UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. HOWARD B. PRESENT, Defendant.	Case No. JURY TRIAL DEMANDED

COMPLAINT

Plaintiff Securities and Exchange Commission ("the Commission") alleges the following against defendant Howard Present ("Present") and demands a jury trial:

PRELIMINARY STATEMENT

1. On many occasions between August 2008 and September 2013, Howard Present made materially false and misleading statements about "AlphaSector," the flagship product offered by F-Squared Investments, Inc. ("F-Squared"), an investment adviser in Wellesley, Massachusetts. Present is the co-founder of F-Squared, which is the nation's largest marketer of index products[1] using "exchange-traded funds."[2] Until his departure in November 2014, Present was the CEO of F-Squared.

[1] An "index" is an imaginary portfolio of securities. Some indexes represent a particular economic sector. For example, a technology sector index holds securities in technology-related companies. An index enables investors to evaluate the investment performance of an overall sector. One well-known index is the Standard & Poor's 500 Index ("S&P 500 Index"), which is an index of 500 stocks chosen for market size, liquidity, and industry sector. The S&P 500 is designed to be a leading indicator of U.S. equities.

[2] An "exchange-traded fund" ("ETF") is a fund, managed by a financial institution, that is usually made up of securities in a particular sector of the economy or tracking a particular index. Unlike a mutual fund, ETF shares trade on an exchange like a stock and experience price changes throughout the day.

2. In August 2008, Present and F-Squared began creating AlphaSector, a model portfolio[3] of ETFs invested in different sectors of the U.S. economy. One step in this process was F-Squared's acquisition of the right to use a new quantitative algorithm[4] that generated signals indicating when to buy or sell an investment. The AlphaSector portfolio of ETFs was to be rebalanced periodically based on changes in the signals for each ETF. The collective performance of the model portfolio was to be published daily as an index. F-Squared launched the first AlphaSector index in October 2008. Since then, fees generated from AlphaSector have been by far the largest source of F-Squared's revenue.[5]

3. From 2008 until he left the company in November 2014, Present was the public face of F-Squared. He was quoted in its press releases and gave interviews to the financial media. He drafted many of its earliest advertising materials, some of which were posted on the company website, and he sent many of the materials to clients and prospective clients. He was involved in drafting the descriptions of AlphaSector in F-Squared's filings with the Commission, and he certified the accuracy of those filings.

4. From August 2008 to September 2013, Present made material misrepresentations about the AlphaSector strategy and its advertised performance. He falsely claimed that AlphaSector was based on an investment strategy that had been used to invest client assets since April 2001. He falsely claimed that AlphaSector's advertised track record for the period from April 2001 to September 2008 was based on actual investment performance and was not

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[3] A "model portfolio" can be a collection of hypothetical investments in certain specific securities. The performance of the model portfolio can be measured and tracked using the actual performance of the underlying investments.

[4] An "algorithm" is a mathematical model. In this case, the model analyzed price trend and volatility data to generate "signals" indicating when to buy or sell a particular security.

[5] F-Squared currently licenses many indexes under the "AlphaSector" brand. The indexes at issue here used a portfolio of ETFs, each of which held stocks in a different sector of the U.S. economy. The relevant indexes, collectively, will be referred to as "AlphaSector."

"backtested."[6] In reality, Present knew that the algorithm was not finalized until the late summer of 2008, when he himself selected rules for turning the algorithm's signals (own or do not own) into a model portfolio of ETFs – rules that an F-Squared analyst working with Present then used to calculate hypothetical returns for the model portfolio going back to April 2001. As a result, Present knew or was reckless in not knowing that the proprietary AlphaSector strategy was *not* based on a strategy that had been in use since April 2001. He also knew or was reckless in not knowing that AlphaSector's advertised performance for the period from April 2001 to September 2008 was based on hypothetical, backtested calculations – *not* on the actual performance of real investments for real clients.

5. The F-Squared analyst who calculated the backtested AlphaSector performance inadvertently applied the buy/sell signals to the wrong weeks. For every week from April 2001 to September 2008, the claimed "performance" of AlphaSector was based on hypothetical purchases or sales that were treated as having taken place one week too soon. The error thus created the mistaken appearance that AlphaSector had consistently bought ETFs one week before the prices rose and sold ETFs one week before the prices fell. From April 2001 to September 2008, the S&P 500 Index (the relevant benchmark) rose approximately 28%. If the algorithm's signals had been applied correctly to the historical ETF price data, the backtested performance of AlphaSector from April 2001 to September 2008 would have been a gain of as much as 38%. (The exact figure varied slightly with each AlphaSector index.) The calculation error, however, produced a gain of as much as 135% – more than 350% of the backtested gain if the signals had been applied correctly.

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[6] In this case, "backtesting" is the process by which a quantitative model – like the algorithm here – is applied to historical market data (that is, the past prices of the underlying securities), as if the model had actually been in use during that historical time period. The result is the hypothetical performance of the model during a past time period.

6. In late September 2008, Present was informed about a possible error in the calculation of AlphaSector's claimed performance since April 2001. He did not investigate further. He did nothing to ascertain whether the extremely positive track record that he was already advertising for AlphaSector had been calculated in error. As a result, Present knew or was reckless in not knowing that the pre-September 2008 performance of AlphaSector that he touted to the public was substantially overstated.

7. F-Squared's AlphaSector indexes are currently the nation's largest ETF-based strategy. As of June 30, 2014, approximately \$28.5 billion of invested assets tracked the indexes. Present profited handsomely from the firm's success. Between 2008 and 2014, he received more than \$8.1 million in wages and profit distributions. In addition, upon his departure from the company in November 2014, he was awarded a twelve-year package worth approximately \$8.5 million.

8. Through the activities alleged in this Complaint, Present engaged in: (a) fraudulent or deceptive conduct with respect to investment advisory clients, in violation of Sections 206(1), 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-8 promulgated thereunder; and (b) the making of untrue statements of material fact in reports filed with the Commission, in violation of Section 207 of the Advisers Act. Present also aided and abetted F-Squared's violation of Section 206(4) of the Advisers Act and Rule 206(4)-1 thereunder (the advertising rule).

9. Accordingly, the Commission seeks: (a) a permanent injunction prohibiting Present from further violations of the relevant provisions of the federal securities laws; (b) disgorgement of his ill-gotten gains, plus pre-judgment interest; and (c) a civil penalty due to the egregious nature of his violations.

JURISDICTION

10. The Commission seeks a permanent injunction and disgorgement pursuant to Section 209(d) of the Advisers Act [15 U.S.C. §80b-9(d)]. The Commission seeks a civil penalty pursuant to Section 209(e) of the Advisers Act [15 U.S.C. §80b-9(e)].

11. This Court has jurisdiction over this action pursuant to Sections 209(d), 209(e) and 214 of the Advisers Act [15 U.S.C. §§80b-9(d), 80b-9(e), 80b-14]. Venue is proper in this District because, at all relevant times, Present lived here.

12. In connection with the conduct described in this Complaint, Present directly or indirectly made use of the mails or the means or instruments of transportation or communication in interstate commerce.

13. Present's conduct involved fraud, deceit, or deliberate or reckless disregard of regulatory requirements, and resulted in substantial loss, or significant risk of substantial loss, to other persons.

DEFENDANT AND RELATED PARTY

Defendant

14. **Howard B. Present**, age 53, lives in Wellesley, Massachusetts. He co-founded F-Squared Investments, Inc. in May 2006 and was the CEO until his departure on November 14, 2014. Before founding F-Squared, he had a long career in the development and marketing of mutual funds. From April 2002 to November 2004, he was a managing director and the head of product development at a large mutual fund company, where he was responsible for the content of the firm's advertising materials, including representations about the historical performance of its mutual funds. From June 1996 to January 2002, he was a managing director and the head of

product development at another large mutual fund company, where he was involved in creating the firm's advertising materials.

Related Party

15. **F-Squared Investments, Inc.** ("F-Squared") is an investment adviser with its headquarters in Wellesley, Massachusetts. It has been registered with the Commission as an investment adviser since March 2008.[7] F-Squared licenses approximately 75 "AlphaSector" indexes. The AlphaSector indexes are currently the nation's largest ETF-based strategy. As of June 30, 2014, approximately $28.5 billion of invested assets tracked the indexes. F-Squared is the sub-adviser for $13 billion of mutual fund assets. Other assets are invested through separately managed accounts that buy and sell ETFs based on information they receive from F-Squared.

FACTUAL ALLEGATIONS

F-Squared's Financial Problems in mid-2008

16. In 2006, Present co-founded F-Squared to develop and market a quantitative-based product called "AlphaCycle." In 2008, despite two years of effort, AlphaCycle had yet to turn a profit. Indeed, as of July 15, 2008, F-Squared had received only $189 of AlphaCycle fees for the calendar year, while suffering a $609,000 net loss. By mid-2008, the company was struggling to meet its payroll.

17. As of mid-2008, Present held a 26% ownership share of F-Squared. As a result, he stood to profit handsomely if he could find a way to turn the company around.

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[7] F-Squared consented to the Commission's entry of an administrative order imposing sanctions for the misconduct at issue in this Complaint. The Commission issued the order on December 22, 2014.

Present Creates AlphaSector and Starts Advertising
the Product with False and Misleading Statements

18. In early June 2008, Present had several discussions with the principal of a private wealth advisory firm (hereafter, the "Wealth Advisor"), hoping to interest him in a joint venture using AlphaCycle. The two also discussed the potential advantages of a sector rotation strategy using ETFs.

19. At that time, Present learned that the Wealth Advisor had a 20-year-old college intern (hereafter, "the Intern") who was working on various quantitative projects, including a momentum-based algorithm that analyzed price trend and volatility data to generate buy/sell signals for investments.

20. In late July 2008, Present proposed that the Wealth Advisor grant F-Squared a license for the buy/sell signals from the Intern's algorithm, so that F-Squared could market a sector rotation strategy using ETFs. The Wealth Advisor expressed interest in the proposal.

21. On July 29, 2008, the Wealth Advisor delivered to Present a set of backtested signals for several sector ETFs that the Intern had generated with his algorithm. The signals indicated whether to own the ETFs during each week from March 8, 1999 to June 2, 2008.

22. Present began work on turning the algorithm's signals – which, by themselves, were simply discrete buy/sell recommendations for individual ETFs – into a model portfolio of ETFs whose overall performance could be measured and tracked as an index. To do so, he and an F-Squared analyst experimented with different portfolio construction rules, such as equal weighting of all ETFs with a positive signal, setting a cap on the exposure to any single ETF, deciding when and how to switch to "cash" (an ETF holding U.S. Treasury securities), and determining how often to rebalance the portfolio.

23. On July 30, 2008, Present emailed the Wealth Advisor's director of portfolio analysis asking about the "weighting scheme and rebalancing methodology" used by the Wealth Advisor. Later that day, his analyst followed up by asking how the algorithm generated its trade signals. The director of portfolio analysis responded, "We are still testing different theories with regards to shorting as well as how to allocate." Present's analyst forwarded the response to Present with the comment:

> Seems as if the global portfolio construction methodologies aren't fully set yet. They're still playing with ideas.

The analyst told Present that he was going to create a model portfolio of ETFs using an equal weighting approach.

24. On July 31, 2008, Present sent the Wealth Advisor the hypothetical performance of a model portfolio of ETFs for the period from December 2000 to May 2008. His analyst had calculated the figures using signals from the Intern's algorithm, along with portfolio construction rules Present had selected. Present told the Wealth Advisor:

> I had [the analyst] take your model and build performance returns. The attached shows the results... The Benchmark 1 is your overlay just using ETFs, and the Benchmark 2 is S&P 500 total return. Pretty impressive results.

The calculations showed a hypothetical gain of 238.62% for the algorithm, compared to only 21.33% for the S&P 500 Index.

25. On August 4, 2008, Present's analyst sent him the hypothetical performance of two model portfolios of ETFs for the period from December 2000 to May 2008. Both portfolios applied signals from the Intern's algorithm and used a 25% cap on the holding of any single ETF. One portfolio was rebalanced every month and showed a hypothetical gain of 223.87%. The other was rebalanced every two weeks and showed a hypothetical gain of 224.59%.

26. On August 8, 2008, Present sent a one-page presentation entitled "Performance Evaluation" for a product identified as "AlphaCycle Sector Rotation Strategy" to several potential clients. Referring to one of the model portfolios of ETFs that Present's analyst had created, the document represented that, for the period from December 2000 to May 2008, the strategy gained 223.87%, compared to 21.33% for the S&P 500 Index. Present's identical cover emails stated:

> The product has been run on a live basis since 12/2000, and currently has over $90M [million] managed against a version of it.

The statements in the presentation and the emails – (a) F-Squared's new product "has been run on a live basis since 12/2000"; (b) the product "currently has over $90 million managed against a version of it"; and (c) the product gained 223.87% from December 2000 to May 2008 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

27. In his August 8, 2008 email to prospective clients, Present also stated:

> Key to this is that we just worked through the complexities of bringing this track record out as an index published daily, which means that we can use the historical track record in marketing to both advisors and individual investors (this is a major breakthrough on the marketing front).

The same day, he emailed the Wealth Advisor, "Getting this set up as an index is a huge win regarding marketing opportunities." As these emails indicate, if F-Squared could point to an actual historical track record for the new product, that would be a substantial marketing advantage. The problem was that the new product had only a hypothetical and backtested track record.

28. On August 26, 2008, Present met with the Intern to discuss his latest changes to the algorithm. Present then emailed the Wealth Advisor:

> Great update meeting with [the Intern] this am. Just what I needed.

> His new approach is thoughtful, and creates a lot more resolution, but need to confirm back-tested versus live periods. The original data/approach was based off of rolling 40-week periods. Therefore two quick questions:
>
> 1. How long has live money been managed against a version of this sector rotation model?
>
> 2. Was the original model similar to the rolling 40 week version, or something else?

The Wealth Advisor's response was simply: "2003. Similar model."

29. On August 26, 2008, the Intern sent Present two sets of weekly ETF signals. One set (labeled "Custom") reflected buy/sell signals generated by his algorithm for the relevant ETFs since 2000 or 2001 (depending on when the ETF was launched). The other set reflected price trends for each ETF derived from a 40-week simple moving average since October 2000.[8]

30. On August 27, 2008, Present contacted the American Stock Exchange ("AMEX") about the possibility that it would calculate the composite performance of F-Squared's new model portfolio of ETFs and publish the performance daily as an index:

> I will be looking for new [calculation] and publication once per day, as well as back tested data through 1/2000. It is possible from a timing standpoint that we begin publishing while the back testing is under way.

Present described the portfolio construction rules (which he had selected) as follows:

> - Sector rotation applied exclusively to existing ETFs.
> - Maximum of 10 ETFs in Index at any time, minimum of 4.
> - Rebalanced monthly…
> - Back-generated data through 1/2000.

(F-Squared eventually hired NASDAQ OMX, not AMEX, to calculate and publish the AlphaSector indexes.)

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[8] A "simple moving average" tracks the average price of a security over a specific number of time periods. It is a widely-used indicator in technical analysis because it can be used to compare a security's long-term price trend to the security's short-term price fluctuations.

31. On September 2, 2008, F-Squared entered into an agreement to license the algorithm's buy/sell signals with a new company that the Wealth Advisor and the Intern had formed (hereafter, the "Data Provider"). F-Squared agreed to make quarterly payments to the Data Provider equal to 20 basis points (or 0.20%) of the assets invested by third parties who followed the strategy.

32. On September 3, 2008, Present sent an email asking the Intern what approaches the Wealth Advisor had used when investing for his own clients:

> I need a pretty explicit set of detail regarding which data set was driving investments, and over what time periods. For example, 1/1/2003 - 6/1/2006 = 60 week rolling. 6/1/2006 - 6/30/2008 = 40 week rolling average. 6/30/2008 to date is "custom" data [*i.e.*, the Intern's algorithm].

The Intern responded, "I spoke with [the Wealth Advisor]. He said before I began systemizing, he used the 60 week moving average." The Intern also sent Present the price trends for the relevant ETFs based on 60-week simple moving averages.

33. On or shortly after September 3, 2008, Present told his analyst to compile a composite performance record for the period from April 2001 to September 2008. Rather than using the backtested signals from the Intern's algorithm for the entire period, Present told his analyst to combine portions of several data sets received from the Intern:

April 2001 to June 2006	60-week simple moving average
July 2006 to June 2008	40-week simple moving average
July 2008 to Sept. 2008	the Intern's algorithm

For the first two periods covering more than seven years, the analyst created a backtested track record by making hypothetical trades in the ETFs based on changes in one of two simple moving averages. For the most recent period of barely two months, the analyst created a backtested track record by making hypothetical trades in the ETFs based on signals from the Intern's algorithm. In all cases, the analyst applied the portfolio construction rules that Present had selected.

34. On September 5, 2008, Present emailed his staff about the track record that his analyst had just created:

> We have compiled the pro forma "true" track record for the product. It is a composite of three discrete data "engines" that [the Wealth Advisor] used over the past 6.5 years, and it reflects the true calendar periods that each data engine was in use.

The statements in the email – (a) the track record created by his analyst was the "'true' track record for the product"; (b) the Wealth Advisor used "three discrete data 'engines' … over the past 6.5 years"; and (c) the track record created by his analyst "reflects the true calendar periods that each data engine was in use" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

35. On September 9, 2008, Present provided his staff with draft advertising materials for the new product, to be called the "AlphaSector Rotation Strategy." A presentation entitled "Construction Methodology" claimed that the strategy's buy/sell signals had been "developed and used by an independent wealth management firm, currently $3.9B in assets under management, from 2001 through today to manage individual client assets." The statements in the presentation – (a) the AlphaSector strategy uses signals that were "developed and used by an independent wealth management firm"; (b) the wealth management firm currently has $3.9 billion in assets under management; and (c) the wealth management firm has used the strategy "to manage individual client assets" since 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

36. On September 11, 2008, Present sent AlphaSector advertising materials to a large financial institution. His cover email stated:

> I am attaching our performance record for our sector rotation product… Data inputs have been used on a live basis since 2001, with modifications to portfolio construction to allow it to be viable as an index (i.e. 25% cap on individual holdings).

The statements in the email – (a) the AlphaSector strategy uses "data inputs [that] have been used on a live basis since 2001"; and (b) F-Squared merely "modified" portfolio construction rules that were already in use – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

37. On September 18, 2008, F-Squared issued a press release announcing the launch of AlphaSector. The press release pitched AlphaSector as a strategy designed to outperform the S&P 500 Index while providing "superior downside risk management." It claimed that AlphaSector used buy/sell signals that had been the basis for investments on behalf of real clients since 2001:

> Since 2001, the product has averaged 3% annualized excess return versus the S&P 500 … The buy and sell signals used in the product have been used to manage Private Client assets since 2001 and currently has [sic] over $100M [million] in client assets linked to it.

As an example of the strategy's supposed ability to avoid market downturns, the press release claimed that AlphaSector had eliminated its exposure to the financial sector in July 2007 (when the sector was beginning to suffer from the subprime mortgage crisis). On September 23, 2008, Present sent the press release to many potential clients. The statements in the press release – (a) the AlphaSector strategy uses signals that "have been used to manage Private Client assets since 2001"; (b) the strategy "currently has over $100 [million] of client assets linked to it"; (c) the strategy eliminated clients' exposure to the financial sector in July 2007; and (d) the strategy "has averaged 3% annualized excess return versus the S&P 500" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

38. On September 19, 2008, Present provided his staff with a presentation about AlphaSector to be posted on the F-Squared website. The presentation claimed that the "AlphaSector Rotation Strategy has consistently outperformed the benchmark S&P 500 since its

inception in 2001." It included a table purporting to compare returns for the period from April 2001 to August 2008: a gain of 54.73% for AlphaSector vs. a gain of 26.18% for the S&P 500 Index. A section entitled "History" represented:

> • The primary buy and sell triggers for each sector are quantitatively based and in use since 2001 by a $3.9B [billion] wealth management firm.
> • Currently there is over $100M [million] in Private Client assets under management linked to this strategy.
> • The model for determining sector buy and sell triggers has evolved over the years, but the specific buy and sell decisions reflected in the historical track record were those actually used to manage Private Client assets.

Present sent the presentation to many potential clients. The statements in the presentation – (a) the AlphaSector strategy uses signals "in use since 2001 by a $3.9 [billion] wealth management firm"; (b) over $100 million of assets under management are currently "linked to this strategy"; (c) "the model for determining sector buy and sell triggers has evolved over the years"; (d) the "historical track record" reflects "specific buy and sell decisions … actually used to manage Private Client assets"; (e) the strategy "has consistently outperformed the benchmark S&P 500 since its inception in 2001"; and (f) the AlphaSector Rotation index gained 54.73% since April 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

39. On September 19, 2008, an F-Squared employee ("CCO") sent output from the algorithm to NASDAQ OMX and asked if the data, which covered the period since April 2001, was in the proper format for calculating an index. A NASDAQ OMX employee told Present and the CCO, "I will be able to run the back-test off of this data and will send over the daily values when it is complete." Later that day, Present asked the NASDAQ OMX employee, "Any ETA on the backtesting?"

40. On September 22, 2008, Present prepared a letter addressed to "the investors, Board members, and other interested parties of F-Squared." The letter focused on the imminent launch of AlphaSector and represented:

> F-Squared is partnering on this product with a $4B [billion] Wealth Management firm that has been managing a portion of its Private Client assets against this strategy since 2001, and currently has over $100 million tracking this strategy.
>
> Some highlights of the strategy:
> • Since 2001, AlphaSector has outperformed the S&P 500 by 3% per year...
> • AlphaSector eliminated all exposure to Financials in July of last year.

On September 23, Present sent the letter to many potential clients. The statements in the letter – (a) a $4 billion wealth management firm "has been managing a portion of its Private Client assets against [the AlphaSector] strategy since 2001"; (b) the wealth management firm "currently has over $100 million tracking this strategy"; (c) the strategy "has outperformed the S&P 500 by 3% per year" since 2001; and (d) the strategy "eliminated all exposure to Financials in July of last year [*i.e.*, 2007]" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

Present Ignores a Warning about a Possible Error in
<u>Calculating AlphaSector's pre-September 2008 Performance</u>

41. As set forth in paragraphs 21, 29 and 32 above, between July 29 and September 8, 2008, Present received several sets of buy/sell signals compiled by the Intern. Some of these signals derived from the Intern's algorithm, while others were based on changes in simple moving averages. The dates shown for each weekly signal were all Sundays (except for Monday holidays, in which case the date was the Monday). In using the data to calculate the performance of the model portfolio of ETFs, Present's analyst had assumed that the signal shown next to each Sunday's date was to be implemented as of the preceding Friday. In other words, if the signal

shown for a given Sunday was a buy or a sell, the model portfolio would be treated as having bought or sold the ETF on the Friday before the Sunday in question.

42. On September 21, 2008, the Data Provider sent F-Squared a new set of weekly buy/sell signals. For each ETF, there was one line per week starting with January 7, 2001. As usual, each line included a date, a price, and a buy/sell signal. The most recent date was Thursday, September 18, 2008. (The signals shown for that date were the first "live" signals sent by the Data Provider to F-Squared after the licensing agreement went into effect.)

43. On September 23, 2008, Present's analyst emailed the Data Provider with questions about the signals received on September 21:

> The first column contains dates (for the most part, these are Sundays).
>
> The second column contains ETF prices (the row labeled 8/3/2008 has the ETF closing price for Friday 8/8/2008).
>
> The third column contains a trend indicator. (The row labeled 8/3/2008 has a trend indicator of -1.) Does this imply a negative (do not invest in sector) for the week of Monday 8/4 to Friday 8/8? Or is this the signal that would have been generated after close of business 8/8, indicating a "do not invest" recommendation for the week of Monday 8/11 to Friday 8/15?...

As this email indicates, when Present's analyst tried to implement the signals received on September 21, he noticed that the price shown next to each Sunday matched the closing price for the Friday *after* the Sunday, not the Friday *before* the Sunday. As a result, the analyst was confused about whether he had been applying the algorithm's signals correctly when he calculated AlphaSector's backtested performance prior to September 2008.

44. Soon after, the analyst had a meeting with Present in which he tried to explain this possible error about when to implement the signals used to calculate AlphaSector's historical performance. Present did not investigate further. He did nothing to ascertain whether the

extremely positive track record that he was already advertising for AlphaSector had been calculated in error.

45. Because Present's analyst had implemented all the algorithm's buy/sell signals one week too soon, the model portfolio was treated as having bought ETFs one week before the prices rose and having sold ETFs one week before the prices fell. The effect was to significantly inflate AlphaSector's backtested performance prior to September 2008. From April 2001 to September 2008, the S&P 500 Index rose approximately 28%. If the algorithm's signals had been applied correctly to the historical ETF price data, the backtested performance of AlphaSector from April 2001 to September 2008 would have been a gain of as much as 38%. (The exact figure varied slightly with each AlphaSector index.) The calculation error, however, produced a gain of as much as 135% – more than 350% of the backtested gain if the signals had been applied correctly.

Present Continues to Make False and Misleading
<u>Public Statements about AlphaSector</u>

46. From 2008 until he left the company on November 14, 2014, Present was the public face of F-Squared. He was quoted in its press releases and gave interviews to the financial media. He drafted many of its earliest advertising materials, some of which were posted on the company website, and he sent many of the materials to clients and prospective clients. He was involved in drafting the descriptions of the AlphaSector strategy in F-Squared's filings with the Commission, and he certified the accuracy of those filings.

47. From October 2008 to September 2013, Present made public statements about AlphaSector that were materially false and misleading in two primary respects: (1) he claimed that the AlphaSector strategy had been used to make real investments for real clients since April 2001; and (2) he advertised performance figures for the period from April 2001 to September

2008 that did not reflect actual investments and that were substantially overstated. Examples of Present's false and misleading statements on these subjects are described in the following paragraphs.

48. On October 3, 2008, Present sent AlphaSector advertising materials to a large financial institution. His cover email stated:

> The strategy behind the index is based on a live portfolio that has been managed by a large Wealth Management firm since 2001, and currently has over $100M of aum [assets under management] tracking it. We tweaked the strategy slightly to fit within an index structure, but the sector buy-sell triggers are the live ones used by the firm.

The statements in the email – (a) "the strategy behind the [AlphaSector Rotation] index is based on a live portfolio that has been managed by a large Wealth Management firm since 2001"; (b) the AlphaSector strategy currently has over $100 million of assets under management "tracking it"; (c) F-Squared simply "tweaked" an existing strategy; and (d) the AlphaSector strategy relies on the same "sector buy/sell triggers" that the prior firm used – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

49. As an investment adviser registered with the Commission, F-Squared is required to keep current an application for investment adviser registration on Form ADV. [*See* 17 C.F.R. §279.1.] On or about October 14, 2008, F-Squared filed an updated Part II to its Form ADV. Present signed the Form ADV on behalf of F-Squared and certified that its contents were true and correct. The updated Part II contained a supposed "History of the Strategy":

> AlphaSector is built upon the monthly buy and sell indications from a proprietary analytical engine. The analytics was developed and has been in use since 2001. The developer of the strategy (analytical model and the corresponding portfolio construction methodology) is a multi-billion dollar wealth management firm that has been managing Private Wealth Client assets against the strategy since 2001. As of the second quarter of 2008, this firm had over $100 million of client assets tracking the strategy.

> F-Squared has slightly modified the portfolio construction approach that the wealth firm has used to create a more systematic approach, improve slightly the risk management profile of the portfolio, and allow the strategy to be able to meet the construction requirements of a public index. The primary modifications were to set trading to once per month and to place a maximum cap on any sector position at 25% of the overall portfolio.

The statements that Present certified – (a) the AlphaSector strategy is based on a "proprietary analytical engine … in use since 2001"; (b) a "multi-billion dollar wealth management firm" developed both the "analytical model" and the "corresponding portfolio construction methodology"; (c) the prior firm currently has "over $100 million of client assets tracking the strategy"; and (d) F-Squared "slightly modified" the other firm's approach – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

50. On November 3, 2008, *Investment News* published an article about AlphaSector that included the following:

> The index may be new, but the formula it follows has a track record, Mr. Present said. It's been used by a $3 billion wealth management firm – which he declined to identify – for private-client accounts since 2001. The strategy directed investors out of financials in July 2007, allowing clients to escape the carnage that subsequently occurred in the banking sector, he said…

The statements quoted in the article – (a) the AlphaSector strategy has been "used by a $3 billion wealth management firm … for private-client accounts since 2001"; and (b) the strategy "directed investors out of financials" in July 2007 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

51. In early November 2008, F-Squared launched a second AlphaSector index. The "Premium Index" was identical to the "Rotation Index," except that it was rebalanced weekly instead of monthly. The change in frequency, coupled with the inflated pre-September 2008 results that had been calculated incorrectly, produced an even better comparison to the S&P 500

Index. On November 5, Present provided his staff with AlphaSector advertising materials to be used with clients and prospective clients. The materials represented that, for the period from April 2001 to October 2008, the Premium Index gained 113.46% and the Rotation Index gained 46.27%, while the S&P 500 Index lost 4.37%. The statement in the advertising materials – that the AlphaSector Premium and Rotation indexes gained 113.46% and 46.27% respectively since April 2001 – was materially false and misleading, for the reasons set forth in paragraphs 87-89.

52. On February 18, 2009, Present provided his staff with a presentation to be used with clients and prospective clients. The presentation claimed that the "proprietary analytical engine" for AlphaSector has been "developed over [a] 7+ year period." It claimed that the "AlphaSector Rotation has consistently outperformed the benchmark S&P 500 since its inception in April, 2001." It included a table purporting to compare returns for the period from April 2001 to December 2008: the Premium Index gained 113.8%, the Rotation Index gained 45.4%, while the S&P 500 Index lost 10.3%. The statements in the presentation – (a) the AlphaSector strategy has been "developed over [a] 7+ year period"; (b) the strategy has "consistently outperformed" the S&P 500 Index since April 2001; and (c) the AlphaSector Premium and Rotation indexes gained 113.8% and 45.4% respectively since April 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

53. The presentation that Present provided to his staff on February 18, 2009 also contained a disclaimer stating that any index is "hypothetical" to an extent, because it does not incorporate the reinvestment of dividends or the payment of fees that would affect the performance of an actual client's account:

> One cannot invest directly in an index... Some of the returns presented reflect hypothetical performance an investor would have obtained had it invested in the manner shown and does not represent returns that an investor actually attained. Hypothetical backtested performance has many inherent limitations. The hypothetical performance is adjusted to

> reflect the reinvestment of dividends. The fee schedule and anticipated expenses are included in the client agreement. F-Squared's fees are available upon request and also may be found in Part II of its Form ADV.

The disclaimer, which F-Squared continued to use in its advertising materials, was materially false and misleading, because it did not disclose that AlphaSector's advertised 2001-2008 performance was hypothetical in a much more fundamental sense – it was based on backtested calculations and hypothetical trades, not on the actual performance of real investments for real clients.

54. On May 19, 2009, F-Squared issued a press release claiming that the AlphaSector Rotation Index had outperformed the S&P 500 Index by 11.8% per year for the past five years. The press release represented:

> [The index] will completely eliminate sectors which are forecasted to underperform cash. For example, it first eliminated all exposure to Financials in July, 2007.

The statements in the press release – (a) the AlphaSector Rotation index outperformed the S&P 500 Index by 11.8% per year for the past five years; and (b) the AlphaSector strategy "eliminated all exposure" to the financial sector in July 2007 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

55. F-Squared did not enjoy immediate marketing success with AlphaSector. The company did not land its first fee-paying client for the strategy until June 2009. For the year ending on June 30, 2009, F-Squared received only $23,102 in fees for AlphaSector and suffered a net loss of more than $1.7 million.

56. The big breakthrough for F-Squared occurred in late September 2009, when it entered into a subadvisory agreement with a mutual fund company (hereafter, "the Fund Company") that wanted to use the AlphaSector strategy for two of its funds. Present had wooed

the Fund Company for months, making many false and misleading statements along the way, including the following:

a. On February 6, 2009, Present sent advertising materials to the Fund Company. A presentation entitled "AlphaSector™ Rotation Strategy" claimed that the "proprietary analytical engine" for AlphaSector has been "developed over [a] 7+ year period." It claimed that the "AlphaSector Rotation has consistently outperformed the benchmark S&P 500 since its inception in April, 2001." It included a table purporting to compare returns for the period from April 2001 to December 2008: the Premium Index gained 113.8% and the Rotation Index gained 45.4%, while the S&P 500 Index lost 10.3%. The statements in the presentation – (a) the AlphaSector strategy has been "developed over [a] 7+ year period"; (b) the strategy "consistently outperformed" the S&P 500 Index since April 2001; and (c) the AlphaSector Premium and Rotation indexes gained 113.8% and 45.4% respectively since April 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

b. On March 2, 2009, Present sent updated advertising materials to the Fund Company. A presentation entitled "Index Construction Methodology" claimed that AlphaSector "is a quantitatively driven index that mirrors an investment strategy that dates back to 2001." The statement in the presentation – the AlphaSector strategy "mirrors an investment strategy that dates back to 2001" – was materially false and misleading, for the reasons set forth in paragraphs 87-89.

c. On May 5, 2009, Present responded to the Fund Company's request for materials to assist the Board of Trustees with its due diligence pursuant to Section 15(c) of the Investment Company Act of 1940 ("Investment Company Act").[9] The response claimed:

> The Index is modified on a monthly basis based on an existing analytical program or its precursor versions, which have been in use since 2001.
>
> Key aspects of the Index's track record and positioning that should appeal to the market: ...
> • 5 year track record of significant and consistent outperformance of the S&P 500.

The statements in the response – (a) the AlphaSector strategy is "based on an existing analytical program or its precursor versions" that "have been in use since 2001"; and (b) the strategy has a "5 year track record of significant and consistent outperformance of the S&P 500" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

d. Also on May 5, 2009, Present sent updated advertising materials to the Fund Company. A presentation entitled "AlphaSector Rotation Strategy" claimed that "investment decisions are based on a proprietary quantitative model developed over an 8 year period." It also claimed that, for the period from April 2001 to March 2009, the AlphaSector Rotation index gained 45.6% while the S&P 500 Index lost 20.2%. The statements in the presentation – (a) the AlphaSector strategy is "based on a proprietary quantitative model developed over an 8 year period"; and (b) the AlphaSector Rotation index gained 45.6% since April 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

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[9] Section 15(c) of the Investment Company Act [15 U.S.C. §80a-15c)] regulates the process whereby a registered investment company approves a contract with an investment adviser. It provides that an investment company's board members have a duty to request, and the investment adviser has a duty to furnish, such information as may be reasonably necessary to evaluate the terms of the proposed contract.

e. On June 9, 2009, Present sent a presentation entitled "AlphaSector Rotation Strategies: Defensive Allocation in Practice" to the Fund Company. The presentation claimed:

> Fortunately, there is a live track record dating back to 2001 that embodies the core principles of *Defensive Allocation* and demonstrates the power of this approach. The track record belongs to a public index, AlphaSector Rotation Index.
>
> The Index can be 100% invested in Treasuries if all nine sectors are forecasted to underperform cash, as happened in July, 2002 and again in October, 2008.

The statements in the presentation – (a) the AlphaSector strategy has a "live track record dating back to 2001"; and (2) the AlphaSector Rotation index was invested entirely in U.S. Treasury securities in July 2002 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

f. On August 17, 2009, Present sent a presentation entitled "Strategies Tracking the AlphaSector Series of Indexes" to the Fund Company. The presentation claimed that the AlphaSector strategy has "succeeded in systematically avoiding extreme market losses since inception in 2001." It also compared the supposed returns on a hypothetical investment of $1 million made on April 1, 2001. Using stated assumptions about inflation and annual withdrawals, it claimed that an investment in AlphaSector Premium would have grown to $1.56 million as of March 31, 2009, whereas an investment in the S&P 500 Index would have shrunk to $440,000. The statements in the presentation – (a) the AlphaSector strategy has "systematically avoid[ed] extreme market losses since inception in 2001"; and (b) a $1 million investment in the AlphaSector Premium index on April 1, 2001 would have grown to $1.56 million as of March 31, 2009 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

g. On September 16, 2009, Present emailed the Fund Company with proposed answers to questions about AlphaSector that its sales agents could use with clients and prospective clients. In response to a question about whether AlphaSector's track record was hypothetical or actual, Present claimed:

> The performance is generated as an index. An index by definition is a "normalized" version of a strategy, with investors never matching index returns identically... The [AlphaSector] index is based on a live strategy, with live client assets, that was run since inception in 2001. Client assets were invested using the same investment inputs/outputs as was [sic] used to drive the index returns... Just to be clear, there is a very distinct and critical difference between historical and backtested for indexes. All indexes are hypothetical at some level. Backtested implies that the decisions that drove the index were generated in the future, and applied historically. Our model uses decision variables from the past, and therefore is not backtested in any manner.

The statements in the proposed answers – (a) the AlphaSector strategy is "based on a live strategy, with live client assets, that was run since inception in 2001"; (b) "client assets were invested using the same inputs/outputs" as were "used to drive the index returns"; (c) the strategy "uses decision variables from the past"; and (d) the AlphaSector indexes are "not backtested in any manner" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

h. On October 1, 2009, the Financial Industry Regulatory Authority ("FINRA") denied the Fund Company's request for permission to use certain marketing materials for its two funds that were now following AlphaSector. On October 15, Present provided the Fund Company with his response to FINRA's concerns. In his cover letter (which the Fund Company forwarded to FINRA), Present stated:

> AlphaSector Rotation Index is based on investment decisions that were generated on a live basis since 2001. These decisions were the output of an evolving analytical engine that generated "signals" driving investment allocation of sector-based ETFs. The investment philosophy, portfolio construction methodology, and actual investment

> securities were established, and remained largely unchanged over the past eight and one-half years. The Index therefore explicitly does not reflect backtested data, but instead represents live, historical data.

The statements in the letter – (a) the AlphaSector Index is "based on investment decisions that were generated on a live basis since 2001"; (b) the investment decisions are "the output of an evolving analytical engine"; (c) the strategy "evolved" since 2001 but the "investment philosophy, portfolio construction methodology, and actual investment securities" (*i.e.*, the ETFs) "remained largely unchanged"; and (d) the AlphaSector index "explicitly does not reflect backtested data" but instead "represents live, historical data" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

i. Present's response to the Fund Company about FINRA's concerns included a presentation entitled "History of the AlphaSector Rotation Index" that purported to describe the genesis of AlphaSector:

> The AlphaSector Rotation Index was built to reflect the track record of a live investment strategy ("AlphaSector Strategy") that has been in continuous use, invested using actual assets, since 2001.
>
> All investment decisions are based on the output of a quantitative engine ("signals"). This engine has evolved over the years, but these output signals are never over-ridden. The historical signals that were generated over time, and drove the portfolio decisions, were maintained as was the investment engine algorithms that were in use at prior periods.
>
> F-Squared maintains the historical output of the analytical engine since inception, as well as explicit descriptions of the algorithms behind the engine through each stage of its development. F-Squared engaged in an extensive due diligence effort to both validate the algorithms and timing of implementation of each enhancement, as well comparing the published output with a simulated version of the analytics to ensure accuracy.
>
> The high net worth clients with accounts tracking the Strategy had some degree of flexibility regarding implementation schedule based on each client's overall tax and investment situation. After evaluating the trading strategy and patterns of the individual client accounts, it was

> determined by F-Squared that the monthly trading schedule was a reasonable extrapolation… The concept of a maximum allocation to any sector-based ETF and a cash equivalent alternative was a critical component of all historical client accounts. However, depending on the client there was some variance between a 25% cap and a 33% cap. F-Squared decided on the 25% cap due to diversification and anti-concentration considerations.

The statements in the presentation – (a) the AlphaSector strategy "has been in continuous use, invested using actual assets, since 2001"; (b) the "quantitative engine" underlying the strategy "evolved" but the "output signals" that "drove the portfolio decisions" have been maintained; (c) the "investment engine algorithms that were in use at prior periods" have also been maintained; (d) F-Squared has "explicit descriptions of the algorithms behind the engine through each stage of its development"; (e) F-Squared "engaged in an extensive due diligence effort" to "validate the algorithms and timing of implementation of each enhancement"; (f) F-Squared compared "the published output with a simulated version of the analytics to ensure accuracy"; (g) F-Squared "evaluat[ed] the trading strategy and patterns of the individual client accounts" before deciding that it would rebalance the model portfolio of ETFs every month; and (h) the strategy previously employed a maximum per ETF ranging from 25% to 33%, but F-Squared decided to use a 25% cap – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

57. On January 13, 2010, F-Squared issued press releases about the performance of the AlphaSector Rotation and Premium Indexes in 2009. The press releases claimed that, since their inception in April 2001, the Premium Index gained 198% and the Rotation Index gained 82.5%, while the S&P 500 Index gained only 13.5% in the same period. The statement in the press releases – the AlphaSector Premium and Rotation indexes gained 198% and 82.5% respectively since April 2001 – was materially false and misleading, for the reasons set forth in paragraphs 87-89.

58. On January 30, 2010, *Investment Weekly News* published an article about F-Squared in which Present was quoted as saying:

> "The past 18 months taught everyone that investors cannot absorb 30%, 40%, or 50% losses unscathed," said Howard Present, CEO of F-Squared Investments. "Our AlphaSector Indexes have delivered, across two ugly bear markets, dramatically reduced downside losses, while outperforming the S&P 500 in most up markets."

The statements as quoted in the article – (a) the AlphaSector indexes "dramatically reduced downside losses" during "two ugly bear markets"; and (b) the indexes "outperform[ed] the S&P 500 in most up markets" – were false and misleading, for the reasons set forth in paragraphs 87-89.

59. On May 7, 2010, *Investment Management Weekly* published an interview with Present in which he was quoted as saying:

> Historically, our Premium strategy bests the market by 11.5% a year. But it gets even better because of the strategy's ability to avoid downturns. For the nine years since the strategy's 2001 inception, the strategy is up 213%, compared to a gain of just 20% for the S&P.
>
> [W]hen we see an individual sector like financials moving down, as happened in 2007, we get out of financials completely. We eliminate it.

The statements as quoted in the interview – (a) the AlphaSector Premium index outperformed the S&P 500 Index by 11.5% per year; (b) the AlphaSector Premium index gained 213% since its inception in 2001; and (c) the AlphaSector strategy got out of the financial sector completely in 2007 – were false and misleading, for the reasons set forth in paragraphs 87-89.

60. On June 28, 2010, Present emailed the Fund Company:

> We define the start of the track record as identical for both monthly and weekly/Premium. 4/2001. The client assets tracking the strategy in 2001 were all customized to some level, and the signal outputs were identical for both strategies [AlphaSector Rotation and Premium] so therefore they both have the same start date, and both "qualify" as having live client assets tracking them since 2001.

The statements in Present's email – (a) the AlphaSector strategy has a "track record" starting in April 2001; and (b) the strategy is based on "signal outputs" that "live client assets" have been "tracking" since 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

61. On October 1, 2010, *Bank Investment Consultant* published a "portfolio manager profile" of Present that contained the following:

> Back in mid-2007, well before the financial debacle that began with the collapse of the investment bank Bear Stearns, Howard Present, co-founder, president and CEO of F-Squared in Boston, had a strategy that determined that financial stocks were becoming risky. But they didn't just sell down the financial holdings, which at the time represented one-ninth of his strategy's investments. He sold *all* his financial stock holdings.
>
> Present's AlphaSector Premium strategy is up 194% cumulatively from Apr. 1, 2001 through Aug. 31, 2010, compared with the S&P, which rose only 8.2% for the period.
>
> "We eventually dropped the tech sector in 2001," says Present.

F-Squared posted the profile on its website. The statements cited in the article – (a) Present had an investment strategy in mid-2007 that prompted him to sell all holdings in the financial sector; (b) "we" (*i.e.*, F-Squared) "dropped the tech sector in 2001"; and (c) the AlphaSector Premium index gained 194% since April 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

62. On November 3, 2010 and January 21, 2011, Present emailed F-Squared's responses to due diligence requests from the Fund Company pursuant to Section 15(c) of the Investment Company Act. The responses claimed:

> The Index is evaluated for modification on a weekly basis based on an existing analytical program or its precursor versions, which have been in use since 2001.

> Overall, the track record of the Index for the past 9 years demonstrates the Index's shifting participation in different markets. The Index has outperformed the S&P 500 over that time period by 11.5% per annum. On a cumulative basis, the S&P 500 is up approximately 20% while the AlphaSector Premium Index has more than tripled.

The statements in the responses – (a) the AlphaSector strategy is "based on an existing analytical program or its precursor versions [that] have been in use since 2001"; (b) the AlphaSector Premium index outperformed the S&P 500 Index by 11.5% per year over the past nine years; and (c) the AlphaSector Premium index gained three times as much as the S&P 500 Index in that period – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

63. On March 9, 2011, Present responded to a client's questions about the historical performance of AlphaSector. He represented:

> • The strategy was originally designed, and was used to drive client portfolios starting in April of 2001. It was used exclusively to manage SMAs [separately managed accounts] for wealth [sic] clients. The nine … ETFs, the core model design of binary decisions regarding each ETF, and the use of cash as the defensive metric after the majority of the sectors turned off, were all in place and consistent to our current methodology.
>
> • The key deviation was that the trading/rebalancing frequency was often customized to each client based on asset size, tax and fee sensitivity. The typical range was weekly to quarterly timing.
>
> • The core engine that drove decision-making has evolved over the years, but has been consistently in place since 2001. In the beginning, the engine did not have a variable component adjusting engine response time to market volatility (what we call "dynamic volatility window"). It was a constant and long term rolling average with various data smoothing elements. In late 2003 the rolling window was shortened modestly in reaction to the observed slow response time to the market recovery in 2003. In 2004 an initiative was launched to create a more fundamentally sound enhancement to the issue. The effort took several years, but in 2007 the new version was implemented (which is virtually identical to the model in place today), including the use of the dynamic volatility window.

The statements in the response – (a) the AlphaSector strategy has been "used to drive client portfolios starting in April of 2001"; (b) the use of buy/sell signals for nine ETFs and the use of cash as a "defensive metric" were "all in place and consistent to our current methodology" as of April 2001; (c) the primary difference between the original approach and AlphaSector is that the rebalancing period was originally "customized" to each client; (d) the "core engine" driving decision-making "has evolved over the years" but "has been consistently in place since 2001"; (e) the original approach involved a "constant and long term rolling average with various data smoothing elements"; (f) the "rolling window" was shortened in 2003; and (g) a "new version was implemented" in 2007 that was "virtually identical to the model in place today" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

64. On September 28, 2011, Present stated during an interview with *Closing Bell* that "we" have been managing the AlphaSector strategy for ten years. F-Squared posted a video of the interview on its website. The statement – "we" (*i.e.*, F-Squared) have been managing the AlphaSector strategy for ten years – was materially false and misleading, for the reasons set forth in paragraphs 87-89.

65. On March 6, 2012, *Private Wealth* published an article about F-Squared that included the following:

> On a dark and stormy night, a beacon can raise the hopes of lost travelers. As Howard Present tells it, something like this happened for F-Squared in 2008. The S&P 500 plummeted 37%, while his firm's flagship AlphaSector Premium Strategy lost less than 2%.
>
> [. . .] [W]hen F-Squared sold out of financials in July 2007, that sector had been declining for nearly three months during an extended low-volatility investment period.

The statements as quoted in the article – (a) F-Squared sold its holdings in the financial sector in July 2007; and (b) the AlphaSector Premium index lost less than 2% in 2008 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

66. On or about March 23, 2012, F-Squared filed an updated Part II to its Form ADV. Present signed the Form ADV on behalf of F-Squared and certified that its contents were true and correct. The updated Part II claimed:

> The investment models, portfolio design, and ETFs within the portfolio for our flagship US equity versions of the Indexes have been used to manage actual clients assets since April, 2001 (primarily in the form of SMAs), and are therefore stress-tested across two bear markets and a bull market.

The statements that Present certified – (a) the "investment models, portfolio design, and ETFs" used for AlphaSector have been "used to manage actual clients assets" since April 2001; and (b) the AlphaSector strategy has been "stress-tested across two bear markets and a bull market" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

67. Largely due to the size of the Fund Company's funds tracking the AlphaSector strategy and the resulting marketing momentum, F-Squared's assets under management grew significantly in 2010 and 2011:

December 2009	$250,000,000
December 2010	$1,500,000,000
December 2011	$6,000,000,000

Present Ignores Warnings about His False and
<u>Misleading Statements concerning AlphaSector</u>

68. On June 1, 2012, F-Squared received a report from an attorney who had been hired to perform a "mock audit" of the company's practices and procedures. One of the attorney's recommendations was that F-Squared "should ensure that it has books and records to support its performance disclosed for years prior to the year 2006." After receiving the report, F-

Squared's then-CCO began asking Present for documentation to support AlphaSector's track record since April 2001.

69. On June 18, 2012, Present asked the Data Provider for documentation about AlphaSector's historical track record:

> [W]e had an issue that was flagged during one of our annual mock SEC audits that we just recently completed. It refers to documentation that the performance record we present reflects "live" output from the engine driving the US sector signals prior to our signing a licensing agreement.
>
> [The Intern] and I spent many hours working through the data during our due diligence effort, and he provided three sets of data for us: Output from 4/2001 reflecting a 5 year rolling average; output from mid 2003 (not sure of the exact date any longer) to 6/2007 reflecting a 3 year rolling average; and data from 7/2007 forward reflecting the current investment engine. Obviously after we starting [sic] running the data on a live basis we have appropriate back up...
>
> What I am looking for is a simple letter from [the Data Provider] to me, stipulating that the data delivered to us, and reflected in historical performance indexes such as we show in our materials, reflects that accurate output of the investment engine in use for the strategy over time.

The statement that the Intern had provided three sets of signal data separated by time period (specifically, a 5-year rolling average for April 2001 to mid-2003, a 3-year rolling average for mid-2003 to June 2007, and his own algorithm for July 2007 onward) was false. As set forth in paragraphs 29 and 32 above, the Intern had provided Present with complete data series back to 2000 or 2001 for a 60-week simple moving average, a 40-week simple moving average, and his algorithm. Present had then told his analyst to pull out portions of each data set and cobble together the composite, and wholly artificial, set of results that Present later portrayed as the actual historical track record of the AlphaSector strategy.

70. Later on June 18, 2012, the Data Provider's CEO responded:

> [The Intern] is 24 years old and he worked on the underlying technology in 2007 and 2008 (when he was 20 and 21 years old) – he didn't work on this when he was 14 in 2001… [The Intern] started working on this in 2007 and [the Data Provider] didn't exist until August 2008. [The Intern] says that any data that has been provided by [the Data Provider] was either backtested data based on the original model in 2007/2008 … or live data (not backtested) from the model after 2007/2008.

The CEO offered to write a letter stating that the data sent to F-Squared starting in the fall of 2008 reflected "live data" from the Intern's algorithm, while the data for earlier periods was "backtested." Present did not accept the offer.

71. Despite being reminded in June 2012 that any buy/sell signals for the period prior to the fall of 2008 were backtested, and despite the Data Provider's failure to provide the letter he had requested, Present did not investigate further. He did nothing to ascertain the impact of any error on the extremely positive track record that he had been advertising for AlphaSector. To the contrary, he continued to claim that AlphaSector's pre-September 2008 track record was based on real investments for real clients.

72. For example, on or about October 8, 2012, F-Squared filed an updated Part II to its Form ADV. Present signed the Form ADV on behalf of F-Squared and certified that its contents were true and correct. The updated Part II claimed:

> The investment models, portfolio design, and ETFs within the portfolio for our flagship US equity versions of the Indexes have been used to manage actual client assets since April, 2001 (primarily in the form of SMAs), and are therefore stress-tested across two bear markets and a bull market.

The statements that Present certified – (a) the "investment models, portfolio design, and ETFs" used for AlphaSector have been "used to manage actual clients assets" since April 2001; and (b) the AlphaSector strategy has been "stress-tested across two bear markets and a bull market" – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

73. On October 15, 2012, Present asked the Wealth Advisor for documentation to support AlphaSector's historical track record:

> My goal is to have clean documentation regarding the fact that we received the original data output for what we now call AlphaSector from your firm, and that to the best of your knowledge the data reflects the output of your analysis prior to us entering into our agreement with [the Data Provider] in 2008. Specifically, we are focused on the periods 2001-2008.
>
> We can reconstruct the email history, but it would be cleaner just to have a letter from you stating that the data reflects the output of the engines that were used by your firm in managing client assets for the period I mentioned.

The Wealth Advisor did not respond in writing.

74. Also on October 15, 2012, Present asked an assistant to locate all emails between F-Squared and the Wealth Advisor in 2008 concerning historical performance. On October 16, the CCO sent Present a list identifying 13 emails dated from May 30 to October 6, 2008. Present asked him to print the emails. The CCO did so, and he provided copies to either Present or his assistant. Two of the emails on the CCO's list contained the September 23, 2008 email from Present's then-analyst to the Data Provider, described in paragraph 43 above, in which the analyst noted that, on the spreadsheets of weekly signals that F-Squared had received, the price shown next to each Sunday matched the closing price for the Friday *after* the Sunday, not the Friday *before* the Sunday (as the analyst had previously assumed). Shortly after sending that email in September 2008, the analyst had told Present about the possible error in calculating AlphaSector's pre-September 2008 performance. Despite being shown the analyst's September 23, 2008 email, Present did not investigate further. He did nothing to ascertain the impact of any error on the extremely positive track record that he had been advertising for AlphaSector. To the contrary, he continued to tout AlphaSector's erroneous and overstated performance.

75. For example, on October 26, 2012, Present emailed F-Squared's response to a request by the Fund Company for due diligence materials pursuant to Section 15(c) of the Investment Company Act. The response claimed:

> The AlphaSector Premium Index is based on an active strategy with an Inception date of April 1, 2001. Inception date is defined as the date as of which Investor assets began tracking the strategy.

On December 14, 2012, Present gave a presentation using identical language to a national sales meeting of the Fund Company's wholesalers. The statements in these materials – (a) the AlphaSector Premium index is "based on an active strategy with an inception date of April 1, 2001"; and (b) "investor assets began tracking the strategy" on April 1, 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

76. On or about April 1, 2013, F-Squared filed an updated Part II to its Form ADV. Present signed the Form ADV on behalf of F-Squared and certified that its contents were true and correct. The updated Part II claimed:

> The investment models, portfolio design, and ETFs within the portfolio for our flagship US equity versions of the Indexes have been used to manage actual clients assets since April, 2001 (primarily in the form of SMAs), and are therefore stress-tested across two bear markets and a bull market.

The statements that Present certified – (a) the "investment models, portfolio design, and ETFs" used for AlphaSector have been "used to manage actual clients assets" since April 2001; and (b) the AlphaSector strategy has been "stress-tested across two bear markets and a bull market" – were materially false and misleading, for the reasons set forth in paragraphs 87-89

77. In May 2013, the Data Provider and the Fund Company discussed the possibility of a joint venture involving quantitative models developed by the former Intern (who had graduated from college in 2009). In the course of their discussions, the Fund Company asked why the Data Provider's proposed strategy substantially underperformed AlphaSector in 2008.

On May 28, a Data Provider employee ran a backtest using the data for 2008 that had been sent to F-Squared. He found a large difference between the performance he calculated and AlphaSector's 2008 performance as advertised by F-Squared. On May 29, the former Intern himself ran several backtests of the data sent to F-Squared, and his results were also quite different from AlphaSector's advertised performance. On May 30, the former Intern tried again. This time he found that, by applying the buy/sell signals one week before they should have been applied, he could generate results that were close to AlphaSector's reported performance. In other words, he discovered the calculation error that had substantially inflated AlphaSector's purported pre-September 2008 track record.

78. On July 1, 2013, the former Intern and the Data Provider's CEO met with Present. They described their difficulties with replicating the advertised performance of AlphaSector for 2001-2008, reminded Present that the Intern's algorithm had not been completed until the summer of 2008, and asked if Present was going to correct his claims that AlphaSector's 2001-2008 performance reflected real investments for real clients. Present essentially told them to drop the subject.

79. On July 30, 2013, the Commission's examination staff began a routine examination of F-Squared. On July 31, the examination staff interviewed Present, who said that the performance of AlphaSector prior to September 2008 was based on accounts managed by another investment adviser, but that he could not reveal the name of the other adviser due to a confidentiality agreement. Later that day, the examination staff asked F-Squared to produce additional documents as soon as possible, including:

> Supporting documentation for the investor assets within the Premium AlphaSector Index starting in April 2001 including the investor names and the managers / firms responsible for managing the accounts.

80. On July 31, 2013, while the Commission staff was in F-Squared's office, Present emailed the Wealth Advisor, "Please call. Left you voicemail. Time sensitive subject." Two hours later, Present left another voicemail for the Wealth Advisor:

> Hey [the Wealth Advisor], it's Howard Present. How ya doin? It is Wednesday at 3 o'clock. Please give me a call at your earliest convenience. Uh, I have a regulator in my office, and they are looking at the contracts between us and [the Data Provider], and some of the deliverables that were associated with that. There are some confidentiality issues that I'm about to have to breach and I'm going to give you a heads up. I am going to talk to you about what's being provided and see if we can forestall because I don't want them to walk out of my office and over to yours. Um, that doesn't help either of us. So, if you can give me a call, I'm on my cell. Thank you.

81. On August 1, 2013, Present gave F-Squared's CCO a table entitled "Year End Assets" with the following figures:

2001	$13,141,288
2002	$29,108,405
2003	$44,404,110
2004	$58,776,822
2005	$69,981,592
2006	$86,691,007
2007	$103,983,100
2008	$134,272,346
2009	$211,000,000

Next to the figures, Present had written the Wealth Advisor's name and "Financial AUM ASP Strategy 4/10." His cover email to the CCO stated:

> [A]ttached is the spreadsheet that verifies assets under management tracking the strategy that we refer to as AlphaSector Premium. The information was provided to us from [the Wealth Advisor]... The asset totals were conveyed to us from [a Wealth Advisor employee] per a request we made in early 2010. [An F-Squared employee] was the recipient of the data. The assets reflect [the Wealth Advisor]'s clients who had some portion of their investment portfolio managed according to the strategy. Virtually all of their clients were managed in a customized manner.

Present told the CCO that someone at the Wealth Advisor's firm had provided the information over the phone to someone at F-Squared. Present did not participate in the conversation with the Wealth Advisor's employee. He had no first-hand knowledge of what the F-Squared employee actually asked for, or what the Wealth Advisor's employee actually said when communicating the figures. Nevertheless, Present told the CCO that the figures "verified" the annual total of actual client investments made by the Wealth Advisor using the strategy that became AlphaSector. The CCO then provided the figures to the Commission examination staff.

82. On September 4, 2013, the Data Provider's CEO emailed Present saying that he and the former Intern had found no evidence "that would give us the support we would need to say that we delivered live, current signals" for the period prior to September 2008.

83. As of September 16, 2013 – despite the warnings Present had received in June 2012, October 2012, July 2013, and early September 2013, as well as the questions posed by the Commission staff starting in July 2013 – many false and misleading statements about AlphaSector remained on F-Squared's website. These included:

a. A presentation entitled "AlphaSector® Premium Index" that claimed:

> In bear markets such as 2001-2002 and 2008-2009, the portfolio reduced exposure to equity sectors and increased exposure to cash equivalents through an allocation to a Short-Term U.S. Treasury ETF.

The statement in this presentation – AlphaSector reduced clients' exposure to equity sectors and increased their exposure to U.S. Treasury securities during the bear market of 2001-2002 – was materially false and misleading, for the reasons set forth in paragraphs 87-89.

b. A presentation entitled "AlphaSector® Premium" that claimed:

> The AlphaSector Premium Index is based on an active strategy with an inception date of April 2001. Inception date is defined as the date as of which investor assets began tracking the strategy.

The statements in the presentation – (a) the AlphaSector Premium index is "based on an active strategy with an inception date of April 2001"; and (b) "investor assets began tracking the strategy" in April 2001 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

c. A presentation entitled "Strategies Tracking the AlphaSector Series of Indices" that claimed, "Decisions are based on a proprietary quantitative model in operation and development since 2001." It claimed that, for the period from April 2001 to June 2013, the AlphaSector Premium index gained 368.2% while the S&P 500 Index gained only 76.0%. It also compared the purported results as of June 30, 2013 for a hypothetical investment of $100,000 made in April 2001: an investment in the AlphaSector Premium index would supposedly have grown to $468,000, while an investment in the S&P 500 Index would have grown to only $176,000. The statements in the presentation – (a) the AlphaSector strategy is "based on a proprietary quantitative model in operation and development since 2001"; (b) the AlphaSector Premium index gained 368.2% from April 2001 through June 2013; and (c) $100,000 invested in the AlphaSector Premium Index in April 2001 would have grown to $468,000 as of June 30, 2013 – were materially false and misleading, for the reasons set forth in paragraphs 87-89.

d. The presentation entitled "AlphaSector Rotation Strategies: Defensive Allocation in Practice" released in June 2009 (see paragraph 56(e) above).

e. The "Manager Profile" that *Bank Investment Consultant* published on October 1, 2010 (see paragraph 61 above).

Present Finally Removes AlphaSector's pre-October 2008
Performance from F-Squared's Advertising Materials

84. On September 23, 2013, Present told his staff that F-Squared was going to drop pre-September 2008 results from its calculations of AlphaSector's historical performance. He explained:

> As most of you should know, now that we have crossed over the 5 year mark for our AlphaSector US Equity strategies..., we are going to shift our presentation decks to define "live" as 9/08 forward and everything prior as backtested. While when we acquired rights to the AlphaSector strategy from [the Data Provider] they provided us with historical performance of the strategy, now that we have crossed the five year window we feel there is no need to deal with the distractions and confusion of even asserting that the live track record is [sic] in existence prior to the formation of the firm.

After five years of telling the public and his own staff that AlphaSector's 2001-2008 performance was based on real investments for real clients and was not backtested, Present did not explain why those statements had caused "distractions and confusion," or why the 2001-2008 track record should now be described as "backtested."

Present Profits from F-Squared's Success

85. Present profited handsomely from the success of F-Squared. Between 2008 and early 2014, he received more than $8.1 million in wages and profit distributions. In addition, upon his departure from the company on November 14, 2014, he was awarded a twelve-year package worth approximately $8.5 million.

Present Knew or Was Reckless in Not Knowing that his
Statements about AlphaSector Were False and Misleading

86. As set forth above, from August 2008 to September 2013, Present made public statements about AlphaSector that were materially false and misleading in two primary respects. First, he claimed that the AlphaSector strategy had been used to make real investments for real

clients since April 2001. Second, he advertised performance figures for the period from April 2001 to September 2008 that did not reflect actual investments and that were substantially overstated.

87. Present knew or was reckless in not knowing that those statements were false and misleading.

a. Present knew that virtually all of AlphaSector's supposed track record from April 2001 to September 2008 was actually created by his own analyst in the late summer of 2008 based on trends in simple moving averages – a widely-used indicator that any professional money manager could easily generate from publicly available information.

b. Present knew that the Intern's algorithm – the proprietary basis for the AlphaSector strategy that he was marketing – had not actually been completed until the late summer of 2008.

c. Present knew that the algorithm merely generated buy/sell signals for an investment, and that he himself – not the Wealth Advisor or the Intern – had decided to apply the algorithm to a new sector rotation strategy involving ETFs.

d. Present knew that he himself – not the Wealth Advisor or the Intern – had selected the portfolio construction rules for turning the algorithm's signals into a model portfolio of ETFs whose performance could be tracked as an index.

e. Present saw no records reflecting any of the Wealth Advisor's investments for his clients.

f. Present saw no records indicating that the Wealth Advisor had ever used a sector rotation strategy based on ETFs for his clients.

g. Present saw no records to corroborate the Intern's statement that in 2003 the Wealth Advisor began using a 60-week simple moving average to make certain investment decisions.

h. Present saw no records indicating that the Wealth Advisor began using a 60-week simple moving average in April 2001, switched to a 40-week simple moving average in July 2006, and switched to the Intern's algorithm in July 2008 – the precise sequence that Present told his analyst to use when manufacturing AlphaSector's hypothetical track record.

i. Present saw no records to support his decision to push AlphaSector's supposed start date back to April 2001, thereby creating the impression that the strategy had avoided the worst effects of the market downturn in 2002. (The S&P 500 Index fell nearly 25% in 2002.)

88. In short, Present knew that the AlphaSector strategy had been created in September 2008. The strategy had *not* been used to make real investments for real clients since April 2001. The strategy did *not* have an actual track record dating back to April 2001. On the contrary, as Present himself acknowledged in emails to AMEX and NASDAQ OMX (see paragraphs 30 and 39 above), the strategy's pre-September 2008 performance calculated by his analyst was backtested – *i.e.*, the retroactive application of portfolio construction rules to historical trade data.

89. The problems with Present's public statements about the AlphaSector strategy were even worse than that. Not only was AlphaSector's supposed track record actually backtested using historical trade data, but the backtesting was done incorrectly – and the calculation error substantially inflated the strategy's hypothetical performance.

90. Present was told by his analyst in late September 2008 about a possible error in implementing the signals used to calculate AlphaSector's historical performance. Present did not

investigate further. Despite his many years of experience with the mutual fund industry and the calculation of fund performance, he did nothing to ascertain whether AlphaSector's extremely positive track record had been calculated in error. In other words, even if his analyst did not tell him about the actual impact of the calculation error on AlphaSector's advertised performance prior to September 2008, Present was reckless in continuing to tout that performance.

FIRST CLAIM FOR RELIEF
(Violation of Sections 206(1) and 206(2) of the Advisers Act)

91. The Commission repeats and incorporates by reference the allegations in paragraphs 1-90 above.

92. At all relevant times, Present was an "investment adviser" within the meaning of Section 202(a)(11) of the Advisers Act [15 U.S.C. §80b-2(a)(11)].

93. Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§80b-6(1), 80b-6(2)] provide that it is unlawful for an investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly: (1) to employ any device, scheme, or artifice to defraud a client or prospective client; or (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client.

94. As set forth above, Present made materially false and misleading statements about AlphaSector: (1) he claimed that the AlphaSector strategy had been used to make real investments for real clients since April 2001; and (2) he advertised performance figures for the period from April 2001 to September 2008 that did not reflect actual investments and that were substantially overstated.

95. As a result, Present violated and, unless enjoined, will continue to violate Sections 206(1) and 206(2) of the Advisers Act.

SECOND CLAIM FOR RELIEF
(Violation of Section 206(4) of the Advisers Act and Rule 206(4)-8)

96. The Commission repeats and incorporates by reference the allegations in paragraphs 1-90 above.

97. Section 206(4) of the Advisers Act [15 U.S.C. §80b-6(4)] provides that it is unlawful for an investment adviser to engage in an act, practice, or course of business which is fraudulent, deceptive, or manipulative, and that the Commission shall issue rules to define and prescribe measures to prevent such misconduct. Rule 206(4)-8 issued under the Advisers Act [17 C.F.R. §275.206(4)-8] provides that it is unlawful for an investment adviser to a pooled investment vehicle: (a) to make an untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; or (b) to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle. Rule 206(4)-8 defines a "pooled investment vehicle" to include an investment company as defined in Section 3(a) of the Investment Company Act of 1940 [15 U.S.C. §80a-3(a)].

98. As set forth above, from February 2009 to at least October 2012, Present made materially false and misleading statements to the Fund Company about AlphaSector: (1) he claimed that the AlphaSector strategy had been used to make real investments for real clients since April 2001; and (2) he advertised performance figures for the period from April 2001 to September 2008 that did not reflect actual investments and that were substantially overstated. At all relevant times, the Fund Company's funds were a "pooled investment vehicle" for purposes of Rule 206(4)-8.

99. As a result, Present violated and, unless enjoined, will continue to violate Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

THIRD CLAIM FOR RELIEF
(Violation of Section 207 of the Advisers Act)

100. The Commission repeats and incorporates by reference the allegations in paragraphs 1-90 above.

101. Section 207 of the Advisers Act [15 U.S.C. §80b-7] provides that it is unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission under Section 203, or to omit to state in any such application or report any material fact which is required to be stated therein.

102. As set forth above, Present drafted descriptions of AlphaSector that appeared in Part II to F-Squared's filing with the Commission on Form ADV, and he certified the accuracy of those filings. On several occasions between 2008 and 2013, Part II of F-Squared's Form ADV contained material misrepresentations and omissions to the effect that the AlphaSector strategy had been used to make real investments for real clients since April 2001.

103. As a result, Present violated and, unless enjoined, will continue to violate Section 207 of the Advisers Act.

FOURTH CLAIM FOR RELIEF
(Aiding and Abetting F-Squared's Violation of
Section 206(4) of the Advisers Act and Rule 206(4)-1)

104. The Commission repeats and incorporates by reference the allegations in paragraphs 1-90 above.

105. As set forth above, Section 206(4) of the Advisers Act [15 U.S.C. §80b-6(4)] provides that it is unlawful for an investment adviser to engage in an act, practice, or course of

business which is fraudulent, deceptive, or manipulative, and that the Commission shall issue rules to define and prescribe measures to prevent such misconduct. Rule 206(4)-1 issued under the Advisers Act [17 C.F.R. §275.206(4)-1] provides that it is unlawful for an investment adviser that is registered under Section 203 of the Advisers Act, directly or indirectly, to publish, circulate, or distribute an advertisement that contains an untrue statement of a material fact or that is otherwise false or misleading.

106. As set forth above, Present wrote advertising materials for F-Squared, which was registered with the Commission under Sector 203 of the Advisers Act. The advertising materials contained materially false and misleading statements about AlphaSector: (1) they claimed that the AlphaSector strategy had been used to make real investments for real clients since April 2001; and (2) they advertised performance figures for the period from April 2001 to September 2008 that did not reflect actual investments and that were substantially overstated.

107. As a result, F-Squared violated Section 206(4) of the Advisers Act and Rule 206(4)-1 thereunder, and Present aided and abetted F-Squared's violations.

PRAYER FOR RELIEF

WHEREFORE, the Commission requests that this Court:

A. Enter a permanent injunction restraining Present and each of his agents, servants, employees, and attorneys and those persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, including facsimile transmission or overnight delivery service, from directly or indirectly engaging in the conduct described above, or in conduct of similar purport and effect, in violation of:

1. Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§80b-6(1), 80b-6(2)];

2. Section 207 of the Advisers Act [15 U.S.C. §80b-7]; and

3. Section 206(4) of the Advisers Act [15 U.S.C. §80b-6(4)] and Rules 206(4)-1 and 206(4)-8 thereunder [17 C.F.R. §§275.206(4)-1 & 275.206(4)-8];

B. Require Present to disgorge his ill-gotten gains, plus pre-judgment interest;

C. Order Present to pay an appropriate civil penalty pursuant to Section 209(e) of the Advisers Act [15 U.S.C. §80b-9(e)];

D. Retain jurisdiction over this action to implement and carry out the terms of all orders and decrees that may be entered; and

E. Award such other and further relief as the Court deems just and proper.

Respectfully submitted,

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