MORILL STANFILL & CO./EDWARD F. O'KEEFE

Pub. Avail. April 13, 1978

TOTAL NUMBER OF LETTERS: 2

SEC REPLY 1: RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No: 77 1029CC
Edward F. O'Keefe
File No. 132 3

March 14, 1978

Section 206(4) of the Investment Advisers Act of 1940 (the "Act") makes it unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative. Rule 206(4)-1(a) (5) (the "rule") under the Act provides that it shall constitute a fraudulent, deceptive or manipulative act for any investment adviser to distribute, directly or indirectly, any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

The Act, and the rules thereunder, do not prohibit an investment adviser from informing prospective clients of the "performance" of accounts under management so long as such information is not false or misleading. Care, therefore, should be taken in providing prospective clients with information about the "performance" of accounts under management.

In the absence of a specific statement as to what is the relevance to a prospective client of the "performance" of accounts under management of an investment adviser, we assume that the implied relevance of such information is that it is an indication of the competence of the investment adviser or the experience of the adviser's clients and, thus, an indication of the competence that a prospective client can expect to be exercised on his behalf or an example of an investment experience that is possible for him.

Information concerning performance is misleading if it implies something about, or is likely to cause an inference to be drawn concerning, the experience of advisory clients, the possibilities of a prospective client having an investment experience similar to that which the performance data suggests was enjoyed by the adviser's clients, or the adviser's competence when there are additional facts known to the investment adviser, or which he ought to know, which if also provided would cause the implication not to arise or prevent the inference from being drawn.

Thus, giving a prospective client performance data concerning only certain periods or about only some accounts under management would not necessarily be misleading if the inclusion of information concerning other periods, or the experience of any of the accounts whose experience is omitted, would not prevent any implication from arising or inference being drawn that is based on the information that has been provided and concerns advisory competence, the experience of the adviser's clients or the possibility of the client or prospective clients having a similar experience.

The giving of information concerning the average or median performance of all accounts under management or of all accounts meeting the fully disclosed selection criteria for a designated category of accounts under management is similarly, not necessarily misleading but may be misleading under certain circumstances. For example, assume two accounts under management: one with assets of $100,000 and the other with assets of $1,000,000. Assume further that the first account goes up to $150,000 and the second goes down to $500,000. The "Performance" of the first account may be described as a 50% loss. The average or median performance could be described as zero. Such a statement by itself, however, would be misleading.

Providing information as to the percentage change in accounts under management without indicating the respective sizes of such accounts may also be misleading. A mere statement with respect to the foregoing example that one account under management increased 50% and the other account decreased 50% may imply or cause an inference to be drawn about advisory competence or the experience of advisory accounts which would not arise if it was also stated that the account which increased 50% went from $100,000 to $150,000 and that the account which decreased 50% went from $1,000,000 to $500,000.

Information concerning performance of accounts over a period or periods attended by special market characteristics may imply or cause an inference to be drawn about the competence of the adviser or the possibility of a client enjoying a similar experience which would not arise if such characteristics were also disclosed. For example, the statement to a prospective client that accounts under management appreciated 50% in the last three years may contain an implication or give rise to an inference about the possibility of the prospective client having a similar experience that would not arise if the last three years represented an unusual period in the history of the market and this fact was also stated. The inclusion of a statement that the adviser does not guarantee that future results will equal past results or that a prospective client should not assume that future results will equal past results may not, by itself, deal effectively with what is misleading about the statement which is that it implies something about, or gives rise to an inference concerning, the possibility of a prospective client having a similar experience that would not be implied or inferred if all of the relevant facts known to the adviser, or which he should have know, had been stated. Furthermore, a statement that accounts appreciated 50% may cause an inference to be drawn about advisory competence that would not be drawn if it was the fact and it was stated that the S & P 500 also increased 50% during the same period. However, comparisons of investment results with a market index or with other portfolios may be misleading unless facts bearing on the fairness of any comparison are disclosed such as (1) the inclusion of income and capital gains or losses both realized and unrealized in one of the figures to be compared, (2) the type of security, i.e., equity or debt, composing the account, (3) the object of the account and the stability or volatility of the market prices of the securities in which it is invested, (4) the diversification in the account, and (5) the size of the account.

In addition, if accounts are subject to commission, advisory and other expenses and charges, performance figures not reflecting such expenses and charges may convey an impression or give rise to an inference concerning the experience of existing accounts which is misleading.

While we have attempted to indicate, generally, what kind of information is necessary to prevent information about performance from being misleading, whether or not any communication is or is not misleading will depend on all the particular facts including (1) the form as well as the content of a communication, (2) the implications or inferences arising out of the communication in its total context and (3) the sophistication of the prospective client. Accordingly, we cannot and do not "clear" specific advertising materials for use.

Stanley B. Judd, Assistant Chief Counsel
Division of Investment Management

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October 17, 1977

Office of Chief Counsel
Division of Investment Management
Securities and Exchange Commission

Washington, D.C. 20549

Re: Investment Advisors Act of 1940:
Reg. Section 275.206(4)-1; Request for No Action Response

Gentlemen:

Morrill Stanfill & Co. is a Colorado corporation located at Suite 700, 600 South Cherry Street, Denver, Colorado 80222. The Corporation is registered as an investment advisor pursuant to the Investment Advisors Act of 1940. The corporation has two principal officers and employees, Mr. James R. Morrill and Mr. William D. Stanfill. This writer serves as counsel for the firm.

By letter to the Division of Investment Management dated August 31, 1976, Morrell Stanfill & Co. attempted to solicit comment from the Commission Staff with regard to certain items of sales literature then being utilized by the corporation in its solicitation of clientele. In response to that letter, the Assistant Chief Counsel of the Division of Investment Management advised that because of budget and manpower limitations, the Division would be unable to review the said sales material and to comment thereon. The suggestion was given that a more appropriate method to be unable to review the said sales material and to comment thereon. The suggestion was given that a more appropriate method to be utilized in soliciting a response from the SEC Staff with regard to the corporation's sales literature would be through the medium of a no action letter (please refer to your Ref. No. 76 474CC; Morrill Stanfill & Co.; File No. 801-10445-3).

This letter constitutes a no action request to the SEC staff.

Since no specific guidelines have been adopted by the SEC relating to the utilization of sales literature by investment advisors (with exception of Rule 206(4)-1 under Section 206 of the Investment Advisors Act), it is impossible for this writer to determine whether the enclosed items of sales literature would, or would not, be deemed acceptable by the Commission. It is this writer's opinion, however, that the items do not violate any of the provisions of Rule 206(4)-1.

The absence of any such guidelines, and the resultant difficulty in determining whether a particular item of sales literature may, or may not, be deemed to be objectionable by the Commission or by the SEC Staff, is the prime precipitant for the no action request made herein.

The enclosed items of sales and advertising materials which are utilized by Morrill Stanfill & Co. in its solicitation of clientele are as follows:

Exhibit A: Morrill Stanfill & Co. brochure entitled "Statement of Policy and Investment Philosophy."

Exhibit B: Document entitled Revised Fee Schedule, which accompanies the brochure entitled "Statement of Policy and Investment Philosophy."

Exhibit C: Introductory letter, a hypothetical example of which is the enclosed letter to Mr. Homer Price dated September 13, 1977;

Exhibit D: Becker performance data, which accompanies Exhibit C. This performance data relates to the portfolio management efforts of Morrill Stanfill
& Co. from June, 1974 through a recent date in 1977, in providing service to one of the corporation's investment advisory clients.

Exhibit E: Performance data containing information relating to Hamilton Income Fund, Inc., a publicly offered, registered investment company, for which Mr. James R. Morrill, the President of Morrill Stanfill & Co., served as portfolio manager from 1971 through October, 1974. This also accompanies Exhibit C.

Exhibit F: A narrative page containing no heading, which provides an explanation of the performance data included on Exhibits D and E, and which outlines the restrictive nature of the conclusions which should be drawn from the said performance information. This page always accompanies Exhibits D and E.

Exhibit G: Three data sheets, comparing the performance of two trust accounts managed by Morrill Stanfill & Co. with the leading market indices. Exhibit G 1 provides current year to date data, Exhibit G 2 provides data for the preceding year, and Exhibit G 3 provides data from the date of inception of management of the accounts by Morrill Stanfill & Co. through the most recent quarter years. These exhibits are rarely mailed to prospects or to clients; instead, they may be shown to prospects or clients during personal meetings.

In its consideration of the enclosed materials, the SEC Staff should be advised of the following:

1. Morrill Stanfill & Co. deals primarily with sophisticated investors. For example, although the company will agree to manage smaller accounts in efforts to accommodate existing clientele or for similar reasons, its solicitation efforts are generally limited to accounts having an asset base of at least $500,000 and generated additional cash flow.

2. The performance results of the accounts about which performance information is provided in Exhibits D and G are representative of the results achieved by Morrill Stanfill & Co. in providing investment advisory services to similar clients during the indicated periods of performance.

3. Where such performance results are provided to a prospective client, Morrill Stanfill & Co. can justify the applicability of the results to the account being solicited: i.e., the accounts will be similar in investment objectives, in the investment approach to be utilized in the management thereof, in the types of securities to be purchased for and on behalf of the solicited account, and in other particulars which Morill Stanfill & Co. might deem relevant.

4. Morrill Stanfill & Co. is prepared to provide similar performance records for any other accounts upon request, and so states in the narrative information which accompanies the performance materials (Exhibit F).

5. The Becker performance data is updated on a quarterly basis; the most recent quarterly summary data provided by Becker is utilized by Morrill Stanfill & Co. as the item of sales literature corresponding to that enclosed as Exhibit D.

Morrill Stanfill & Co. requests a response from the SEC Staff that, on the basis of the facts stated in this letter and on the basis of the Exhibits enclosed herewith, the Staff would not recommend that the Commission take any enforcement action against Morrill Stanfill & Co. if the corporation continues to utilize the sales literature enclosed herewith in the solicitation of investment advisory clients.

Thank you for your assistance and cooperation.

Very truly yours,

Edward F. O'Keefe