Third quarter 2008
Volume 1, Issue 1

ARETE INSIGHTS

Welcome

Wow! What a quarter to start up an investment management operation! While Arete has certainly not emerged unscathed from recent selling pressures, we are extremely encouraged by the quality and quantity of investment opportunities we are finding. This is a great time to be a stock picker! We also appreciate the many risks and concerns in the market, however, and are always happy to share our point of view and to discuss what we see going on. Please always feel free to give us a call.

As we research and probe and reflect on recent market action, perhaps the clearest message we see emerging is how important it is to have sound investment principles. It is now abundantly clear that highly leveraged businesses are highly risky. It is also clear that there have been too many instances in which managers' and investors' interests have not been not well-aligned. Simplicity has its advantages and complexity has its risks.

In contrast, Arete has been designed from the bottom-up to be easy to understand and evaluate and ultimately be best able to serve its clients' interests. For example, Arete has a very simple organizational and product structure so as to minimize potential for conflicts of interest. We have a very reasonable fee structure in order to preserve client performance. We have a sound investment philosophy and process that clearly guides us through all kinds of markets. And we strive to keep you informed in good times and bad.

Inside This Issue

We hope you find our proposition compelling and welcome any feedback you may have!

Insights

Amidst all of the turmoil we have witnessed in the markets the last few months, and in light of our debut newsletter, there is a whole host of topics I could discuss. Since we have all heard too much of the talking heads blather on about the financial crisis, I think this is a great chance to take a different tack and instead reflect on the timeless topic of judgment.

Whenever I step back and try to boil down which one or two things are absolutely essential to a sustainably successful investment management effort, I keep arriving at good judgment and decision-making. This is not to say there aren't other important factors, or that there aren't a lot of things that go into making good judgment. The point is, if judgment is absolutely critical to investment success, then it behooves us to do everything in our power to pave the way to being ready, willing, and able to exercise good judgment. The following are my thoughts regarding judgment and decision-making in an investment management environment.

The path begins with a credible investment philosophy. Such a philosophy should lay the foundation for how the entire firm views the markets, defines market inefficiencies, and describes how those inefficiencies can be exploited. Without a solid philosophical foundation, it is virtually impossible to productively deploy analytical resources.

The path to good judgment continues with good information. We view the goal of good information not so much being to accumulate more and more information, but to identify the most relevant information and to get the best information and ideas to "bubble up" to the top. We believe this happens best through actively engaging in dialogue about thoughts and ideas.

Good information is a function of good sharing which is a function of company culture. We believe the best way to nurture a sharing environment is by continuously expressing behaviors that engender communication and idea-sharing. While many talk of "creating" a certain culture, we believe that view is too simplistic. Instead, we believe culture *emerges* from behaviors. In other words, you can't create a culture without embracing and personifying it; you need to "walk the walk."

It is also important that good judgment gets parlayed into effective decisions. Part of this depends on ensuring correct incentives are in place such as aligning interests and minimizing or completely avoiding conflicts of interest. It is also important to note that decision-making can be improved by studying the lessons of both good and bad decisions. In fact, a substantial body of literature exists regarding biases, decision-making heuristics, and the importance of context and incentives. These lessons are quite useful for anyone driven to optimize the quality of decision-making.

Finally, we believe an often under-appreciated element of decision-making quality resides in the temperament of the decision-maker. At the margin, what is that person's greater motivation – to deliver superior investment performance to you, or to enrich himself or herself? We often see clues to the answer reflected in compensation structures.

A cogent investment philosophy to define the nature of the investment task, a research effort that reveals information relevant to the process, and individual and institutional incentives in place to align interests, are all necessary, but individually insufficient conditions for good decision-making. We also focus much attention on the mechanics of decision-making because it is an inherently fragile process. Whenever the system is stressed by volatility, difficult markets, or other factors, the integrity and continuity of any of the above components can be seriously challenged and vulnerable to breakdown if they are not firmly embedded. Conversely, in good times, it is quite easy to get lulled into a sense of security and complacency which can allow for the relaxation of the efforts it takes to keep the system running well.

Every single aspect of Arete has been designed with these ideas in mind. It is certainly fair to say that Arete would not have been founded without a great deal of confidence in being able to deliver superior investment performance. That said, our challenge to ourselves, and the source of endless enjoyment for us, is to continue learning, adapting, and getting better every day.

Business Update

In many ways, it feels like Arete has already accomplished a lot. The firm's articles of organization were filed in January, it became registered with the state of Maryland in April, and began live management of its first portfolio in July. While I am pleased with how Arete is shaping up thus far, I also realize that this is just the beginning of what hopefully will be a very long journey.

It has been with a keen eye to sustaining this journey that I developed the business plan for Arete. One of the key features of this plan is to tightly manage costs along the way. By closely managing costs and converting some normally fixed costs into variable ones, I believe the chances for the sustainability of Arete's business are vastly improved. I very much appreciate the fact that it takes time to thoroughly evaluate a manager and to reach a comfort level necessary to entrust one's money to someone else. I firmly believe it is just a matter of time before many of you appreciate the value that Arete brings to the table. We plan to be there for you when you do.

Another comment I have is regarding my use of the words "we" and "us" in relation to Arete. To be clear, for the time being, I am the sole employee of Arete. However, I use "we" and "us" in describing Arete's activities for a couple of reasons. Perhaps most importantly, Arete even at this early stage, already reflects the thoughts, insights, feedback, and countless other contributions of friends, family, vendors, and colleagues as well as the support of its clients. As such, I truly view Arete as a collective effort and therefore naturally refer to it in the collective voice.

Along the same lines, my vision for Arete is to grow and evolve into an organization that reflects the unique and special talents of each of its individual employees. It is also with sight of this vision that I refer to Arete in the collective voice. I apologize in advance for any confusion this may cause and hope you will grant me this liberty with the use of "we" and "us".

Thanks and take care!

David Robertson, CFA
CEO, Portfolio Manager

Portfolio Characteristics

Portfolio Characteristics (9/30/08)

	Arete MCC	Midcap Index*
Size		
Average Market Cap ($ mil.)	5,304	5,181
Median Market Cap ($ mil.)	4,263	3,983
Minimum Market Cap ($ mil.)	981	258
Maximum Market Cap ($ mil.)	15,606	22,475
Number of holdings	52	806
Valuation		
P/E current year	14.0	13.2
P/E forecast Y1	11.4	14.7
P/B	4.4	3.9
P/S	2.2	2.4
Yield (%)	1.4	2.3
Valuation drivers		
ROE (%)	20.3	21.8
LT eps growth forecast (%)	15.0	14.4

Source: The Applied Finance Group™
**Note*: Arete currently does not subscribe to the Russell Indexes and therefore the statistics presented here represent approximations of the Russell Midcap® Index.

A key proposition for Arete's Mid Cap Core strategy is that it is a truly representative mid cap portfolio. In general, this suggests that over time, you can expect to see the aggregate characteristics and sector exposures of the strategy will migrate to those of the Russell Midcap Index. During intervening periods, however, sector exposures and other characteristics will reflect the opportunities we find in the market at that point in time.

Sector exposures for the strategy in the third quarter are for the most part well within our general guidelines of 50% - 150% of benchmark sector weights. The most important exceptions are autos and transportation which is right at 150% due to especially attractive stocks we are finding in that sector, and in consumer staples where we are slighthly under our guidline minimum of 50% due to a dearth of attractive valuations there.

Sector exposure (percent of assets on 9/30/08)

Economic sector	Arete MCC	Midcap Index*	Difference
Autos & Transportation	5.0	3.3	1.7
Consumer Discretionary	18.0	17.0	1.0
Consumer Staples	1.9	4.9	-2.9
Financial Services	17.6	21.6	-4.1
Health Care	10.1	8.8	1.3
Energy	7.2	7.8	-0.6
Materials & Processing	11.7	8.5	3.2
Producer Durables	7.6	7.8	-0.1
Technology	7.6	9.8	-2.3
Utilities	8.3	9.2	-0.9
Other	2.4	1.4	1.0
Equity exposure	97.4	100.0	
Cash and equivalent	2.6	0.0	

Source: The Applied Finance Group™
**Note*: Arete currently does not subscribe to the Russell Indexes and therefore the statistics presented here represent approximations of the Russell Midcap® Index.

Performance review – Mid Cap Core

The Arete Mid Cap Core product is designed with the flexibility to invest in the most attractive mid cap stocks, regardless of any particular "style" designation. With that context, the primary criterion for selecting stocks market value is significantly less than our estimation of intrinsic value. In other words, we try to find situations in which our expectations for a company are substantially more positive than the expectations discounted by the market and our expectations are borne out over time.

Our investment process is designed to discover, analyze, and assemble stocks into a diversified portfolio that consistently outperforms its benchmark over time. Specifically, our investment objective is to outperform the benckmark Russell Midcap® Index by 200-400 basis points, net of fees, over the course of a market cycle.

Stock performance (6/30/08 - 9/30/08)

Best performers

Company	Return in quarter (%)*
BB&T Corp.	74.0
Barr Pharmaeceuticals	51.9
Sears Holdings Corp.	32.5
Weyerhaeuser Co.	28.8
Toll Brothers	27.4

Worst performers

Company	Return in quarter (%)*
Constellation Energy Group	-69.6
Shaw Group Inc.	-47.7
Genworth Financial	-40.3
NRG Energy	-37.7
Foster Wheeler	-36.6

**Note*: Live performance began after 6/30/08; therefore return in quarter reflects return from date of purchase.

The enormous volatility in the market in the third quarter was certainly reflected in the best and worst performers in the portfolio. The best examples of this were BBT which reflects an opportunistic purchase in mid July, CEG which fell victim to the the credit crunch, and GNW which got caught up in fears about the housing market and growing concerns about capital for life insurers in general. Importantly, these results demonstrate that volatility can be a two way street – it can also provide terrific entry prices for quality companies.

The common theme among the worst performers was energy. The violent decline in oil, gas, and other commodity prices clearly took its toll on stock prices.

Finally, the silver lining in the results was BRL which received a takeout offer at a significant premium from TEVA shortly after purchase in July. We believe this serves as yet another reminder that regardless of what is going on in the markets as a whole, there are always good stocks to be had, as long as you keep doing the work to find them.

Arete takes a longer-term view towards owning stocks and generally purchases stocks with the idea of holding them for three to five years. Such a holding period implies a turnover rate of about 25% which we believe is a fair estimate of what to expect from the Mid Cap Core strategy.

Volatility and opportunity both precipitated transactions in the third quarter. First, we sold BRL after it received an attractive acquisition offer due partly to some concerns that the deal may unravel and partly because falling prices created opportunities elsewhere. We also sold BBT in the quarter after an unusually short holding period simply due to our valuation discipline: we were able to purchase it at a very cheap price and it very quickly appreciated to what we considered to be full value.

The sales raised cash that we re-deployed into energy-related stocks. When the strategy was funded early in the third quarter, we were significantly underweight the energy sector. Substantial price declines during the quarter allowed us to buy BTU and add to FWLT at prices far more attractive than at the beginning of the quarter.

Investment philosophy

As indicated above in our discussion about judgment, we firmly believe in the critical importance of a cogent investment philosophy. In order to emphasize this point, and to assist you in understanding how we work, we provide the full text of our investment philosophy here. This text is also described in our Form ADV, Part II which is available upon request at any time.

Performance derives from exploiting mispriced securities.

The key to investment performance is finding and exploiting market inefficiencies in the form of mispriced securities. There are two components to this. One component involves determining the fair price of securities in the form of underlying intrinsic value. We calculate intrinsic value using any and all tools available to us including discounting cash flows, comparing to similar companies, and determining liquidation and asset values, among others. We believe that while mispricings do occur in the market, securities prices eventually migrate back to their intrinsic values over longer periods of time and this “migration” can be exploited.

The second component of exploiting mispriced securities is establishing a clear understanding as to the various mechanisms at work that allow mispricing to occur. By understanding the mechanisms and motivations of the marginal buyer and seller, we believe we can more accurately estimate the probabilities and expected values of investment opportunities.

Nobody has perfect information.

In the early days of professional investment management, there were relatively few people conducting research on companies and industries and those that were derived an important advantage from doing so. Important asymmetries in information existed. Over the ensuing years, competitive pressure and technological development have conspired to make most data and analysis commodities which no longer provide a meaningful competitive advantage. What can provide an advantage, however, is *how* that information is used and *how* it gets interpreted in making investment decisions. Indeed, research shows that a common explanation for market liquidity is not differential information, but disparities in interpretation.

The information that enters a research organization enters in many forms - numbers, data points, summaries, stories, reports, interviews, editorials, etc. In order to convert the raw material of information into the useful output of a good investment decision, it is necessary to assimilate and synthesize the information into some meaningful form. We believe the most effective way to accomplish this is to thoughtfully deploy resources available according to the nature of the research tasks at hand. For example, we believe that “open-ended” issues that involve many available options are better suited to the mind of the expert investor who can quickly eliminate unproductive avenues of inquiry. Likewise, tasks that are well-defined and “programmable” are better suited to the discipline of quantitative tools.

Two other (interrelated) factors that affect information usage are research culture and research prioritization. We believe that the best research efforts are organized primarily around ideas and are comprised of analysts who are cognitively diverse. Further, we believe that the best way to leverage the collective knowledge and experience of a research team is to encourage active and open dialogue designed to explore multiple perspectives and to challenge individual assumptions, biases, and beliefs. Only by enduring such scrutiny do the best ideas rise to the top. In order to fully leverage these ideas, we believe research efforts must be dynamic and flexible in allocating resources such that ideas receive attention in proportion to the expected benefit to the portfolio.

Execution is crucial for investment success.

A good investment strategy is a necessary, but not sufficient condition for superior investment performance. In order to create value, that strategy needs to be implemented continuously and comprehensively. Actions speak louder than words. We believe the most effective efforts focus on a few simple, but key concepts that work to ensure proper execution of a firm's investment strategy and to mitigate forces that may work against proper execution.

The first key to execution is structural in nature and involves a firm's independence. By maintaining independent ownership, an investment firm eliminates agency effects which can present a conflict of interest between clients and certain of its ownership groups. The most common manifestation of agency effects in money management firms occurs when certain owners of the firm desire short-term growth delivered through asset accumulation and that accumulation makes it progressively more difficult to generate superior investment performance for existing clients. Independent ownership ensures that client and manager interests are optimally aligned. In fact, independence is regarded by some industry veterans as a competitive advantage.

Another key to execution is behavioral in nature. Many of the best investment decisions are the most difficult to make because of high levels of uncertainty and/or because such decisions are well outside the boundaries of conventional thinking. These types of situations are very difficult for most people. The best investors tend to have a temperament that provides them the courage and initiative to act, often going against the grain, when opportunities arise. However, the same temperament provides balance such that decision making is not simply a risk-taking activity, but a very conscious and targeted effort to engage in propositions with high risk-adjusted expected returns.

Finally, another important element of execution is simply doing what you say you do in your investment process. Too often, perfectly acceptable investment processes fail when actual investment activities bear little resemblance to the process described in the marketing presentation. We call this the “marketing gap;” the difference between what is said and what is done. Execution is optimized when the marketing gap is minimized.

Mid Cap Core composite

Arete Asset Management, LLC
Mid Cap Core Composite
July 31, 2008 - September 30, 2008

Month	Gross-of-Fees Return (percent)	Net-of-Fees Return (percent)	Russell Midcap® Index Return (percent)	Number of Portfolios	Internal Dispersion (percent)	Total Composite Assets ($)	Composite Assets With Bundled Fees ($)	Percentage of Composite Assets With Bundled Fees	Total Firm Assets ($)
August	3.75	3.75	1.85	1	NA	117,163	117,163	100%	318,582
September	-12.68	-12.68	-12.26	1	NA	102,287	102,287	100%	286,495
Cumulative	-9.40	-9.40	-10.64	1	NA				

Arete Asset Management Mid Cap Core performance composite disclosures are presented on the following pages.

Arete Asset Management Mid Cap Core performance composite disclosures:

Compliance statement
Arete Asset Management has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

Definition of the firm
Arete Asset Management, LLC (Arete) was established in 2008 and is registered as an investment adviser in the state of Maryland. Arete is defined as an independent investment management firm and is not affiliated with any parent organization. Arete currently manages one strategy, the U.S. equity mid cap core strategy, which it markets to individual and institutional clients.

Benchmark
The benchmark is the Russell Midcap® Index and its performance is reported in U.S. dollars.

Calculation methodology
Portfolio valuations are calculated as of calendar month-end and are computed in U.S. dollars and performance is also reported in U.S. dollars. Time-weighted rates of return are used which adjust for external cash flows. Our smaller, retail accounts contain fee structures in which one flat, per-transaction fee is charged for trading expenses and which embeds an implicit charge for custody. Since trading and custody charges cannot be directly segregated in these cases, they constitute "bundled fees". Gross-of-fees performance returns are presented before management and custodial fees when custodial fees can be segregated from trading, but are presented before management fees and after bundled (trading and custodial) expenses for our retail accounts. Net-of-fees returns are presented after management fees, trading expenses, and custodial expenses are deducted or after management fees and bundled (trading and custodial) fees for retail accounts. There are no instances in which management fees are bundled with trading or custodial fees. Returns are presented net of nonreclaimable withholding taxes when applicable. Arete does not use leverage or derivatives in the management of portfolios. Additional information regarding policies for calculating and reporting returns is available upon request.

The composite
This U.S. Equity Mid Cap Core composite was created in August, 2008 and includes all fee-paying, taxable and non-taxable, discretionary, long only, fully invested portfolios benchmarked to the Russell Midcap Index. For purposes of composite construction, "fully invested" is defined as having greater than 90% of portfolio assets invested in equity securities. Every new portfolio is added to the composite in the first complete calendar month that it is "fully invested". A complete list and description of firm composites is available upon request.

Fee schedule
The management fee schedule is as follows: 1% of AUM up to $1 million, 0.75% on AUM greater than $1 million, but less than $5 million, and 0.65% on assets greater than $5 million.

Arete Asset Management Mid Cap Core performance composite disclosures continued:

Minimum account size
There is no minimum account size for inclusion in the composite. Please note, however, the minimum initial account size accepted is $100,000.

Dispersion
Internal dispersion is currently not meaningful as there are five or fewer portfolios included in the composite. In the future, we plan to calculate dispersion using the dollar-weighted standard deviation of all portfolios included in the composite for each performance period.

Verification
Arete has not been verified by an independent verifier for its compliance with GIPS. Please note that the initial minimum period for which verification can be performed is one year and Arete does not currently have sufficient history to meet this requirement.

To receive a copy of the firm's Form ADV Part II, please contact David Robertson at 410/649-0086 x710, by email at droberston@areteam.com, or by mail at the address listed below.