



KOVITZ INVESTMENT GROUP

*Capital Ideas.®*

**Disclosure Brochure  
(Form ADV Part 2A)**

January 31, 2012

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This brochure provides information about the qualifications and business practices of Kovitz Investment Group, LLC (KIG). If you have any questions about the contents of this brochure, please contact us at [312.334.7300](tel:312.334.7300) or at [info@kovitzinvestment.com](mailto:info@kovitzinvestment.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority. Registration with the SEC does not imply a certain level of skill or training.

Additional information about KIG also is available on the SEC's website at

[www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)

## MATERIAL CHANGES

This brochure is substantially similar to our previous version dated March 31, 2011. However, we have made several changes by adding the following:

- We have added disclosure about our affiliated mutual fund which we recently launched. Please refer to the discussion of the Green Owl Intrinsic Value Fund under the following sections: “KIG’s Investment Advisory Business;” “Fees and Compensation;” “Performance-Based Fees/Side-by-Side Management;” “Types of Clients;” and “Other Financial Industry Activities and Affiliations.”
- We have added disclosure regarding new affiliated private funds which we recently launched. Please refer to the discussion of these funds under the following sections: “KIG’s Investment Advisory Business,” “Performance-Based Fees/Side-by-Side Management,” and “Other Financial Industry Activities and Affiliations.”

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## **KIG'S INVESTMENT ADVISORY BUSINESS**

KIG is an investment adviser that provides investment management and financial planning services. Previously, our owners were employed by Rothschild Investment Corp. in Chicago, Illinois where they formed the Kovitz Group in 1994. The Kovitz Group left Rothschild and formed KIG on October 1, 2003. KIG has over 30 employees, and we provide our services to individual and institutional clients. We include endowments, ERISA plans, corporations, and other entities as institutional.

As of December 31, 2011, KIG managed 2,530 accounts on a discretionary basis with assets totaling approximately \$1.98 billion. We do not manage assets on a non-discretionary basis.

KIG has six owners. The principal owner is Mitchell Kovitz.

### **Investment Management**

Our main business is providing discretionary investment advice (further described below under the section entitled "Investment Discretion"). We primarily manage for each of our client's portfolios of equities (stocks) and fixed income (bond) securities, or a combination of these. Each of our clients has his/her own account, and the equities and bonds in the account are usually individual securities and not mutual funds.

We first consult with our clients to understand their financial situation, such as their objectives for asset growth, income and liquidity, principal protection, risk tolerance, and tax minimization.

We next determine each client's initial target asset allocation, generally meaning the percentage of stocks and bonds to be put in the portfolio. We will meet with our clients to understand their needs, circumstances and objectives, work with our clients' other advisers, and set, rebalance to, and periodically review the client's asset allocation. We will consider the client's individual situation and the nature, position size, and suitability of specific securities when reviewing and making purchase and sale decisions for each of our clients. In this manner, we tailor our investment management services to the needs of our clients.

Our clients may restrict us in the management of their accounts, such as to the amount, type, or identity of stocks or bonds to buy or sell. We will still need to be comfortable that the restrictions are consistent with our professional responsibility and our investment philosophy and strategy.

Our investment management services are generally limited to these securities.

### **Equities**

For the stocks portion of our clients' portfolios, we seek total return and long-term capital appreciation. Total return is generally viewed as coming from dividends and stock price appreciation. We look to maximize the investment return we achieve given the investment risk we take. We view risk as the permanent loss of capital and not primarily as a measure of volatility of returns. We emphasize the preservation of capital primarily by investing in companies we believe to be significantly undervalued. These companies are usually larger capitalized companies. We strive

to achieve superior long-term performance for our clients by buying them the stock of competitively advantaged and financially strong companies at prices substantially less than our assessment of their intrinsic (business) value. We approach buying equities for our clients as if we are part owners of businesses, not traders of stocks.

We are the investment manager for clients of other investment advisers. These advisers operate programs that we participate in and we are paid a portion of the fees that they collect. We manage the equities in these portfolios in a manner similar to how we manage equities for our advisory clients. We are also a sub-adviser for a mutual fund. We are one of several sub-advisers in this regard. We manage these assets consistent with restrictions imposed by the mutual fund and this management is similar to how we manage the hedge funds we discuss below.

### **Fixed Income Securities**

For the bond portion of our clients' portfolios, we focus on diligent execution and high credit quality. We take into consideration our clients' tax situation, the type of issuer and bond (e.g., essential services, general obligation), and general market conditions when we construct bond portfolios for our clients. Our portfolios may include taxable, tax-free and alternative minimum tax (AMT) municipal bonds, pre-refunded and escrowed bonds, corporate bonds, Treasury and agency bonds, and Treasury Inflation Protected Securities, depending on client needs and market conditions and pricing.

Our goal is to capture excess yield without accepting additional risk. We try to accomplish this by patiently bidding on bonds owned by third party bond sellers and by our willingness to buy odd (smaller) lots of bonds, bonds selling at a premium, bonds subject to AMT, and "sinking fund" bonds. The demand for these kinds of bonds is typically lower, and therefore we are able to buy them at lower prices (and higher yields) for our clients. We anticipate holding the bonds to maturity and therefore our less concerned with interim price fluctuations. We do not have KIG own or inventory bonds for later sale to our clients. We buy bonds for direct allocation to specific client accounts based on the specific client's asset allocation and circumstances.

Depending on our specific client's investment objective, we will build a bond ladder of individual bonds maturing in different years in order to provide liquidity, an income stream, and to help guard against interest rate and credit risk. We typically do not purchase bond mutual funds for our clients.

We are the investment manager for clients of other investment advisers. These advisers operate programs that we participate in and we are paid a portion of the fees that they collect. We manage the bonds in these portfolios, if any, in a manner similar to how we manage bonds for our advisory clients. However, we may be limited by the primary adviser or its platform in the way we can execute transactions.

### **Other Types of Securities**

#### **Options**

We occasionally use option transactions in conjunction with our day-to-day management of clients' equity investments. We generally only will sell covered calls. We own the stock and, in return for a premium, we sell to a third party the right to buy our stock at a certain price by a certain date. We

usually do this for tax reasons to extend the holding period in order to gain favorable long-term capital gain tax treatment. When option prices are volatile we have also sold covered calls to generate income for clients and to manage our sector exposures. Typically, we will sell “at the money” calls (the call strike price is near the underlying stock’s market price) in order to maximize the premium received.

### **Mutual Funds and Exchange-Traded Funds**

#### 1) Unaffiliated Mutual Funds and Exchange-Traded Funds

Occasionally, we may recommend investments in no-load mutual funds or exchange-traded funds (ETFs) instead of individual securities. We may deem this appropriate for diversification in smaller accounts below our recommended investment minimums (described below in the section entitled “Types of Clients”) or to gain access to sectors outside of our core investment strategy.

In managing our affiliated hedge funds and certain separately managed accounts (described below under “Hedge Funds and other Private Placements”), we may take short positions in ETFs that we also recommend for long positions in individual advisory client accounts. We acknowledge the potential conflict of interest in making such recommendations. However, we believe that it is not inconsistent or disadvantageous to a particular client to use large ETFs in the hedge funds as part of an overall hedging strategy (and not necessarily as an assertion of our view on the sector covered by the ETF) and also as a way to gain exposure in a diversified manner to that same sector for a particular advisory client. We have considered that it is unlikely we would impact the price of the large ETF and that use for individual advisory clients is very infrequent. Mutual funds and ETFs are a very small portion of our assets under management.

#### 2) Green Owl Intrinsic Value Fund

We also manage an affiliated mutual fund, the Green Owl Intrinsic Value Fund (ticker: GOWLX) (Green Owl). Green Owl is an advisory client of KIG, and KIG generally intends to manage Green Owl according to the same strategy as that of its separate (equity) account clients. Depending on the prospective client or client’s investment objectives and risk tolerance, we generally recommend Green Owl for those advisory clients who have assets below our investment minimums (refer to the section below entitled “Types of Clients”), or otherwise for clients and prospective clients who we believe would be better served by the diversification that we intend for Green Owl to provide. Please refer to the Green Owl prospectus for more information, or the Green Owl website ([www.greenowlfund.com](http://www.greenowlfund.com)).

### **Collateralized Mortgage Obligations**

If suitable for a particular client, we also may recommend an investment in collateralized mortgage obligations (CMOs), also known as mortgage-backed securities. This recommendation would depend on the client’s investment objectives and risk tolerance, and be part of the client’s overall asset allocation. We may use a third party sub-adviser to assist us as we purchases CMOs for our clients.

## Hedge Funds and other Private Placements

KIG owns, controls, manages, or is otherwise involved in the following investment activities in which clients are (or were) solicited to invest:

- 1) KIG is the general partner of Anchor Capital Partners I, L.P. (Anchor), a private limited partnership. Anchor is limited to accredited investors. Anchor is a hedge fund that generally invests in equities, fixed income securities, options, and futures contracts on market indices.
- 2) KIG is the general partner of New Millennium Fundamental Hedged Equity, L.P. (New Millennium), a private limited partnership. New Millennium is limited to accredited investors. New Millennium is a hedge fund that generally invests in equities, fixed income securities, options, and futures contracts on market indices.
- 3) KIG is the general partner of New Millennium Fundamental Hedged Equity QP, L.P. (New Millennium QP), a private limited partnership. New Millennium is limited to accredited investors who are qualified purchasers. New Millennium is a hedge fund that generally invests in equities, fixed income securities, options, and futures contracts on market indices.
- 4) Kovitz Securities, LLC (KS), a broker-dealer owned by the same individuals as KIG, was a placement agent to introduce investors to Sandbox Ventures, L.P. (Sandbox), a venture capital fund. Sandbox funds the creation, investment in, development of, and operation of, new businesses. Sandbox is limited to accredited investors and is not accepting new investors. KIG is an investor in Sandbox. Mitchell Kovitz is an investor in the general partner of Sandbox, and is on the Advisory Board of Sandbox.
- 5) KIG owns 50% of VK Industrial I GP, LLC (VK GP). VK GP is the general partner of VK Industrial I, L.P. (VK). VK is limited to accredited investors and is closed to new investors. VK invests in industrial real estate.
- 6) KIG is the sole owner of Kovitz PH Manager, LLC, which is the sole Manager of Kovitz Private Holdings, LLC (KPH). KPH is a private equity holding company limited to accredited investors. Its investment objective is to acquire controlling interests in existing companies and to make other investments. KIG is the investment adviser to KPH.
- 7) KIG is affiliated with PWK Partners, LLC (PWK), an Illinois limited liability company. The sole owners of PWK are KPH (i.e. PWK is a portfolio company of KPH), and a KIG employee. PWK's purpose is to act as general partner to PWK QP (see below), a diversified, pooled investment vehicle that will generally invest in equities, fixed income securities, options, and futures contracts on market indices.
- 8) PWK is the general partner of PWK Partners QP, L.P. (PWK QP), a private limited partnership. PWK QP is limited to accredited investors who are qualified purchasers. PWK QP is a hedge fund that generally invests in equities, fixed income securities, options, and futures contracts on market indices. KIG is the investment adviser to PWK QP, and is responsible for the day-to-day operations and investment decisions of PWK QP.

- 9) KIG is affiliated with PWK Partners Atlas Funds, LLC (PWK Atlas), an Illinois limited liability company. The sole owners of PWK Atlas are KIG and a KIG employee. The purpose of PWK Atlas is to act as general partner to PWK Atlas I (see below), a private, pooled, concentrated investment vehicle that will primarily invest in a single core holding, but may also invest in other equities, fixed income securities, and options.
- 10) PWK Atlas is the general partner of PWK Partners Atlas Fund I, L.P. (PWK Atlas I), a private limited partnership. PWK Atlas I is limited to accredited investors. PWK Atlas I is a private, pooled, concentrated investment vehicle that will primarily invest in a single core holding, but may also invest in other equities, fixed income securities, and options. KIG is the investment adviser to PWK Atlas I and is responsible for the day-to-day operations and investment decisions of PWK Atlas I.

### **Financial Planning Services**

KIG also provides financial planning services (Planning Services) to certain investment management clients. The Planning Services may include analyses regarding retirement cash flows, goal identification and funding, Monte Carlo simulations, education funding, estate planning, and charitable giving. KIG determines client eligibility for Planning Services on a case-by-case basis. KIG will consider the size of the client relationship and whether the client uses other financial advisers in determining whether to offer Planning Services. KIG generally does not charge fees for Planning Services in addition to the fees it charges for investment management services.

The scope of Planning Services will be agreed upon by KIG and the client. KIG anticipates that it will provide the Planning Services and investment management services to its clients in a coordinated manner. KIG acknowledges that if it provides Planning Services and investment management services to a particular client, there is a potential conflict of interest in making and implementing planning and investment recommendations to the client. The conflict is that the planner is a KIG employee and will have an incentive to choose to use or recommend KIG as investment manager. We believe that the conflict is addressed by the aligned long time horizon of the client, the KIG planner, and the KIG investment professionals, and by the fact that the KIG employees are not compensated in a manner that will incentivize inconsistent or short-term recommendations.

KIG uses both Certified Financial Planner™ (CFP®) Professionals and non-CFP Professionals in the process of gathering and analyzing client information, in providing recommendations to the client, and in providing Planning Services.

### **FEES AND COMPENSATION**

We charge our individual clients an annual fee (paid quarterly) based on the fair market value of assets under management as of the last day of the previous calendar quarter. We can change our fees if we give prior written notice to clients. If a client relationship ends, we will use the date of termination to value the account to calculate the final fees the client owes us. We prorate fees using the termination date and we reimburse clients for any portion of collected fees we do not earn.

## **Standard Fee Schedule**

We list below our standard fee schedule for separate accounts. We are willing to negotiate fees.

- 1 ¼ % per annum of all equity assets up to \$5,000,000;
- 1% per annum on all equity assets \$5,000,000 - \$10,000,000;
- ¾ of 1% per annum on all equity assets \$10,000,000 - \$25,000,000;
- ½ of 1% per annum on all equity assets over \$25,000,000;
  
- ¼ of 1% per annum on all assets in mutual funds and ETFs; and
- ½ of 1% per annum on all fixed income and cash assets up to \$5,000,000;
- ¾ of 1% per annum on all fixed income and cash assets over \$5,000,000.

Usually, we deduct our management fees from client accounts. We bill certain clients for our fees. Clients may choose which method of payment they prefer.

## **Other Fees and Expenses**

We invest certain client assets in mutual funds and ETFs which pay management fees to their own managers and pay brokerage commissions to execute transactions for the fund or ETF. These fees and commissions are in addition to the management fees we charge the client and the brokerage commissions the client pays to KS or another broker to execute our transactions.

With respect to Green Owl, however, clients that hold Green Owl in their KIG-managed accounts do not pay management fees in addition to the management fee that KIG charges Green Owl itself. In other words, there is no “layering of fees” in such circumstances.

Our clients may also pay IRA trustee fees and custodial fees if the client chooses or uses these services. The IRA trustee KIG selects charges each client IRA a nominal annual fee. The custodian that KIG recommends does not charge clients a fee for this service. The client will pay brokerage costs and the amount will depend on the brokerage firm executing the client transactions. Brokerage is discussed in greater detail in the sections entitled “Use of KS for Client Trades; Conflicts of Interest” and “Brokerage Practices.” If a client selects the IRA trustee, the custodian, or the broker, KIG will not control the amount of these fees. KIG will not be able to negotiate these fees on behalf of the client.

We are the investment manager (sub-adviser) for clients of other investment advisers. These advisers operate programs in which we participate and we are paid a portion of the fees that they collect.

KIG directly or indirectly receives fees in consideration for its management of the hedge funds and other private funds described above in amounts described in the prospectuses and other offering documents for those investments.

## **Use of KS for Client Trades; Conflicts of Interest**

Clients pay brokerage commissions for execution of transactions in their accounts.

Generally, we recommend and select KS as broker for client accounts and transactions. KIG also uses KS for execution of certain transactions for Green Owl, and for certain transactions in or for the affiliated hedge funds and other private placements described above. KS receives a nominal brokerage commission to execute each client transaction for which it acts as broker. KS clears its transactions through Pershing, LLC (Pershing), which also is the custodian for KIG client accounts. Clients may direct KIG to use a different broker to execute that client's transactions. If a client selects the broker, KIG may not be able to negotiate the amount of the commissions or provide best execution of transactions.

KS receives 12b-1 trail commissions from unaffiliated mutual funds that are purchased for client accounts, including money market funds in which KIG invests clients' cash balances. KS receives a fee for its placement of investors in Sandbox. The owners of KIG are also the owners of KS and they receive a financial benefit from the use of KS in executing client trades. This is a conflict of interest. Clients may use brokers not affiliated with KIG to execute transactions.

Employees of KIG who provide investment advice to clients are also registered representatives of KS. These employees do not receive any portion of commissions from transactions in client accounts. These employees can receive a portion of the investment management fee the client pays KIG. Therefore, they have an incentive to grow their clients' assets, not to generate brokerage commissions. KIG and its owners are incentivized monetarily to maximize long-term growth of client assets, not to generate brokerage commissions. Our investment management philosophy is concentrated on long-term asset growth, not on short-term trading. Although we do not offset brokerage commissions against management fees, we believe that it is in our, our clients', and our employees' best interest to minimize transaction costs and increase the value of the clients' accounts. This is reflected in the fact that KS's revenues are a small percentage of the revenues that KIG receives for providing investment management services.

For more details of our brokerage practices, including our use of KS for client trades, see the section below entitled "Brokerage Practices."

## **PERFORMANCE-BASED FEES/SIDE-BY-SIDE MANAGEMENT**

As we described above, we charge quarterly investment management fees for providing investment management services to our advisory clients.

We charge performance-based fees to our affiliated private funds, including Anchor, New Millennium, New Millennium QP, PWK QP, and PWK Atlas I. We also may receive performance-based benefits from our involvement in Sandbox, VK, and KPH, though these investments are not open to new investors.

This is a conflict of interest in that we have an incentive to favor the private funds over our advisory clients who only pay investment management fees and not performance-based fees.

We have addressed this conflict as follows:

### **KIG's Affiliated Private Funds**

- KIG's affiliated private funds are not suitable for all clients, they are not permitted for certain clients, and we do not market them to the general public. As described above, we first consult with our clients to determine the nature of their financial condition, their financial objectives, income and liquidity needs, desire and need for principal protection, risk tolerance, and tax sensitivities. We also assess the client's investment sophistication, net worth, and eligibility in determining whether it is suitable to recommend investments that pay performance-based fees;
- The affiliated private funds have a different investment objective, require a higher risk tolerance, have a different investment strategy, and are usually less liquid than investments held in our non-private fund advisory clients. The private funds often invest in securities in which non-private fund investors do not invest;
- When the private funds do invest in the same securities as non-private fund investors, we generally execute those transactions at the same time and use an average price to complete the transaction;
- Also, when the private funds do invest in the same securities as non-private fund investors, and if we cannot complete the entire desired transaction for all clients, we use a lottery system to determine on a random basis for which investors we allocate the desired security transaction;
- KIG does not exercise discretion with respect to investing client assets in its affiliated private funds (that is, the client must choose to invest in such funds);
- Our employees do not receive transaction-based compensation (commissions) for recommending the private funds to clients. As we discussed above, our employees have an incentive to grow their clients' assets over time and receive a portion of the fees that the clients pay to KIG;
- Many of the investors in the affiliated private funds are also separate advisory clients of KIG, and these clients' non-private fund assets under management usually significantly exceed their investments in the private funds. This creates a disincentive for KIG to favor the private funds over separately managed accounts;
- Sandbox, VK, and KPH are not open to new investors, and Sandbox, VK, KPH, and PWK Atlas I generally do not invest in the same kinds of investments as non-private fund advisory clients, and;
- KIG will not, directly or indirectly, charge fees in a manner which results in charging more than once on particular assets (sometimes referred to as double dipping).

## **Green Owl**

With respect to Green Owl, and as noted above, KIG generally intends to manage Green Owl according to the same strategy as that of its separate (equity) account clients (i.e. side-by-side). Subject to day-to-day cash flows in Green Owl (which result from underlying shareholder activity over which KIG has no direct control), KIG generally intends to transact in the same securities as in its separate accounts, and apply an average price to such transactions. If we cannot complete the entire desired transaction for all clients, we use a lottery system to determine on a random basis which clients (including Green Owl) will receive an allocation of the intended transaction.

## **TYPES OF CLIENTS**

We provide investment management services to:

- Individuals (primarily those with a high net worth) and their related accounts such as retirement accounts (IRAs), trusts, partnerships, and businesses;
- Retirement plans such as 401(k) and profit-sharing plans;
- Business Accounts of small businesses;
- Certain institutional clients (such as Taft-Hartley plans);
- Charitable foundations and other not-for-profit organizations; and
- Affiliated private funds (including hedge funds) (described above).

We also have arrangements with other investment advisers where we serve as sub-adviser for their clients, and we manage their clients' investments on a day-to-day basis.

We also act as a sub-adviser to a mutual fund.

In addition, we act as investment adviser to Green Owl (refer to our discussion of Green Owl in various places throughout this brochure. Please also refer to the Green Owl prospectus for more information, available at [www.greenowlfund.com](http://www.greenowlfund.com)).

### **Investment Minimums**

We inform clients that we prefer a \$500,000 minimum initial relationship for separate accounts.

## **METHODS OF ANALYSIS, INVESTMENT STRATEGIES, RISK OF LOSS**

Investing in securities involves the risk of loss, and the loss may be permanent, and clients should be prepared to bear that risk. We try to manage that risk for our clients by considering the client's financial condition, financial objectives, income and liquidity needs, desire and need for principal protection, risk tolerance and tax sensitivities, and by managing and rebalancing the client's assets to a target asset allocation. We also manage this risk of loss by diligent security selection. We discuss this issue in more detail below.

The following discussion is limited to our investment strategies, methods of analysis, and risks relating to individual equities and fixed income securities. These are the strategies and securities that are significant in our investment management for our advisory clients.

## **Equities**

### **Our Investment Philosophy, Strategy, and Material Risks**

Our equity selection philosophy is based on adopting a business owner mentality and adhering to a “Margin of Safety” principle. Risk of loss from an investment in equities can arise from faulty assumptions about a company’s intrinsic value, including assumptions as to normalized earnings, growth of earnings, and the company’s competitive advantage. We try to pay a price significantly below our estimate of intrinsic or private business valuation. This approach mitigates risk of permanent loss of capital should our analysis or assumptions prove inaccurate. We apply this methodology and analysis diligently.

There are other risks in investing in equities. Equity prices can be volatile and unpredictable over short periods of time. Unexpected external influences such as economic and political events can significantly impact equity prices. Certain equities may be illiquid and the sales price might be impacted if the holder has to sell before he or she intended.

### **Discipline**

We look to invest in industry leading, prudently capitalized (focus on use of leverage) companies that have a competitive advantage. We are very focused on the price we pay. We will pay a price we believe is significantly below intrinsic value and we are willing to wait for the market to realize that value. Intrinsic value is based on the discounted value of future cash flows. We do not decide to buy, sell, or hold stocks based on what others think the market or the economy is going to do, but based instead on how the intrinsic value of the business compares to the market price of the stock. We select (or hold) clients’ equities in much the same way we would evaluate a business if we wanted to buy or keep the whole company.

### **Patience**

We believe that having a long time horizon is an advantage to investing successfully (out-performing a benchmark over multi-year periods). Our business structure allows us a long time horizon as the interests of the client, the planner, and the investment manager are aligned. Our decisions are based on long-term business values rather than short-term events or financial reports. Our client base has a long time horizon that allows us this investment advantage.

### **Perspective**

While we strive to maximize return, we stress the importance of safety of principal with a focus on minimizing permanent loss of capital. We therefore purchase stocks at a significant discount to our estimate of underlying intrinsic value. This allows us to generate substantial return when our analysis and assumptions prove correct, while minimizing downside risk if a particular investment thesis is flawed or if for some other reason our assumptions prove incorrect. Implementing these principles often results in investment decisions that run counter to general market sentiment. We

believe this approach is consistent with our focus on maximizing long-term net worth whether or not we generate short-term performance. Market price movements are important to us because they alternately create low price levels at which we can buy and high price levels at which we can sell.

### **Equity Research – Method of Analysis**

Our equity research and method of analysis apply a thorough process to screen, track, evaluate, and manage our clients' equity portfolios. Our method of analysis is primarily fundamental and we rely heavily on our review of publicly available filings and other proprietary research. We do not concentrate on meetings with management or research reports prepared by third party analysts. We summarize below the important facets of our approach:

#### **Qualitative Assessment**

- Market leaders with strong competitive positions;
- Stable products and economies of scale and/or scope;
- Low capital requirements; and
- Experienced and competent management with ownership stakes.

#### **Quantitative Assessment**

- High returns on capital;
- High correlation between earnings and cash flow;
- Low financial risk; and
- Valuations based on discounted cash flow models.

### **Fixed Income**

Our investment approach to fixed income investing stresses preservation of wealth. We believe that a quality bond portfolio constructed and rebalanced to pursuant to a thoughtful asset allocation mitigates risk by adding a low correlated asset class to equities. We believe our competitive advantage in managing fixed income lies in our diligent execution process which enables us to achieve excess yield without accepting excess risk.

We try to accomplish this by patiently bidding on bonds owned by third party bond sellers and by our willingness to buy odd (smaller) lots of bonds, bonds selling at a premium, AMT bonds, and sinking fund bonds. The demand for these kinds of bonds is typically lower, and therefore we are able to buy them at lower prices (and higher yields) for our clients. We anticipate holding the bonds to maturity and therefore our less concerned with interim price fluctuations. We do not have KIG own or inventory bonds for later sale to our clients. We buy bonds for direct allocation to specific client accounts based on the specific client's asset allocation and circumstances.

Depending on our specific client's investment objective, we will build a bond ladder of individual bonds maturing in different years in order to provide liquidity, an income stream, and reinvestment at higher rates. We typically do not purchase bond mutual funds for our clients.

Our strategy, method of analysis, and objective in purchasing bonds are:

- to preserve client principal;
- to not attempt to forecast interest rates. Instead, we take advantage of current market conditions to identify excess yield available in the bond market;
- to not compromise credit quality. We consider underlying ratings and financial health of the bond issuer and any insurer. We focus on the nature of the bond issue, and we prefer general obligation and essential service backed bonds;
- to obtain above market returns through a disciplined purchasing strategy, and not by assuming added credit risk;
- to adhere to the client's specific needs and circumstances such as state preferences, income needs, and tax sensitivities;
- to be flexible as to the timing of principal and interest payments so long as our clients receive satisfactory additional yield due to this nuance;
- to be willing to accept modest liquidity risk when such risk can potentially lead to greater returns;
- to match the client's cash flow needs with our view of interest rate and liquidity risk to build a suitable portfolio;
- to purchase and sell through an open bidding process to ensure fresh, accurate, and above market yields. We do not hold bonds in inventory. We do not buy bonds from clients for our company's account, nor do we sell bonds to clients from our own company's account; and
- to purchase bonds with specific clients in mind.

There are risks in investing in fixed income securities. Fixed income security prices can be volatile and unpredictable over short periods of time. Unexpected external influences such as economic and political events can significantly impact fixed income prices. Certain fixed income securities may be illiquid and the sales price might be impacted if the holder has to sell before he or she intended. Rating changes will impact fixed income security prices. The actual or perceived financial health of the issuer will impact fixed income security prices.

Investment strategies, methods of analysis, and risks in investing in our affiliated hedge funds and private placements are described in detail in the offering documents for those investments.

## **DISCIPLINARY INFORMATION**

Not applicable.

## **OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

KIG is affiliated with KS and is owned by the same individuals as KS. KS is a broker-dealer. KIG uses KS to execute most advisory client securities transactions. KS receives nominal commissions for executing these transactions and therefore the owners of KS receive a benefit from the execution of KIG advisory client trades. This is a conflict of interest. Please see the disclosure above in the section entitled "Fees and Compensation – Use of KIG's Affiliated Broker for Client Trades;

Conflicts of Interest” as to how KIG addresses this conflict. Also see the section below entitled “Brokerage Practices” for additional disclosure.

Most of the employees of KIG are also registered as representatives (brokers) of KS. These employees do not receive any portion of KS commissions earned from KIG transactions in client accounts.

KIG is investment adviser to Green Owl. Please refer to our discussion of Green Owl in various places throughout this brochure, including how we manage Green Owl alongside our separate client accounts and affiliated private funds. Please also refer to the Green Owl prospectus for more information at [www.greenowlfund.com](http://www.greenowlfund.com).

KIG is the general partner of each of the affiliated hedge funds, Anchor, New Millennium, and New Millennium QP. This is a conflict of interest. Please see the disclosure above in section entitled “Performance-Based Fees/Side-by-Side Management” for a description of this conflict and as to how KIG addresses this conflict.

KIG or an affiliate serves as managing member, co-owner of the general partner, investment adviser, or is otherwise affiliated with or controls Sandbox, VK, KPH, PWK QP, and PWK Atlas I. Sandbox, VK, and KPH are not accepting new investors. The affiliated private funds do not have the same investment objective as KIG’s separate client accounts. Please see the disclosure above in the section entitled “Performance-Based Fees/Side-by-Side Management” with respect to these relationships.

## **CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS, AND PERSONAL TRADING**

We have adopted a Code of Ethics (Code). We recognize that we have a fiduciary duty to our clients in providing investment management services and we will act in our clients’ best interests. Our Code includes:

- A requirement that our employees read the Code upon the start of their KIG employment, and annually thereafter, and that they certify they have read it;
- Rules regarding the giving and receiving of gifts and business entertainment;
- Rules for review and approval by us if our employees wish to engage in outside business activities;
- Rules regarding KIG or its employees making political contributions;
- Requirements that we review the Code on a periodic basis, and annually assess the risks that exist in our business;
- Rules for enforcing our Code and for reporting violations of our Code to our compliance staff; and

- Rules for reviewing and approving our employees' securities accounts and transactions.

We provide a copy of our Code to our clients or prospective clients upon their request.

### **Personal Trading; Investing Alongside Clients**

Our employees invest in the same securities (particularly equities) in which our advisory clients invest (our discussion of advisory clients in this context generally includes Green Owl). Also, Anchor, New Millennium, and New Millennium QP, though managed according to a different strategy to that of KIG's separate accounts, usually invest in these securities at the same time that we recommend these securities for our advisory clients. In addition, PWK QP and PWK Atlas I may invest in securities at the same time as Anchor, New Millennium, New Millennium QP, or KIG's separate accounts. We are committed to our investment approach and security selection and therefore want to be invested in the same securities we recommend for advisory clients.

This is a conflict of interest. There is a risk that we will favor our own accounts or accounts of our performance-based fee earning affiliated private funds over accounts of our clients in the timing or allocation of security transactions. There is a risk that we may choose to buy a security in our accounts before we buy it in our advisory clients' accounts. There is also a risk that we may allocate a security in limited supply to our accounts or our affiliated private funds' accounts instead of accounts of our advisory clients.

We have addressed these conflicts:

- Employees must report all of their and their family's personal securities holdings. They are required to do so when they start working at KIG and annually thereafter;
- Generally, all employees must obtain "pre-approval" from compliance staff before buying or selling in their own accounts the same securities owned by our clients;
- All employees are required to report securities transactions in their and their family's accounts. This includes transactions executed away from KIG. We review these transactions on a periodic basis;
- We conduct periodic reviews of the performance of employee accounts and whether employees buy or sell securities prior to buying or selling for clients;
- When our employees or our affiliated private funds do invest in the same securities as our advisory clients, we execute those transactions at the same time and use an average price to complete the transaction;
- When our employees or our affiliated private funds do invest in the same securities as our advisory clients, and if we cannot complete the entire desired transaction for all clients, we use a lottery system to determine on a random basis for which accounts the transaction will be completed. Transactions in employee and employee-related accounts are only completed after all other transactions are completed;

- Please see the disclosure above in the section entitled “Performance-Based Fees/Side-by-Side Management” for additional discussion of how we address these conflicts.

### **Participation or Interest in Client Transactions**

As we noted above, we may recommend investments in which we or an affiliate has a financial interest. We will only make this recommendation if the investment is suitable for the client. We will consider the clients’ net worth, risk tolerance, and sophistication. We have described these investments in the section above entitled “KIG’s Investment Advisory Business – Investment Management – Other Types of Securities – Hedge Funds and other Private Placements.”

This is a conflict of interest. We have addressed this conflict. Please see the discussion in the sections above entitled “Fees and Compensation – Use of KIG’s Affiliated Broker for Client Trades; Conflicts of Interest” and “Performance-Based Fees/Side-by-Side Management.”

## **BROKERAGE PRACTICES**

### **General**

Our advisory clients pay brokerage commissions for execution of securities transactions in their accounts. The broker will usually assess these commissions as a minimum charge per trade. If the number of shares involved in the transaction is large, the broker’s commission may be assessed as a charge per share. These commissions are in addition to the investment management fees clients pay to KIG.

KIG considers the following when selecting brokers for client trades:

- Cost;
- Execution price and timing;
- Accessibility and responsiveness of broker staff;
- Quality, depth, and breadth of services the broker offers;
- Tools and applications the broker provides to benefit our clients;
- The broker’s willingness to accommodate clients’ special needs;
- Access to liquidity (to facilitate our sales and minimize market price impact);
- Protection of confidential information;
- Trade allocation policies;
- Trade error correction policies; and
- The broker’s integrity, reputation and financial condition.

### **Use of KIG’s Affiliated Broker**

KIG generally uses KS to execute transactions in advisory client accounts (including Green Owl and affiliated private funds). KS and KIG are affiliated. KS clears transactions through Pershing. Pershing is generally the custodian for KIG advisory client accounts.

Our primary consideration for broker selection is obtaining the best execution for client trades. KIG's use of KS is a conflict of interest. The same individuals own KIG and KS. These individuals will benefit from commissions KS receives. KIG could initiate more transactions for advisory clients than would be in the best interests of the clients to generate more commissions.

KIG has addressed this conflict. KIG generally chooses KS to execute client security transactions to:

- Ensure efficient coordination between the investment management and brokerage functions (that is, we have complete control over both aspects of managing client investments);
- Ease communication between investment manager and broker (KIG and KS share personnel and office space);
- Control commission charges to ensure reductions from stated rates when appropriate and to provide fair trade error correction; and,
- Avoid inappropriate broker selection that might result when brokers compete for and try to influence the adviser's broker selection.

KIG does not allow its employees to share in trade commissions. KIG employees receive higher compensation when client assets grow. This reduces employee temptation to inappropriately trade frequently. A very high percentage of aggregate KIG and KS revenue is investment management fees (not commissions) charged on the value of assets managed. KIG is incented to grow client assets. Frequent trades are not consistent with the KIG investment philosophy described above.

#### **Receipt of Soft Dollar Benefits**

We receive hardware and software tools, administrative and reporting tools, and research and other items as a result of our relationship with Pershing and because of the brokerage relationships with our affiliated private funds. These tools and research products benefit to some extent all KIG clients.

We do not have to pay separately for these tools and research products and we benefit from that. We may have an incentive to enter these relationships based on our receipt of these tools and research products rather than on our clients' interest in receiving best execution. However, we believe that receipt of these tools and products is customary and is not a material element of the relationships.

Neither affiliated private fund nor advisory client commissions are generally used to pay for such tools or for research products.

#### **Trade Errors**

Trade errors occur. We intend to make our clients whole whether the error is caused by us, KS, or Pershing. When we use KS we have control over trade error resolution. This includes discretion as to how we allocate erroneous trades to other accounts. We have policies and procedures governing

this process, and KIG does not retain profits resulting from trade errors. We donate these profits to a charity we choose. We receive an economic benefit if we are allowed a tax deduction for charitable donations.

KIG will use unaffiliated brokers to execute advisory client trades from time to time. KIG has limited ability to effect desired resolutions of trade errors involving unaffiliated brokers.

We consider trade error correction policies in using KS to execute advisory client trades.

### **Aggregation**

We generally aggregate or group advisory client transactions in the same securities when executed on the same day. This ensures efficient trade execution and allows us to provide an average price for each client trade. This treatment also minimizes preferential treatment for certain clients over others and is consistent with our obligations to obtain the best execution for client trades.

Although clients receive an average price for the security transaction when we group transactions, clients do not share the aggregate commissions charged for these trades on a pro rata basis. Each client pays a commission pursuant to its management agreement (or discounted, where appropriate). The commission amounts that each client pays (to KS or other brokers) may vary depending on the client's assets under management, agreed management fee charges, or other factors. Therefore, clients may pay higher or lower commissions than other clients, even if purchasing or selling the same amount of securities. KS does not receive reduced commission charges from Pershing based on the size of a transaction order.

### **Directed Brokerage**

Advisory clients may direct KIG to use a certain broker to execute security transactions.

If a client directs us to use a broker other than KS:

- We have limited ability to negotiate commission rates on the client's behalf;
- We do not have the ability to aggregate or group trades at such brokers with trades that KS executes for clients. We are unable to apply an average price for trades executed by unaffiliated brokers with trades executed by KS. This results in the client paying a different total price than obtained by clients whose trades KS executes;
- We have limited ability to ensure best execution; and
- The client may pay different, and sometimes significantly higher, commission rates than those charged on trades KS executes.

For clients who direct us to use brokers other than KS for their transactions, such brokers may have the ability to group transactions and apply an average price if there is more than one KIG client account held at the same broker. As with trades at KS, that broker may not share or spread aggregate commissions for these trades pro rata among the accounts in the group.

## **REVIEW OF ACCOUNTS**

KIG reviews client accounts on a regular and continuous basis. At a minimum, our portfolio/account managers review accounts quarterly. We also conduct reviews based on other triggers such as significant life events (retirement, receipt of an inheritance, etc.), firm-wide purchases or sales of securities, and bond maturities.

Our portfolio managers consider the following when periodically reviewing their clients' accounts:

- Securities held in the account;
- Position sizes;
- Suitability;
- The client's investment objective;
- Asset allocation; and
- The client's risk tolerance.

Clients receive periodic account statements (usually monthly) and trade confirmations directly from their broker and/or custodian of their assets. We also provide our clients quarterly account statements, annual tax reports, and various other reports from time to time.

## **CLIENT REFERRALS AND OTHER COMPENSATION**

We have agreements with unaffiliated third parties who refer clients to KIG. We pay these third parties a portion of the investment management fees we receive for managing the accounts of the referred clients. The referred clients receive disclosure about the nature of our arrangement and the portion of the management fees that we pay for the referral.

We are also the investment manager for clients of other investment advisers. These advisers operate programs that we participate in and we are paid a portion of the fees that they collect. We also manage assets for a mutual fund. We are one of several advisers in this regard. We are paid a fee by the primary adviser of the mutual fund.

## **CUSTODY**

We do not have custody of the funds or securities in our individual advisory clients' accounts, whether held at Pershing or another broker or clearing firm. We do not have the authority to hold or obtain possession of client funds or securities in connection with the advisory services we provide to clients. We can periodically direct our clients' brokers or custodians to pay us directly from client accounts the management fees we are due for managing client accounts.

As we described in "Review of Accounts," above, clients receive periodic account statements and trade confirmations directly from their broker and/or custodian of their assets. We also directly provide account statements and other reports to our clients on a periodic basis. We urge our clients to carefully review the statements they receive and to compare the statements we provide with the statements they receive directly from their broker or custodian.

Although we do not have custody of our individual advisory clients' assets, we do have custody of the funds and securities of Anchor, New Millennium, New Millennium QP, KPH, PWK QP, and PWK Atlas I because we are the general partner of such funds, or otherwise control or are affiliated with the general partners of such funds. As such, we have control over the trading and movement of assets in and out of the private funds. We have various controls in place to protect the funds and securities in such funds. We use an independent third party to administer Anchor, New Millennium, New Millennium QP, PWK QP, and PWK Atlas I, and to provide statements to the fund investors on a periodic basis. In addition, we use an independent accounting firm to audit the financial statements of Anchor, New Millennium, New Millennium QP, KPH, PWK QP, and PWK Atlas I on an annual basis.

## **INVESTMENT DISCRETION**

We provide discretionary investment management services to our clients. This means that when clients hire us they give us trading authorization. We do not need specific approval from clients each time we decide to purchase or sell securities in the accounts that we manage for them. Clients give us discretionary trading authority by executing our investment advisory agreement when they hire us to manage their assets.

As we have described in the section above entitled "KIG's Investment Advisory Business," clients can limit our trading authority by restricting us from purchasing or selling certain securities.

## **VOTING CLIENT SECURITIES**

As a general practice, we do not vote client securities (proxies) held in individual client accounts unless we specifically agree to accept this authority and responsibility in writing (although clients may always contact us with questions on proxy matters). Clients receive voting and proxy information directly from the issuers of the securities in their accounts.

For institutional clients (including mutual fund clients such as Green Owl), we will vote proxies if the advisory client delegates, and we agree to accept, such authority.

As general partner of our affiliated private funds, we have authority to vote securities held by such funds.

## **FINANCIAL INFORMATION**

Not applicable.