IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	
v.	:	**Civil Action No.**
JEFF THOMAS ALLEN and JAMES BARLOW SMITH,	:	**05-453**
Defendants.	:	

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") alleges for its Complaint the following:

SUMMARY

1. This matter involves a trading scheme conducted by defendants Jeff Thomas Allen and James Barlow Smith, senior officers and shareholders of Advanced Investment Management, Inc. ("AIM"), a now defunct investment adviser. Allen was AIM's President, CEO and Chief Investment Officer. Smith was AIM's Vice President of Equity Trading.

2. From at least January 2002 through July 2002, Allen and Smith conducted unauthorized trading in numerous client accounts, and in violation of advisory agreements. In particular, from April through July 2002, during a time when the S&P 500 Index dropped almost 29 percent, the defendants improperly increased market exposure in an effort to recover from past losses. This trading caused market exposure in

some accounts to reach exceedingly high levels, which, in turn, caused more than $415 million in client losses. In order to conceal the effect of their trading, which otherwise would have been disclosed in monthly account statements, Allen and Smith sold the unauthorized positions before month-end, and repurchased them shortly thereafter. This strategy of "window dressing" prevented clients from discovering the scheme.

3. By knowingly or recklessly engaging in the conduct described in this Complaint, defendants Allen and Smith violated, and unless restrained and enjoined, will continue to violate, Section 17(a) of the Securities Act of 1933 ("Securities Act")[15 U.S.C. §77q(a)], Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)], and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.

4. By knowingly or recklessly engaging in the conduct described in this Complaint, defendant Allen has violated, and unless restrained and enjoined, will continue to violate Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. 80b-6(1) and 80b-6(2)].

5. By knowingly or recklessly engaging in the conduct described in this Complaint, defendant Smith has violated, or aided and abetted violations of, and unless restrained and enjoined, will continue to violate, or aid and abet violations of, Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. 80b-6(1) and 80b-6(2)].

JURISDICTION AND VENUE

6. The Commission brings this action pursuant to Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)], Section 21(d) of the Exchange Act [15 U.S.C. §78u(d)] and Section 209(d) of the Advisers Act [80b-9(d)] to enjoin such acts,

transactions, practices, and courses of business, obtain disgorgement and civil penalties, and for other appropriate relief.

7. This Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)], Section 27 of the Exchange Act [15 U.S.C.§78aa] and Section 214 of the Advisers Act [15 U.S.C. 80b-14].

8. Certain of the acts, transactions, practices, and courses of business constituting the violations alleged herein occurred within the Western District of Pennsylvania and elsewhere, and were effected, directly or indirectly, by making use of the means and instruments of transportation or communication in interstate commerce, or the means and instrumentalities of interstate commerce, or the mails, or the facilities of a national securities exchange.

DEFENDANTS

9. Jeff Thomas Allen, age 48, is a resident of Pittsburgh, Pennsylvania. From 1992 until resigning in July 2002, Allen was AIM's Chairman, President, Chief Executive Officer and Chief Investment Officer. He owned 78 percent of AIM's outstanding shares and directed all activities of the firm.

10. James Barlow Smith, age 46, is a resident of Saxonburg, Pennsylvania. Smith was the Vice President of AIM's Equity Trading Department and served as AIM's equity trader. Smith owned six percent of AIM's shares and reported directly to Allen.

11. As AIM shareholders and senior officers, Allen and Smith made the firm's investment decisions, including those described in this Complaint. Allen and Smith implemented those decisions with the full knowledge of the implications and consequences of their actions.

FACTS

AIM's Enhanced Index Product

12. AIM, formerly located in Pittsburgh, PA, was registered as an investment adviser with the Commission from 1992 to February 2003.

13. At all material times hereto, AIM acted by and through Allen and Smith.

14. As an investment adviser, AIM offered an investment advisory product called "Enhanced Indexing." This strategy sought to outperform the S&P 500 Index by using "synthetic" investment products, *i.e*. derivatives, to mirror the S&P 500 Index, but at only five percent of the 100 percent cost of purchasing the same S&P 500 equities outright. AIM then invested the cash saved from purchasing derivatives in short term, high quality debt instruments, or cash equivalents. By seeking a competitive return on these relatively safe instruments, AIM "enhanced" any return on the S&P 500 Index (mirrored through derivatives) with its return on these debt instruments or cash equivalents. In short, the portfolio sought to closely track the S&P 500 Index under all market conditions and offered a long-term return that outperformed the total return of the S&P 500 Index by 70 to 125 basis points (.70 to 1.25 percent) annually.

15. AIM and its clients, which included several public and private pension funds, entered into investment advisory agreements ("Agreements") which specifically outlined the scope of AIM's investment authority. The Agreements specifically prescribed the amount of risk AIM clients were willing to bear in their portfolios. Most clients required AIM to maintain 100 percent market exposure in their accounts, such that

any market movement in the S&P 500 Index would cause comparable percentage movements in the market value of their portfolio. Thus, the 100 percent market exposure limit reduced the portfolio's risk profile because it assured that the portfolio's market value would move parallel with the S&P 500 Index.

16. A limited number of clients authorized AIM to use leverage in their portfolios and increase their market exposure to levels as high as 120 percent. A portfolio with an exposure level above 100 percent is considered leveraged. This increases the risk profile because it causes the portfolio's value to move disproportionately to the S&P 500 Index. For example, given any movement in the S&P 500 Index, a portfolio that has 200 percent in market exposure would essentially experience twice the gain or loss of the same portfolio with only 100 percent market exposure.

17. Allen oversaw the management and implementation of the Enhanced Index strategy and divided the trading into two categories: "Core" and "Non-Core."

18. The Core trading in AIM's Enhanced Index portfolios was comprised of derivative instruments purchased to create the synthetic S&P 500 Index portfolio up to 100 percent in market exposure. Allen delegated the responsibility of the Core trading to a portfolio manager in the fixed income department who managed the Core positions to ensure the Core exposure remained at 100 percent.

19. The Non-Core trading was reserved for the portion of each client portfolio used for exposure above 100 percent of the S&P 500 Index. Allen and Smith managed this segment separately. The Non-Core trading was supposed to be restricted to accounts where client Agreements expressly authorized AIM to increase exposure levels beyond

100 percent. However, defendants, instead, used the Non-Core trading as the vehicle for their scheme to increase exposure levels beyond authorized limits in an effort both to generate additional trading profits in many accounts and increase management fees, without client knowledge, authorization, or consent, which caused combined client losses of more than $415 million.

20. At all times material hereto, Smith had a direct role in the trading scheme, and knowingly or recklessly participated in it. Smith executed many unauthorized trades, and AIM trading tickets and other documents contain his handwritten notes and signature. Moreover, Smith knew, or was reckless in not knowing, the impact of the trading, since he had access to reports that monitored daily exposure levels.

Allen and Smith's Unauthorized Trading

21. From at least January 2002 and continuing through July 2002, Allen and Smith purchased and then closed out Non-Core positions in excess of authorized amounts (and Non-Core positions for some client accounts who had not authorized any Non-Core trading) on or near the last day of the month. Although clients typically received notice of daily trades, the monthly statements did not disclose that Allen and Smith were violating client Agreements by maintaining excessive exposure levels at particular periods during the month. After reporting the misleading month-end exposure levels, Allen and Smith increased -- often dramatically -- client exposure levels by reestablishing the positions they had sold only days earlier. This strategy of "window dressing" prevented clients from discovering the unauthorized trading, which constituted a knowing or reckless fraud.

22. On April 1, 2002, the S&P 500 Composite Index closed at 1,146 and then steadily declined over the next four months until reaching 819 on July 22, 2002, a drop of 28.5 percent. For AIM clients, the S&P 500's decline exacerbated their losses because of the excess exposure Allen and Smith had created in their accounts. By April 30, 2002, AIM had underperformed the S&P 500 Index by 180 basis points.

23. In late May 2002, Allen and Smith attempted to recover AIM's losses in April by purchasing multiple high-risk call and put options in numerous client portfolios, continuing their unauthorized trading and subjecting AIM clients to excessive and unauthorized exposure. As the market continued to decline and the option contracts approached their June 21, 2002 expiration date, the exposure in some accounts dramatically increased, from approximately 145 percent on June 3 to 385 percent by June 20th. Client losses multiplied as the exposure increased.

24. Rather than minimize losses and cease the unauthorized trading, Allen decided to "double down" on the market's direction by purchasing numerous futures contracts on June 21, 2002. Allen essentially wagered that the S&P 500, which had declined by 33 points, or 3.2 percent, over the first two weeks of June 2002, would reverse course, causing the market value of the portfolios to rebound. By maintaining excessive exposure levels that in some portfolios reached 500 percent, Allen expected that any market increases would beneficially increase the market value of the portfolios, allowing the accounts to recover the losses created by his and Smith's unauthorized trading before the month-end reporting date.

25. Allen's gamble failed. The market did not reverse course in time to avoid rapid declines in portfolio values. The magnitude of the losses was significant; one

account decreased from $117,499,626 to $74,285,680 between May 31 and July 12, 2002, a decline of $43,213,946 or a 37 percent decrease compared to a 13 percent drop in the S&P 500 Index. Combined losses among AIM clients exceeded $415 million.

Defendants' Failure to Disclose Exposure Levels

26. Neither Allen nor Smith informed their clients, until July 2002, that they had been maintaining unauthorized exposure levels in their accounts or otherwise invested their assets in a manner inconsistent with their Agreements. In fact, the monthly statements mailed and/or e-mailed to clients during the months of the unauthorized trading failed to disclose daily exposure levels and made it appear that their investments complied with the Agreements.

27. With Smith's knowledge, and under the direction and control of Allen, AIM personnel prepared, and then distributed to clients, materially misleading monthly account statements as described in this Complaint.

28. The AIM multi-page account statements disclosed an array of month-end portfolio information including, among other things, performance and transaction data and market exposure calculations. However, at no time did Allen or Smith disclose in the monthly statements that they had been routinely conducting Non-Core trading in violation of the Agreements. Nor did they disclose in the monthly account statements the unauthorized intra-month exposure that they had created.

29. In addition, Allen and Smith caused, and/or otherwise failed to prevent, monthly account statements distributed by AIM from understating exposure levels, which further misled investors into believing that they had been trading within the Agreements' authorized limits.

30. Finally, in June, Allen caused AIM to omit, or otherwise failed to prevent AIM from omitting to include, the Non-Core Equity Graph in the May account statement, which otherwise would have revealed any excessive exposure levels in those client accounts. Had the graph been included with the May statement, clients might have realized that their portfolios faced substantial risk of loss from the high-risk options purchased in late May, enabling those clients to liquidate the unauthorized positions before suffering more significant losses.

31. Allen and Smith knowingly or recklessly misled AIM clients when they perpetrated a scheme to use excessive exposure in contravention of client Agreements to generate additional trading profits and management fees. Despite their legal obligation to disclose their use of excessive exposure, defendants knowingly or recklessly concealed their trading by purchasing and then selling the unauthorized positions before month-end so the account statements did not reflect the intra-month exposure. This conduct reveals that Allen and Smith knowingly or recklessly acted with the specific intent to deceive and mislead AIM clients in violation of their Agreements.

FIRST CLAIM FOR RELIEF

Violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

32. The Commission realleges and incorporates by reference each and every allegation in paragraphs 1 through 31, inclusive, as if the same were fully set forth herein.

33. From at least January 2002 through July 2002, as a result of the conduct alleged herein, defendants Allen and Smith, knowingly or recklessly, in connection with the offer, purchase, or sale of securities, directly or indirectly, by the use of the means or

instruments of transportation or communication in interstate commerce, or the means or instrumentalities of interstate commerce, or the mails, or the facilities of a national securities exchange:

(a) employed devices, schemes or artifices to defraud;

(b) obtained money or property by means of, or made, untrue statements of material fact, or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and

(c) engaged in acts, transactions, practices, or courses of business that operated as a fraud or deceit upon offerees, purchasers, and prospective purchasers of securities.

34. By engaging in the foregoing conduct, defendants Allen and Smith violated Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.

SECOND CLAIM FOR RELIEF

Violations of Sections 206(1) and 206(2) of the Advisers Act

35. The Commission realleges and incorporates by reference each and every allegation in paragraphs 1 through 34, inclusive, as if the same were fully set forth herein.

36. From at least January 2002 through July 2002, defendants Allen and Smith made use of the instrumentalities of interstate commerce and of the mails while acting as investment advisers.

37. From at least January 2002 through July 2002, as a result of the conduct alleged herein, defendants Allen and Smith, directly and indirectly, by use of the mails

and the means and instrumentalities of interstate commerce, knowingly or recklessly employed devices, schemes, and artifices to defraud investment advisory clients and prospective clients, and engaged in transactions, practices, and courses of business which operated as a fraud and deceit upon such clients and prospective clients.

38. By engaging in the forgoing conduct, defendant Allen violated, and defendant Smith violated, or aided and abetted violations of, Sections 206(1) and 206(2) of the Advisers Act, [15 U.S.C. 80b-6(1) and 80b-(2)].

WHEREFORE, the Commission respectfully requests that this Court enter an Order:

I.

Permanently restraining and enjoining defendants Allen and Smith from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.

II.

Permanently restraining and enjoining defendant Allen from violating, and defendant Smith from violating or aiding and abetting violations of, Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. 80b-6(1) and 80b-6(2).]

III.

Directing defendant Smith to disgorge any and all ill-gotten gains, together with prejudgment interest, derived from the activities set forth in this Complaint, in accordance with a plan of disgorgement acceptable to the Court and to the Commission.

IV.

Directing defendants Allen and Smith to pay civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)], Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)], and Section 209(e) of the Advisers Act [15 U.S.C.80b-9(e)] as a result of the violations set forth herein.

V.

Granting such other and further relief as the Court may deem just and appropriate.

Respectfully submitted,

_______/s/_____________________________

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