wrap account based on the date as determined by the Program Sponsor. The client will then be charged the pro-rata fee or refunded the unused portion in the event that the client had already paid their full quarterly management fee.

PCM's fee (or PCM's portion of a wrap fee) does not include any transaction costs, execution, or other service, brokerage, or custody charges. Fees may be waived or reduced for the accounts of PCM and PCM employees and their family members.

### **Management Fees-Non-Wrap Programs**

The annual compensation received by PCM is based upon a percentage of the market value of the assets under management using trade date accounting. The management fees charged by PCM are separate and distinct from the fees and expenses charged by the client's broker-dealer, custodian, or fund (if mutual funds are held in a client's account).

If the account is accepted after the first day of a calendar quarter, the fee for the initial quarter will be pro-rated based on the number of days left in the quarter and the opening balance of the account as provided by the client's broker/custodian. The effective date for billing on new accounts is generally the date in which PCM accepts the Investment Management Agreement.

Payment of fees can be made directly by the client; or the client may authorize, in writing, their qualified custodian to debit fees from their account. The client's qualified custodian must send to the client a statement, at least quarterly, identifying the amount of funds and each security in the account at the end of the period and set forth all transactions in the account during that period.

Clients occasionally request that their account be placed in a frozen or suspended status and temporarily removed from active management. In the event of a freeze for legal reasons (for example death, title change, divorce, etc.), a pro-rata refund of the fee, which had been paid in advance, will be made for the period that the account was in frozen status. In circumstances that are for non-legal reasons PCM will continue to charge the management fee. It is the responsibility of the client to notify PCM when an account is to be placed in or removed from frozen status; however, PCM will accept indications of account status change from the financial consultant (which are followed with a letter sent by PCM to the client indicating the change in status).

### **Management Fees-Wrap Programs**

A Wrap Program involves a single fee (wrap fee) paid by the client to the Program Sponsor for all investment advisory, custodial, and other services. The Program Sponsor is responsible for calculating the wrap fee, a portion of which is forwarded to PCM as management fees. The annual fee paid by the client to the Program Sponsor can be up to 2.75% of the client's assets under management, from which PCM's portion of the fee is paid by the Program Sponsor. The Program Sponsor may calculate its fees based on trade date or settlement date accounting. New accounts are billed based on the date the account is approved (which may differ from the PCM inception date) for eligible assets (as determined by the Program Sponsor) for a prorated portion of the quarter; the Program Sponsor may include the next full quarter with the initial billing. Certain Wrap Programs may charge a minimum fee, an additional fee for contributions during the quarter, and generally do not refund for significant withdrawals, for assets moved to an unsupervised status, or for periods that an account may be frozen or suspended. Please consult the Program Sponsor's Disclosure Brochure/Document for details regarding billing procedures.

### **Brokerage Fees**

Fee-in-lieu-of-commission brokerage fee arrangements or Wrap Program Fee arrangements may not include certain additional costs or charges to clients associated with securities transactions, including but not limited to dealer mark-ups or mark-downs, auction fees, odd-lot differentials, exchange fees, transfer taxes, electronic fund and wire transfer fees, specialized account fees (i.e. checking or IRA maintenance fees), interest on debit account balances, fees and expenses charged or incurred by ownership of mutual funds in the account, any charges mandated by law and if applicable certain prototype/custodial fees in connection with trust services rendered by the client's broker/custodian. These brokerage fees (total wrap fee or otherwise) are not controlled in any way by PCM and PCM may not be aware of the total brokerage compensation.

Clients may wish to consider these types of fee arrangements if they appear suitable to meet the client's investment objectives. In some circumstances, it is possible that the fee charged to clients to participate in the various programs offered by brokers may result in higher overall charges to a client than if the fee were to be completely unbundled and commissions were to be charged separately. Furthermore, other brokers/custodians and investment advisors may offer similar fee arrangements that may be more or less costly. In evaluating such an arrangement, the client will want to give special attention to the Disclosure Brochure/Document (if applicable) of the broker-dealer or custodian. Further disclosure regarding these arrangements is provided in the **Brokerage Practices** section below.

Generally, for accounts requiring trading of fixed-income securities, the securities are purchased and sold on a net basis and the executing broker may retain compensation in connection with such transactions.

Besides paying investment management fees to PCM as well as the fees paid to brokers as described elsewhere in previous paragraphs, clients pay management fees on assets invested in mutual funds, which pay advisory fees to the managers of such funds. These mutual funds include money market funds that may or may not be affiliated with the client's brokers/custodians as well as closed or open-end funds and exchange traded funds that PCM may purchase for investment for clients. In the event that a client opens an account with PCM in which all or a portion of the account is invested in a mutual fund(s), PCM may sell all or a portion of such investment and that investment may be subject to early redemption fees. Clients are urged to review the Prospectus and Statement of Additional Information of each mutual fund for a more complete description of the fund's fees and expenses.

#### **Other Compensation (Model Portfolios & Market Commentary)**

PCM does not maintain any standard fee schedule with respect to Model Portfolio and Market Commentary services; the fees paid to PCM and termination conditions are subject to the terms agreed upon in the service agreement between PCM and the engaged party.

## **VI. Performance Based Fees and Side-by-Side Management**

PCM does not charge any performance fees (fees based on a share of capital gains or capital appreciation of the assets of a client's account). Some investment advisers experience conflicts of interest in connection with the side-by-side management of accounts with different fee structures. However, these conflicts of interest are not applicable to PCM.

## **VII. Types of Clients**

PCM provides discretionary investment advisory services primarily for individuals, corporations, public and private pension plans, endowments, and foundations.

PCM's standard minimum account size is \$100,000. PCM reserves the right to waive the required minimum based on individual client needs or circumstances.

All discretionary clients are required to enter into a written Investment Management Agreement, and under such agreement may be required to provide additional documentation/personal information prior to the establishment of an advisory relationship. The agreements required by Program Sponsors and/or PCM for wrap-fee accounts may vary from those listed here.

Clients should note that all or a portion of the securities in their account may be sold during the course of management of the account. The client is responsible for all tax liabilities arising from such transactions and encouraged to seek the advice of a qualified tax professional. New accounts and/or additions to existing accounts may not be immediately fully invested. The level of investment depends on the number of attractive securities that are present at the time the account is funded. Depending on market conditions it may take 3-6 months to fully integrate an account or additional funding. Clients that have sought and obtained approval from their broker/custodian to utilize the writing of or the purchase of puts and calls must understand that there are tax implications and risks associated with option trading strategies; such risks are disclosed in the Options Disclosure booklet provided by their broker/custodian prior to approval of option trading.

Clients must keep PCM apprised of changes to their address. Clients that fail to do so waive any claims resulting from the failure to receive communications from PCM. Address changes from the client should be made in writing and include signatures for all appropriate parties on the account. PCM accepts address changes from client custodians. Upon receipt, PCM will verify the change with the appropriate custodian. PCM is not able to alter custodial address-of-record data; clients must contact their custodian to instruct such changes.

To help the government fight the funding of terrorism, money laundering and identity theft activities, PCM has adopted Anti-Money Laundering and Identity Theft Red Flag policies and procedures. As part of those procedures PCM may request clients to provide documentation to verify their identity.

## **Model Programs**

PCM also offers investment advisory services to Model Program Sponsors in the form of model portfolios based on one or more of its investment strategies. Program Sponsors utilize the model portfolios to provide investment services to their clients in the same manner as the wrap-fee arrangements described above. However, it is up to the Model Program Sponsor to accept, modify, or reject PCM's recommendations.

# **VIII. Methods of Analysis, Investment Strategies and Risk of Loss**

## **General**

All investing involves a risk of loss. Clients must be willing and able to assume the risks of investing and understand that the value of a client's account changes daily and can be effected by a number of factors including, but not limited to general market conditions, sector risks, liquidity risks, currency risk, other political, social, or economic developments, specific matters relating to the companies held in client accounts, business failure, action by the security inconsistent with expectations, credit risk, early redemption, changing interest rates and credit ratings. Past performance is not necessarily an indication of future results; PCM cannot guarantee the future performance of a client's account, or the profitability of any individual investment decisions.

The basic foundation of the PCM investment process is fundamental analysis of sectors, industries, and companies in order to determine areas that may appear attractive for investment. There are risks associated with PCM's methods of analysis, for example the price of an investment can change regardless of factors considered during the evaluation process, assumptions used in the analysis may prove incorrect, or the publicly available information that PCM relies on in its analysis may be inaccurate or misleading.

## **Equity Investment**

Generally, individual equity analysis is made using company shareholder reports, filings made with the Securities and Exchange Commission, company press releases, articles in newspapers, magazines and other financial publications, research materials prepared by others, and may include company visits, conference calls, and/or interviews with company management. Analysis of individual companies may include several measures of valuation, such as price/earnings ratios, price/sales ratios, price/cash flow ratios, dividend yield, the relationship of stock price to book value, as well as analyzing reserve values in the case of natural resource companies or other methods of security analysis. The focus of this analysis is to form an opinion as to whether the present price of an equity security appears undervalued in light of the investment fundamentals and current investor psychology.

## **Fixed Income Investment**

Fixed income investment management centers upon assessments of economic activity, Federal Reserve policy, capital market fund flows, and the influences upon interest rates by developments overseas. From this analysis, forecasts are made for short and long term interest rates using U.S. Treasury securities as a benchmark. Added yield is evaluated versus risk. Interest rate differentials between corporate, U.S. Government Agency, and U.S. Treasury, and municipal securities are considered in allocating assets among these classes of debt instruments. Analyses of economic, political and capital market developments, as well as the investment goals of each client determine which maturity range of fixed income investments appear suitable for each client. Corporate bonds and municipal investments are selected primarily upon the maturity date and quality rating that appears appropriate for clients' investment objectives. Fixed income investments may include preferred stock and bond funds. While fixed income securities can play an important role in stabilizing diversified portfolios, no security is entirely risk-free; safety of principal is not guaranteed and such investments are subject to interest rate, inflation, credit, liquidity, early redemption, and default risks. A rise or fall in interest rates will affect prices of fixed income securities. PCM generally classifies commercial paper with a maturity of 6 months or less in a sub category of cash and cash equivalents.

**The following is a discussion of the strategies that PCM is currently offering new clients:**

### **Small/Mid Value Strategy**

PCM's Small/Mid Value Strategy objective is to seek long-term capital appreciation by investing in companies with market capitalizations below \$5 billion.

PCM's Small/Mid Value investment process utilizes both top-down and bottom-up research methodologies. Top-down research involves the analysis of economic trends, monetary policy, international developments, as well as other factors, to reach conclusions regarding the likely direction of the domestic equity markets and which sectors or industry groups may offer new opportunities. The bottom-up process involves analyzing individual companies to assess performance potential relative to the equity's current market valuation.

PCM's bottom-up process starts by screening the universe of common equities within the strategy's market capitalization range. While screening criteria are tailored to each industry group, our preliminary analysis generally focuses on earnings power, price multiples and balance sheet metrics. We analyze all candidate companies relative to their industry groups, market sectors, and the small- to mid-cap equity universe as a whole. We then assess the performance potential for the candidate company by performing deep fundamental analysis in the context of investment themes derived by our top down analysis. We analyze each candidate's ten-year financial history paying close attention to trends in revenue, margins, earnings per share, cash flow per share, book value per share, tangible book value per share and capital structure. We also pay close attention to the sensitivity of the business to macroeconomic and industry specific factors over time. Once company analysis is complete, we assign a target price range for the stock using one or more appropriate valuation methods. We generally arrive at target prices using forecasted earnings or cash flows and a target multiplier that incorporates our assessment of the company's earnings growth potential and risk profile. If we believe that there is significant upside potential to a stock's target price range, we then consider it for inclusion in client portfolios.

Portfolio sales may be generated when the company's price reaches the top of its projected valuation level. Sales may also result if a negative event changes the fundamentals of the company or if the original thesis for buying the stock has changed or no longer applies. Proceeds from sales can be invested in securities with better investment potential or may be placed in cash reserves awaiting investment in better opportunities.

Additional risk associated with this strategy (in addition to those noted previously): historically, smaller capitalization securities have experienced greater volatility and may be less liquid than larger capitalization securities.

### **Large-Cap Value Strategy**

The Large-Cap Value Strategy objective is to seek long-term capital appreciation in larger capitalization companies that are currently undervalued.

PCM utilizes both top-down as well as bottom-up methodologies in its research process. Top-down research involves the analysis of economic trends, monetary policy, international developments, as well as other factors, to reach conclusions regarding the likely direction of the domestic equity markets and which sectors or industry groups may offer new opportunities. The bottom-up process involves analyzing individual companies that may be part of a sector or industry group deemed potentially attractive by our top down research.

We begin that process by looking at companies from the vantage point of being an owner in that business. We analyze the potential upside for the company within the industry, the financial statements, the management team, publicly available research, and other factors that may determine the attractiveness of the business. We review the relationships of price/earnings, price/cash flow, price/sales, and price/book to project reasonable estimated ranges of valuation. By combining our estimated valuation ranges with estimates of earnings and cash flow, we are then able to project high and low ranges for these equity securities. Since the market appears to be a forecasting mechanism, we use future four quarter projected earnings and cash flow, and by comparing the current price of the stock with the projected valuation range we are able to determine an estimated risk/reward ratio. The Investment Strategy Committee meets, as necessary, to review the potential investment and if deemed attractive, the company is added to the Focus List and purchased for client portfolios as appropriate. The portfolio managers may use some technical analysis such as analyzing momentum and price trends to determine appropriate entry and exit points for the company holding.



Portfolio sales may be generated when the company's price reaches the top of its projected valuation level or when the risk/reward ratio becomes unattractive. Sales may also result if a negative event changes the fundamentals of the company or if the original thesis for buying the stock has changed or no longer applies. Proceeds from sales can be invested in securities with more attractive risk/reward ratios or may be placed in cash reserves awaiting investment in better opportunities.

### **Large-Cap Value Total Return Strategy**

PCM's Large-Cap Value Total Return Strategy objective is to seek long-term capital appreciation in larger capitalization companies that are undervalued, as well as to seek income from dividend paying securities.

PCM utilizes both top-down as well as bottom-up methodologies in its research process. Top-down research involves the analysis of economic trends, monetary policy, international developments, as well as other factors, to reach conclusions regarding the likely direction of the domestic equity markets and which sectors or industry groups may offer new opportunities. The bottom-up process involves analyzing individual companies that may be part of a sector or industry group deemed potentially attractive by our top down research.

PCM begins the process by looking at companies from the vantage point of being an owner in that business. We analyze the potential upside for the company within the industry, the financial statements, the management team, publicly available research, and other factors that may determine the attractiveness of the business. We review the relationships of price/earnings, price/cash flow, price/sales, and price/book and dividend yield to project reasonable estimated ranges of valuation. By combining our estimated valuation ranges with estimates of earnings and cash flow, we are then able to project high and low ranges for these equity securities. Since the market appears to be a forecasting mechanism, we use future four quarter projected earnings and cash flow, and by comparing the current price of the stock with the projected valuation range we are able to determine an estimated risk/reward ratio. The Investment Strategy Committee meets, as necessary, to review the potential investment and if deemed attractive, the company is added to the Focus List and purchased for client portfolios as appropriate. The portfolio managers may use some technical analysis such as analyzing momentum and price trends to determine appropriate entry and exit points for the company holding.

Portfolio sales may be generated when the company's price reaches the top of its projected valuation level or when the risk/reward ratio becomes unattractive. Sales may also result if a negative event changes the fundamentals of the company or if the original thesis for buying the stock has changed or no longer applies. Proceeds from sales can be invested in securities with more attractive risk/reward ratios or may be placed in cash reserves awaiting investment in better opportunities.

Additional risks associated with this strategy (in addition to those noted previously): the income generated by the securities held in this strategy may decline and there is no guarantee that dividend-paying securities will continue to pay dividends.

PCM's existing clients may have previously selected strategies not listed here, such as Large-Cap Value Balanced, Large-Cap Value Total Return Balanced. The risks associated with those strategies would be consistent with those provided in this discussion. PCM's Large-Cap Value Balanced strategy utilizes the Large-Cap Value style coupled with a portion of the portfolio invested in fixed income securities, while PCM's Large-Cap Value Total Return Balanced strategy utilizes the Large-Cap Value Total Return style coupled with a portion of the portfolio invested in fixed income securities. The target weighting for the fixed income portion of the balanced strategies is generally 30%; actual weighting may vary depending on market conditions. Investments may include preferred stocks, taxable and non-taxable bonds of varying maturities and quality ratings, as well as bond mutual funds as deemed appropriate based on the investment objectives of the client and current market conditions. These strategies are no longer offered to new clients.

### **Diversified Income Strategy**

PCM's Diversified Income Strategy objective is to provide income from diversified market segments by opportunistically focusing on investments with higher income potential while at the same time attempting to avoid those asset classes that we believe have greater downside risk. Particular attention is paid to achieving the maximum income relative to the underlying risk/reward ratio.

The investment process begins with a top-down approach by assessing which income producing asset classes provide the most desirable risk reward scenario on a relative basis. Flexibility among asset classes allows the

portfolio managers to focus on market segments that appear more desirable and avoid those with less perceived opportunity. Many factors are included in this analysis such as current fiscal and monetary policies, current interest rates, relative yields on dividend producing equities, and our current economic outlook. Once the weightings of the various asset classes are determined, the portfolio management team then begins its rigorous fundamental research process on individual investments within those asset classes. The equity analysis will focus on a company's ability to maintain or grow its dividend, although capital appreciation will also be considered. Fixed income or preferred stock analysis includes interest rate outlook, yield curve analysis, and credit analysis. The portfolio may also be invested in specialty asset classes utilizing ETFs and REITS for their unique characteristics. The team then generates a focus list of those prospective holdings that meet their criteria, and those considered by the team to have the best income potential and highest relative value become portfolio holdings. The portfolio is monitored and tactical adjustments will be made as relative value parameters change among asset classes or industry groups.

Additional risks associated with this strategy (in addition to those noted previously): the income generated by the securities held in this strategy may decline; this strategy may include investments in lower quality, higher yielding fixed income securities which may be subject to greater price fluctuation than higher quality fixed income securities, the asset allocation selected by PCM may not perform as anticipated, there is no guarantee that dividend-paying securities will continue to pay dividends. The asset allocation in the client's account may vary substantially depending on various factors, including market conditions.

### **All-Cap Tilt Strategy**

PCM's All-Cap Tilt Strategy objective is to seek enhanced index performance by combining an actively managed portfolio of small to mid capitalization stocks with a passive equity investment tracking the S&P 500® Index.

PCM's All-Cap Tilt investment process utilizes a bottom-up research methodology to select stocks for the strategy's active portfolio component. The bottom-up process involves analyzing individual companies to assess performance potential relative to the equity's current market valuation. The passive portfolio portion of the strategy is invested in an Exchange Traded Fund that tracks the S&P 500 Index.

We begin the bottom-up process by screening the universe of common equities within the small- to mid-cap equity range. While screening criteria are tailored to each industry group, our preliminary analysis generally focuses on earnings power, price multiples and balance sheet metrics. We analyze all candidate companies relative to their industry groups, market sectors, and the small- to mid-cap equity universe as a whole.

We then assess the performance potential for the candidate company by performing deep fundamental analysis in the context of investment themes derived by our top down analysis. We analyze each candidate's ten-year financial history paying close attention to trends in revenue, margins, earnings per share, cash flow per share, book value per share, tangible book value per share and capital structure. We also pay close attention to the sensitivity of the business to macroeconomic and industry specific factors over time.

Once company analysis is complete, we assign a target price range for the stock using one or more appropriate valuation methods. We generally arrive at target prices using forecasted earnings or cash flows and a target multiplier that incorporates our assessment of the company's earnings growth potential and risk profile. If we believe that there is significant upside potential to a stock's target price range, we then consider it for inclusion in client portfolios.

Portfolio sales may be generated when the company's price reaches the top of its projected valuation level. Sales may also result if a negative event changes the fundamentals of the company or if the original thesis for buying the stock has changed or no longer applies. Proceeds from sales can be invested in securities with better investment potential or may be placed in cash reserves awaiting investment in better opportunities.

### **ETF Strategy**

The primary objective of our ETF Model portfolio is to build an individualized portfolio utilizing exchange traded funds ("ETFs") to gain broad diversification, and to seek to enhance performance with active asset allocation. For those clients who are uncomfortable with individual equities, and are seeking market diversification, we construct a custom ETF portfolio that reflects an investor's goals and tolerance for risk. PCM's ETF Model Portfolio starts with a client interview and/or survey to gather all financial and personal pertinent information. With an understanding of

our clients risk tolerance, financial goals, and present and future needs, our investment team constructs a customized portfolio utilizing commission-free ETFs.

## **IX. Disciplinary Information**

PCM and its employees have not been involved in any legal or disciplinary events in the past 10 years that would be material to a client's evaluation of the company or its personnel.

## **X. Other Financial Industry Activities and Affiliations**

PCM and its employees do not have any relationships or arrangements with other financial services companies that pose material conflicts of interest; however, Mr. Kenneth Roberts is currently a director and vice-president of The E.S. Bergquist Foundation. Mr. Roberts does not receive any compensation in connection with this non-profit and this activity is not viewed as a potential conflict of interest with PCM's activities.

## **XI. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

To avoid potential conflicts of interest involving personal trades, PCM has adopted certain compliance policies including, a Code of Ethics/Code of Conduct, Personal Securities Transactions, and Insider Trading policies. In summary, these policies require that Employees:

- Act with integrity, competence, dignity, and in an ethical manner when dealing with the public, clients, prospects, financial consultants, and fellow employees;
- Place the interests of clients above PCM's and one's own personal interests;
- Conduct personal securities transactions in a manner consistent with firm policy (summarized below);
- Avoid taking inappropriate advantage of their position;
- Preserve the confidentiality of certain information (see Privacy Statement);
- Avoid if possible, and/or disclose any actual or potential conflicts of interest;
- Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, and taking investment actions (applicable to Traders and Portfolio Managers);
- Maintain full compliance with Securities Law and firm compliance policies.

PCM's Personal Securities Transaction procedures also require employees to:

- Pre-clear certain personal securities transactions;
- Report personal securities transactions on at least a quarterly basis;
- Provide PCM with a detailed summary of all personal securities accounts and certain holdings over which they have a direct or indirect beneficial interest.

PCM's Personal Securities Transaction Policy is summarized as follows:

PCM Portfolio Managers may recommend for client portfolios, securities in which they directly or indirectly have a financial interest. In addition, Portfolio Managers may buy or sell securities that are recommended to advisory clients for purchase or sale. They may also give advice and take action in the performance of their duties to clients which differs from advice given, or the timing and nature of action taken, with respect to other clients' accounts.

To address the potential conflict of interest inherent with investment advisory employees conducting personal securities transactions, PCM will maintain a Restricted List of securities that employees are generally prohibited from trading, as the securities on this list are possible investment candidates or existing investments that may be under consideration for removal or trimming from client portfolios. Generally, two exceptions apply to this prohibition: (1) employee trading accounts maintained with an unaffiliated investment adviser in which the employee has certified, in a written format, that he/she does not have any direct or indirect influence or control over

the trading of the account and that all trading decisions are made pursuant to the discretion of the independent investment adviser; and (2) employee accounts that PCM formally manages under an Investment Management Agreement, however such accounts may not receive any part of a trade allocation in the event that the account was part of a client block order and the entire block was not executed on the same day.

Clients or prospective clients may request a copy of PCM's Code of Ethics/Code of Conduct by contacting Barry Menne, Chief Compliance Officer at the address listed on Page 1 of this Form ADV Part 2A.

## **XII. Brokerage Practices**

### **Non-directed Brokerage/Research and Other Soft Dollar Benefits**

Clients may grant PCM discretion as to which broker to use in effecting transactions. In making any such selection, PCM will take into consideration a number of factors including, without limitation: the overall net economic benefit to the portfolio, transaction costs (which may not be the lowest available), the efficiency of the execution of the transaction, and the ability of the broker to execute trades in a difficult market. In addition, PCM may receive research from the broker selected that may be used for the benefit of all clients, not just the client for whose benefit the trade was executed. The broker-dealer compensation paid may exceed fees and charges that could be obtained from another broker or dealer, in recognition of the value of the research provided by that broker. In this case PCM determines in good faith that the commission is reasonable in relation to the value of such research services received. The research received is generally in the form of a periodical report, access to analyst conference calls and comments regarding economic, market, company or industry information, and other technical data. Access to such research creates a conflict of interest for PCM in allocating brokerage business between firms that provide such research and those that do not. This conflict may be influential to the extent that the research services received could be viewed as benefiting PCM by relieving the firm of the expense involved in purchasing the services itself. During PCM's last fiscal year, PCM did not direct any client transactions to any particular broker/dealer in return for any research and/or other soft dollar benefits. PCM does not have any soft dollar arrangements.

### **Brokerage for Client Referrals**

PCM provides investment advisory services to individuals (or related individuals) that are providing necessary business services to PCM. Additionally, PCM receives clients referred by various financial consultants. These relationships create a potential conflict of interest between a client's interest in obtaining best price and execution and PCM's interest in receiving future referrals or business services.

In the event that a potential client does not have an existing brokerage/custodial relationship, PCM takes into consideration the client's needs for expertise and service when offering the client brokerage options. The potential for a financial consultant to provide ongoing client referrals back to PCM is not taken into consideration, although PCM will generally refer clients to financial consultants with whom it already has clients. This often occurs as a result of PCM's interaction with these financial consultants for existing clients and therefore PCM's understanding of the level of service and expertise offered by the financial consultant.

### **Directed Brokerage**

Clients have various brokerage options, including utilizing the services of a referring financial consultant, any other financial consultant that the client desires, or any firm suggested by PCM to provide custody and execution services for clients. Clients often however designate the broker to be used for effecting transactions in their account since, in most cases clients are participants in fee-in-lieu-of-commission brokerage fee programs or Wrap Programs; as a result, PCM views and terms these arrangements as directed brokerage. Transactions for these clients are effected through the client's broker-dealer/custodian, with no commissions being charged on these transactions, since the broker-dealer/custodian is compensated according to the terms of the client's fee agreement with their broker-dealer/custodian. In these situations PCM is not free to seek the best price and execution for clients; therefore no assurance can be given that PCM will be able to obtain the best price or execution for client whose assets are subject to these fees. Not all advisers and/or broker-dealers require their clients to direct brokerage; some clients participate in managed account programs and choose to pay brokerage commissions instead of an asset-based fee.

In these directed brokerage relationships the client is responsible for negotiating brokerage compensation and other transaction costs with the financial consultant. A client may negotiate a brokerage compensation rate that exceeds

the rate that could be obtained from another brokerage firm, or that PCM's other clients may pay. Furthermore, PCM may not be able to aggregate trades for the clients' account with those of other PCM clients obtaining volume discounts and the price a client pays or receives for a security may be different from the price paid or received by PCM's other clients who utilize different brokers/custodians. The directed broker and the broker-dealer stand to benefit from providing custody and execution services.

PCM's ability to trade fixed income securities for directed accounts may be limited by the inventory of that broker-dealer. Clients must satisfy themselves that the directed broker can provide adequate price and execution for most or all transactions and that the brokerage compensation negotiated by the client is appropriate given the services that may be provided by the financial consultant, potentially including but not limited to, personal advice, retirement, estate, and education planning, manager selection, performance measurement, account and tax reporting, custodial and trade execution capabilities.

With respect to ERISA clients any direction by the plan sponsor must be in the best interests and for the exclusive benefit of the plan participants.

The limitations inherent in the directed brokerage arrangement may limit PCM's ability to achieve best execution; to utilize alternative trading platforms (electronic trading networks and other trading firms compensated by charging commissions) and take away PCM's ability to negotiate commission discounts. It is the client's responsibility to determine the suitability of their directed brokerage arrangement.

Clients may have been able to negotiate a lower brokerage compensation or commission rate if they had not directed their brokerage to the referring financial consultant's firm.

### **Allocation of Trades**

Given that PCM is in the business of providing investment advisory services there is an inherent conflict of interest regarding PCM's time devoted to managing more than one account. To address this issue PCM is first required to disclose this conflict and secondly develop procedures that accommodate PCM's ultimate goal of offering the most favorable execution as well as allocation of opportunities in what it believes is a fair and equitable process.

PCM utilizes a portfolio weightings basis (based on market value, rounded to appropriate lot sizes) when purchasing or selling securities to assure the fairest and most equitable allocation. An allocation may be further adjusted for client-imposed restrictions, general market exposure for clients, cash levels, minimum ticket brokerage commission charges, concentration risk, tax strategy, etc.

When possible and deemed appropriate, PCM will aggregate the same transactions in the same securities for those accounts held at the same brokerage firm/custodian (block trading). The aggregation allows PCM to execute trades in a more timely, equitable, and efficient manner. Accounts traded in a block transaction will receive the same (an average) price per share; this average price may be better than, equal to, or worse than the price received had the transaction not been aggregated. In some circumstances limitations of the broker's trading platform do not accommodate trading in blocks, and orders must be entered on an individual client basis.

PCM informs the Model Program Sponsor of changes to the model, but does not execute trades on behalf of the Model Program Sponsor. The Model Program Sponsor has discretion to execute the submitted model changes and may receive an execution that varies from PCM's discretionary clients.

If the client has not designated a broker for transactions, PCM will provide guidance and assistance with selection. Our recommendation will be based on achieving best execution for that particular client. Issues influencing brokerage selection include, but are not limited to: past experience with the broker, the efficiency of the execution, the price of the security bought or sold, the financial stability of the brokerage firm, reliability, and record keeping. Error-free execution and settlement may be a better value than the cheapest execution.

### **Partial Fills**

In the event that PCM is not able to fill a block order in its entirety, PCM will allocate those shares that were executed on a pro-rata basis among those in the original allocation. For example, if only half of the order was filled, then generally all clients would be allocated ½ of their original allocation.

### **Trading for an individual account**

When a trade is to be executed for an individual account and the trade is not in the best interests of other accounts, then the trade will be entered for that individual account. This is true even if the portfolio manager believes that a larger size block trade would lead to better overall price for the security.

On occasion PCM may deem it appropriate for one client to purchase a particular security and yet the same day, appropriate for another client to sell that same security. Clients should understand that PCM's interest lies in obtaining best execution for both clients. PCM will not instruct the trader to execute a cross-trade; rather PCM will enter the trades separately for execution on the open market at market prices, seeking the most favorable execution for all accounts involved.

### **Fixed Income Securities**

PCM's fixed income allocation process involves taking into consideration, among other things, the existing fixed income securities in client accounts, the available inventory of a particular security, the amount in which accounts deviate from their targeted allocation, appropriate position sizes, and cash levels, ultimately seeking fair and equitable treatment over time.

### **Participation in IPOs/Hot-issue securities**

PCM does not participate in IPOs or hot issue securities for clients.

### **Non-discretionary Trading (i.e. client directed purchases or sales)**

Upon notification and confirmation that all necessary information has been received, all requests are completed on a first-in first-out basis. However, PCM prefers that the client complete such transactions directly with their financial consultant and the securities are moved out of the PCM managed account or specifically designated as unsupervised.

### **PCM managed employee related accounts**

Employee accounts that are managed under contract by PCM (including accounts of PCM) are traded after the recommended action has been taken for all appropriate non-employee managed accounts.

### **Non-managed employee related accounts**

All employees are required to follow the personal securities policy and procedures of PCM. See section “**Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**” for additional detail.

Exceptions to the policies described above may be made if PCM believes it will be fair to its clients on an aggregate basis.

Clients that have intentions of transferring their account from their existing custodian or broker-dealer to another should notify PCM in writing as soon as possible. PCM will suspend the account during the transfer process and unsuspend the account upon notification by the receiving firm that the account is approved for management. Clients that are involved in a fee-in-lieu-of-commission or wrap fee program should understand that if PCM is not timely notified of the transfer and enters a trade while the transfer is in process, the originating or receiving custodian or broker-dealer may charge a commission on the trade(s) or may require PCM to cancel the trade(s). PCM may choose to terminate management services if it is determined that the receiving firm is not able to offer adequate services and functionality required for PCM to carry out its management responsibilities.

### **Trade Errors**

From time to time, errors may occur in the trading or investment process. It is PCM's policy that when an error is detected immediate action is taken to correct the error and ensure the client account is restored by the appropriate party.

### **XIII. Review of Accounts**

Account reviews are made on an ongoing basis by the Chief Investment Officer and Portfolio Managers. In addition to monitoring market conditions, events affecting a particular security, individual client circumstances and other changes in the political or economic environment may trigger additional reviews of client accounts. In addition, security and cash balances are reconciled monthly with statements furnished by the custodian of client assets.

Background information regarding the Chief Investment Officer and Portfolio Managers can be found in Part 2B of the Form ADV (the “Brochure Supplement”).

Clients receive confirmations from their broker/custodian of all securities transactions in their account. However, some brokerage firms are offering clients the ability to waive their right to receive confirmations. In either instance clients will receive from their broker/custodian an account statement that lists all transactions in their account; provided in any month in which there is activity, or at least quarterly. Some custodians are providing clients with the ability to obtain their confirmations and/or statements electronically. Clients are responsible for ensuring consistent retrieval of these records and for providing a secure location (host) for such retrieval.

Custodians are required to provide statements to clients on at least a quarterly basis; however, in some cases the client's brokerage program includes separate quarterly reporting in addition to the standard monthly account statement. Morgan Stanley and Wells Fargo Advisors provide such quarterly reporting to clients (some individual financial consultants at these firms may request that PCM provide statements to their clients).

In situations where the client's brokerage program does not provide quarterly reporting (in addition to their standard monthly or quarterly account statement), PCM will provide a quarterly portfolio appraisal (lists individual security positions, amounts, cost basis as provided by client, market value, and current income) and portfolio performance. Other reports regarding the portfolio including transaction summaries are available upon client request or may be provided to the client at the discretion of PCM. Clients should compare PCM records to those of their custodian. Copies of the quarterly reports are provided to the client's financial consultant as well.

Clients receive an investment strategy commentary, which summarizes economic trends, and other factors that may influence PCM's management of portfolios. Client consultations may be held on whatever schedule the client, the portfolio manager and/or the client's financial consultant may consider desirable. PCM is willing to provide reports and other communications as requested by the client and/or financial consultant.

### **XIV. Client Referrals and Other Compensation**

#### **Other Compensation**

Some brokerage firms/custodians have provided PCM with access to websites or other software which facilitates the trading and/or reconciliation process; specifically, a location to upload invoices for management fees, enter trade orders or allocations, and in some cases, the ability to download brokerage statements and/or account transaction detail. Some websites provide access to compliance material, pricing, research, and other market data. Other services commonly provided by brokerage firms/custodians include receipt of duplicate confirms and statements and the ability to have management fees deducted directly from client accounts (with written approval). The services are provided by the brokerage/custodial firms as a means of supporting investment advisers in general, and are not driven by a level of commissions directed to any specific firm; however, such services do provide PCM with increased operational accuracy and efficiencies. These services may be used to support one or a substantial number of accounts and could represent a conflict of interest for PCM when evaluating firms that are not providing these services. Access to these same trading and operational services may or may not be available to individual investors.

PCM nor any PCM employee provides information or advice regarding individual securities, generates research reports, or acts as a research analyst on behalf of any third party.

## **XV. Custody**

All clients' accounts are held in custody by unaffiliated broker/dealers or banks, however, PCM submits an advisory fee invoices to each custodian and fee may be debited from the client account. For this reason, PCM is considered to have custody of client assets. Account custodians must send statements directly to the account owners on at least a quarterly basis. PCM will take such reasonable steps as are necessary to notify clients their custodian is to provide a compliant and timely quarterly statement. Clients should carefully review these statements, and should compare these statements to any account information provided by PCM.

## **XVI. Investment Discretion**

When PCM has discretionary authorization to effect investment or brokerage transactions in a client's account, the extent of and limitations on that authority are determined by agreement with the client. Such agreement grants PCM authority to effect securities transactions in clients' accounts by way of a limited power of attorney.

In addition, conditions could be imposed in writing, which prohibit or limit the purchase of specific industry groups or stocks for personal reasons or because such transactions would increase individual security or industry/economic sector holdings above a certain percentage, whether absolutely or in relation to the total portfolio. It should be noted that investment restrictions could adversely affect the performance of the client's account. Furthermore, industry restrictions may be subject to interpretation based on an individual client's value system or whether the restricted industry is considered a primary or secondary business of an underlying security. PCM will make best efforts to accommodate adherence to such restrictions, however the client must notify PCM if they wish to modify their restriction instructions to include restricting investment in a specific security. PCM may choose to not accept or terminate an account if clients have imposed overly restrictive limitations on their account and it is determined that such instructions would significantly hinder PCM's ability to manage the account consistent with the stated investment objectives.

In the event that a client utilized the services of another investment adviser prior to engaging the services of PCM, PCM will not be responsible for the actions of the previous advisor, regardless of whether or not the client transfers in securities to their PCM managed account that were purchased by the previous advisor. Furthermore, in the event that a client transfers securities into their managed account (either at inception or thereafter), PCM will not be responsible for the actions relating to the original acquisition of the security or securities.

## **XVII. Voting Client Securities**

PCM has developed Proxy Voting Policies to ensure that proxies for which PCM has been delegated voting authority are voted consistently and in the best interest of PCM clients. Delegation of proxy voting to PCM is at the sole discretion of the client and is applicable to all securities held in the account (supervised and unsupervised).

The client must contact their broker-dealer/custodian to instruct appropriate coding of proxy instructions consistent with their wishes for voting authority. PCM requests documentation of proxy voting authority from the broker-dealers/custodians at inception of new accounts. PCM considers receipt of proxy materials as authorization, by the client to vote proxies on their behalf. If clients wish to rescind this delegation of voting authority they must contact their broker/custodian as well as notify PCM of this change; at this point proxy materials would be delivered to clients from the broker-dealer/custodian, transfer agent, or other party. Clients should note that events causing the broker-dealer/custodian to require new paperwork for an existing account may cause the coding for the proxy voting materials to default back to the client.

PCM will not be responsible or liable for failing to vote any proxies where PCM did not receive the proxies or related shareholder communications in a timely manner.

PCM has retained Institutional Shareholder Services (ISS) as an expert in the proxy voting and corporate governance areas to assist in the due diligence process related to making appropriate proxy voting decisions as well as vote processing and recordkeeping. PCM utilizes the proxy voting guidelines established by ISS as these guidelines are consistent with PCM's policies. PCM's guidelines are not rigid policy positions nor are they intended to address all potential voting issues. PCM may elect to abstain from voting if it is determined that such



action is in clients' best interests. The ISS and PCM guidelines will be reviewed at least annually. PCM may change these guidelines in response to general corporate governance practices without providing prior notice of the changes to clients.

Given the size and nature of PCM's business it is rare when a conflict of interest arises. Furthermore, by engaging the services of ISS to provide guidance on proxy voting matters and consistently applying the guidelines across proxy proposals potential conflicts of interest are minimized. However, in the event that a material conflict of interest is identified (i.e. a PCM employee may personally benefit if the proxy is voted in a certain direction) that employee is removed from the proxy voting process as applicable and PCM will process the vote as recommended by ISS (being an independent third party). PCM employees may own positions in the companies for which ballots are to be cast. Generally, such ownership is immaterial versus the total shares outstanding for the company. However, in the event of significant ownership, the Board will vote the ballots as stated above when a conflict of interest is identified.

A copy of PCM's Proxy Voting Policies may be obtained upon request by contacting PCM. In addition, clients may obtain a record of how proxies were voted on an aggregate basis, direct the vote on a particular account for a specific security (assuming timely notice is provided and PCM's vote has not already been cast), or request information regarding a particular ballot by contacting Barry Menne, Chief Compliance Officer at the address listed on Page 1 of this Form ADV Part 2A.

## **XVIII. Financial Information**

PCM has never filed for bankruptcy and is not aware of any financial condition that is expected to affect its ability to manage client accounts.

## **XIX. Other Information**

### **Submission of Paperwork and/or Approval of Class Action Litigation**

PCM does not accept responsibility in matters relating to class actions, including without limitation, approval of class settlements, bankruptcies or otherwise and will not complete or submit any paperwork on behalf of clients with regard to such matters.

### **Unsupervised Securities**

Assets designated as "unsupervised" are neither managed nor charged a management fee by PCM (fees for those in a wrap program may differ-see Item V. Management Fees-Wrap Programs). PCM assumes no responsibility for these assets.

**PCM should be notified in writing if there are changes in a client's financial situation, if their investment objectives should be modified, if the client wishes to impose or modify reasonable restrictions on the management of their account, if they have intentions of changing custodian or broker-dealer, or if they have a change of address.**

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