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THE ARETE QUARTERLY

Welcome

Inside This Issue

The analytical and research skills we have honed over the years give us the tools to dig into just about any company or industry and get a very good idea of how it works. One of our favorite exercises is to turn the focus of our inquiry onto our own industry of money management. This is a useful way for us to calibrate to the business landscape, but is also a very good way to get signals from investors as to their concerns and wants and needs.

Our working hypothesis, and a signficant reason for founding Arete, is that a lot of investors are not especially happy with, or well served by, existing investment options. A recent article in *Investment News* by Andrew Osterland provided some interesting corroborating evidence.

Osterland quotes Sophie Schmidt with Aite Group LLC, “The online brokerages grew assets by close to $1 trillion between 2008 and 2010.” Further, the financial services research firm, Cerulli, predicts that assets in the direct market will grow to nearly $5 trillion by the end of 2014. In short, the numbers show that investors are moving huge amounts of money from being managed by someone else, to being managed by themselves.

We are not aware of direct evidence of the causes of this fairly dramatic trend, but there are reasonable hypotheses. Schmidt offered hers: “Investors got disgusted with financial advisors who didn’t help them in 2008-2009, so they’ve moved assets to self-directed accounts.”

Disenchanment was not limited to small investors. Osterland noted, “High net worth investors … have made an even more substantial shift to self-directed investing.” Katherine Wolf, associate director at Cerulli, describes what she sees: “Some investors want to try out their own ideas and compare them to results they get with a financial advisor. Others are just testing services elsewhere from where they have most of their money.”

Regardless of the reasons, it is clear investors are scrutinizing the value of investment services like never before. We tend to view this trend as rational, healthy, and if anything, overdue.

In taking on greater responsibilities for managing their own money, individual investors are fortunate to benefit from several positive trends. Discount brokers facilitate transactions at a tiny fraction of the cost of just a couple of decades ago. Further, there are several passive funds that provide exposure to a variety of markets and segments at very low cost. These trends provide extremely good and cheap access to markets.

Arete recognizes that investors have cheap access to passive investments, so we do more than just provide exposure to the market. We try to help investors out by leveraging our unique skills and by focusing on the things that provide the greatest value. For example, we do the research and analysis to find the most attractive stocks whether they are included in popular indexes or not. As a result, clients get a relatively concentrated portfolio of best ideas. Essentially, we apply a similar investment philosophy and process to that of many top hedge funds, but at a fraction of the management fees.

Some of the less positive news for investors is that the exercise of investing can be complicated and it is getting progressively more so. A lot of questions can arise. How can one tell if a stock is undervalued? What is a good asset allocation? How much should one be concerned about inflation?

Here too, Arete can help. The combination of education, experience with so many stocks, and ongoing research activities, puts us in a position from which to reasonably evaluate a wide variety of investment challenges. Sometimes a single nugget of insight or expertise can save a lot of trouble.

In sum, investors are taking a good hard look at what they need and who can help them. Some investors will find a great deal of value in an investment advisor and some will be perfectly happy managing their own money. Some will experiment with several different providers. For those who want to invest as wisely as possible, who can make good use of expertise, and who want conflict-free advice, Arete is well suited to serve. If you or someone you know may benefit from our service, please let us know!

Business Update

As I mentioned last quarter, after four years in business now, I thought it would be a good idea to revisit and refresh Arete's business and marketing plans. This endeavor was motivated in large part by my belief that it is simply a good practice to review plans on a regular basis.

In the process, one issue that became clear is that I have not done as good a job of describing Arete as I could have. While it is true that I have spent a good deal of my career analyzing mid cap stocks and managing mid cap portfolios, I did not form Arete just to create a replacement job for myself. If that were my only motivation, it would have been far easier and more rewarding economically to find a job as a mid cap portfolio manager at another firm.

Instead, I founded Arete as a much, much bigger vision. While I love researching and analyzing mid cap stocks, I also really wanted to make sure my work did some good. I wanted to make sure investors didn't pay too much, that they got good information, and above all else, that they could absolutely trust that their interests were being served and protected. In the context of many dissatisfied investors, I wanted Arete to be part of the solution, not part of the problem.

On the investment side, being part of the solution means managing only those asset groups or strategies that provide real opportunities for active management. Mid cap stocks are perfectly consistent with this vision because they provide such an interesting and vibrant universe of ideas. There are several other asset groups, however, that also provide meaningful opportunities for active management. In my vision, Arete will host many of them someday.

There is so much more to the vision though. A big part of the opportunity was to start from scratch in building an organization unencumbered by legacy practices and vested interests. With a clean slate I could ask questions about every single aspect of the business, "What practice would serve investors best? Who is doing it really well?"

Going through this exercise, it was obvious that many of the decisions would fall outside the expertise and perhaps even awareness of most investors. In these cases, my ideal was the best possible structure for investors upon which a decent business could also be built. In fact, I felt so strongly about quality permeating the organization, that I named the company Arete, from its meaning of functional excellence in Greek philosophy. Arete (excellence) is more than a name, it is also a daily reminder of my vision.

Another issue that emerged from the plan review was that I need to more clearly articulate the benefit that Arete provides. It is not just an investment *product*. It is not just a mid cap strategy. Rather, the benefit that Arete provides is ultimately to help investors. I think of Arete's primary purpose as converting the firm's investment expertise into material benefit for its clients.

Clearly, one important way Arete can help clients is by producing good long-term returns with its mid cap investment strategy. Given Arete's tremendous experience and expertise with the universe of mid cap stocks and with sophisticated valuation models, the firm has significant competitive advantages in offering such a strategy.

Also, however, in the process of researching, analyzing, and valuing a lot of companies for the mid cap strategy, Arete develops a lot of important insights into the market that can be extremely useful to investors. These insights inform and guide a wide variety of investment decisions. Since you can always reach me, Arete offers a truly unique combination of insights and *access*. If you have a question about something, there is a good chance I can provide some useful perspective or relevant information based on other work I have done.

The last major issue that emerged from the plan review is that Arete is now in a position where it needs to add resources and better leverage the resources it does have. I feel like Arete does a lot of things really well, it keeps getting better, and it is extremely well positioned to compete effectively as the investment landscape evolves. Key competencies such as valuation, mid cap universe expertise, and knowledge development are working well and continue to improve.

In order to really blossom and grow, however, Arete will need to add resources to amplify and leverage the practices and structures that are proving successful. A big part of this effort will be reaching out to various people and interested parties to identify opportunities to help each other.

In this effort, I will be paying special attention to opportunities to boost Arete's sales and research efforts. If you or someone you know may be interested in some capacity, please let us know or pass on the word. I am always happy to brainstorm creative ways to make things work.

In sum, I am very happy with what Arete is, but it does need to grow in order to reach its potential. When I originally created Arete, I decided to put an outline of an acorn in the "A" of the Arete logo as a symbol of the great potential for client portfolios. This was also a nice tie-in because the white oak is the state tree of Maryland. That acorn probably also serves as a good symbol for Arete as a business: Enormous potential still to be realized.

Thanks and take care!

David Robertson, CFA
CEO, Portfolio Manager

Portfolio Characteristics – Arete Mid Cap Core

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 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.

We believe maintaining a truly representative mid cap portfolio is important for two reasons. First, a truly mid cap portfolio faithfully plays its role in a broader asset allocation scheme. Second, it allows for accurate assessment of performance. Without an appropriate benchmark it is difficult, if not impossible, to judge whether performance differentials are due to skill or luck, and are sustainable or transient.

For example, many fund managers attempt to beat their benchmark by timing the market and/or migrating style. These tactics rarely generate sustainble out-performance. To us, such activities usually just serve to obfuscate the underlying inability of the manager to add value through a coherent and disciplined investment process.

Portfolio characteristics for the quarter continue to confirm that AMCC is a very representative mid cap portfolio. Market caps for AMCC are extremely similar to the mid cap index and by most measures, AMCC is cheaper. ROE is noticeably lower, but often fails to represent AMCC well due to distortions by negative numbers in some positions.

Sector exposures were all below benchmarket weights due to the high cash position, but within our general guidelines of 50% - 150% of benchmark weights. Several sectors are now close to guideline minimums including Consumer Staples, Financial Services, Energy, and Consumer Discretionary. While we always target best ideas in our research process, we will also be sensitive to these underweights as we deploy cash in upcoming quarters.

Portfolio Characteristics (3/31/12)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	6,376	5,868
Median Market Cap ($ mil.)	4,042	4,419
Minimum Market Cap ($ mil.)	71	124
Maximum Market Cap ($ mil.)	26,011	22,820
Number of holdings	38	779
Valuation		
P/E current year	17.8	18.6
P/E forecast Y1	17.4	17.9
P/B	1.9	3.0
P/S	0.8	1.4
Yield (%)	1.4	2.5
Valuation drivers		
ROE (%)***	9.4	16.4
LT eps growth forecast (%)	10.3	12.7

Source: The Applied Finance Group™
**Note:* Excludes allocations of ASCMA, OSH, and OSHSP from corporate actions.
***Note*: Arete currently does not subscribe to the Russell Indexes and therefore the statistics presented here represent approximations of the Russell Midcap® Index.

While we have reported on this in the past, it bears repeating: It is important to note that cash was not raised through a wholesale culling of the portfolio. Instead, the majority of the cash was raised through exercising our normal sell discipline and through realizing the benefits of several acquisitions for cash. As much as anything, the accumulation of cash reflects an intentional delay in reallocation. Looking to the intermediate future, cash will serve as insurance against significant market dislocations, but will also allow us to make opportunistic purchases. Also, almost exclusively due to the cash position, the number of securities in the portfolio is also lower than our targeted range of 45 to 65.

Sector exposure (percent of assets on 03/31/12)

Economic sector	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	11.0	17.1	64.3%
Consumer Staples	3.5	6.1	57.6%
Energy	4.6	7.4	62.4%
Financial Services	13.0	21.1	61.7%
Health Care	8.7	9.1	96.0%
Materials & Processing	5.6	7.4	75.6%
Producer Durables	8.6	12.9	66.9%
Technology	7.7	11.7	65.6%
Utilities	5.9	7.3	80.7%
Equity exposure	68.6	100.0	
Cash and equivalent	31.3	0.0	

Source: The Applied Finance Group™
**Note*: Arete Mid Cap Core is represented by the aggregate of all assets in the composite at the given date.
***Note*: Arete currently does not subscribe to the Russell Indexes and therefore the sector weights presented here represent approximations of the Russell Midcap® Index.

Transactions review – Arete Mid Cap Core

We had more transactions than normal in the first quarter, but the rationale for each was very consistent with our investment process.

The continued strength in the market caused us to sell our positions in both United Rentals and Coach. As with Liberty Global last quarter, we continue to like the businesses of both companies. After outstanding runs of outperformance, however, extremely optimistic expectations are now priced into these stocks — which provides precious little opportunity for further upside. We'll continue to monitor both as these stocks have been extremely volatile over that last four years and we may get a chance to buy them again at considerably lower prices.

We also sold out of our position in MSCI Inc. this quarter. This decision was founded in valuation, but was also closely related to our regular review of risk factors. When we originally purchased MSCI, the company's core businesses produced exceptionally high returns. While we saw great opportunity for continued growth, we also noted the risk that cash generated from the healthy core business could be allocated to acquisitions of considerably less attractive businesses. Unfortunately, we have gathered enough evidence now to give us great concern that management is more interested in producing eps growth to pad their bonuses than in deploying capital effectively on behalf of shareholders.

We also sold Energy Conversion Devices (ENER) after extremely disappointing performance which finally resulted in the company declaring bankruptcy. We hate losing money for clients, but these things happen. While there are certainly things we could have done better, and will seek to do better next time, it is also true that it took an extraordinary confluence of events to disprove the thesis on ENER. For more discussion on this topic, please see the "Performance" section.

We made one purchase in the quarter with the addition to the existing NII Holdings (NIHD) position. The stock has been hit hard due to concerns about the build out of its 3G network in Latin America, currency fluctuations, and the recent increase in competition in the Brazil market. While these short-term concerns have some merit, we deemed the reaction to be significantly overdone. By our measures, we were able to buy the stock at about half its asset value and at a small fraction of its discounted stream of cash flows.

Finally, we also received Exelon (EXC) stock in its stock-for-stock acquisition of Constellation Energy (CEG). Since EXC is fairly large and we did not buy it outright, we do not view it as a long-term holding. That said, the stock is not expensive and maintains a healthy dividend, so there is no immediate compulsion to sell it.

Market Overview

Although our valuation based investment philosophy is sound over longer periods of time, the last few years have been challenging. Extraordinary measures of monetary easing have artificially boosted some stocks while forestalling a real recovery in the economy for others. All of the valuation oriented managers we follow have faced similar headwinds as we have the last two years.

One manager in particular, Horizon Kinetics, made the case that significant purchases and high trading volume of exchange traded funds (ETFs) and other passive products have been distorting the valuations of underlying securities.

While it is no mystery that ETFs have been popular, the extent to which this is the case is impressive. "Since 1999, the number of ETFs has expanded from fewer than 100 to more than 1,100, even as the number of listed stocks in the U.S. has declined by one-third," according to their fourth quarter commentary. In dollar terms, over $1 trillion has flowed into ETFs with even more going to index mutual funds. These huge flows have had a significant effect on the market.

In addition to huge fund flows, some of the popular ETFs also attract huge trading volume. For example, "The annual turnover of the SPDR S&P 500 ETF is on the order of 12,000%." Further, "The dollar value of all ETF shares traded now accounts for about 50% of total U.S. equity market trading."

Some of the funds flow to ETFs is undoubtedly cash seeking higher returns, and some appears to be active equity investors switching to passive funds. The only explanation for such incredibly high turnover of some of these ETFs, however, is that there is a *significant cohort of participants making short-term bets on the direction of the market*. This phenomenon has important implications for other participants.

Vitaliy Katsenelson, a well known value investor recently described in *Institutional Investor*, "Speculators are indifferent to what asset they hold (junk or quality). Their time horizon is much shorter, and they are just looking for a greater fool on whom they can unload their stuff. The next tick in price is the only variable that matters to them." He continues, "Speculators are the ones driving stock prices up (and down) in the short run, but they leave as quickly as they arrive."

Because this frenetic trading activity in ETFs is speculative, it means that the market prices themselves are more prone to deviate significantly from fair valuations. As a result, and perversely, it has meant gaining exposure to the market through an ETF now implicitly also involves making short-term bets. As Horizon Kinetics describes, "Indexes, which are meant to measure the performance of, and provide exposure to, groups of stocks, have come to distort the prices of the stocks they are meant to measure."

That's not all they do. A recent article by Rodney N. Sullivan, CFA and James X. Xiong, CFA in the *Financial Analysts Journal* also shows that "A meaningful relationship [exists] between passive investing and a rise in equity market risk." Put another way, "The average beta for all equity segments over 1997 – 2010 shifted meaningfully higher."

Sullivan and Xiong show in their article, "How Index Trading Increases Market Vulnerability" that the consequences of increased passive investing, "plainly suggest a decrease in the ability of investors to diversify risk in recent decades."

The insights of Horizon Kinetics, and Sullivan and Xiong, go a long way in explaining our concern regarding the health of the market. For one, the high trading volume of major ETFs, combined with the increasing weight of ETFs in the market, is causing far more trading action to be based on short-term trading rather than long-term valuation. For another, since equity risk has risen, a 100% equity portfolio today is far riskier than a 100% equity portfolio of fifteen years ago.

These findings support Arete's actions in a couple of ways. First, in our role as stewards of our clients' capital, we work hard to earn attractive *risk-adjusted* returns. Since equity risk is higher now, that means generating either higher returns or lower risk. High valuations preclude widespread opportunities for high returns, so we have opted to raise cash in order to lower risk — until we find better return opportunities.

Second, these phenomena really highlight the importance of our best ideas approach.

The highest correlation, and therefore least diversifying value, resides among stocks in major indexes. Since the active share of the Arete Mid Cap Core strategy is so high (over 90%), our stocks act differently than the index and therefore provide much greater diversification value.

Performance review – Arete 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 a stock in the Mid Cap Core strategy is that market value is significantly less than our estimate of intrinsic value. In other words, we try to find situations in which our research generates expectations for a company's growth and profitability that justify substantially greater valuations than what the market discounts.

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 benchmark Russell Midcap® Index by 200-400 basis points per year, net of fees, over the course of a market cycle.

Our target of 200-400 basis points of outperformance is based upon our experience with the strategy and upon our judgment of value creation. The primary metric we use to judge value creation is the information ratio. The information ratio compares a portfolio's excess return to its risk as measured by tracking error. Our goal is to outperform by a large enough margin relative to risk to clearly merit the cost in time and resources to evaluate investing with us.

Arete's Mid Cap Core (AMCC) strategy was up 10.18% (net of fees) versus 12.94% for the Russell Midcap Index® (RMC) in the quarter (see pages 12 – 14 for performance and related disclosures). In the first two months of the quarter, AMCC underperformed RMC modestly, but respectably, given the large cash position. In March, concerns about slower economic improvement had a disporportionately negative effect on AMCC and it underperformed by a larger margin.

Individual stock performance reflected substantially similar market conditions as in the fourth quarter of 2011.

Stock performance* (12/31/11 - 3/31/12)

Best performers

Company	Return in quarter (%)
Sears Holdings	108.5
Seagate Technology	64.3
Synovus	45.4
Autodesk	39.5
Ingersoll Rand	35.7

Worst performers

Company	Return in quarter (%)
Dex One	-14.5
NII Holdings	-14.0
NRG Energy	-13.5
Peabody Energy	-12.5
Dresser Rand	-7.1

**Note*: Performance includes price changes only; it does not include dividend income in the quarter.

Two of the top performers, SHLD and STX, reflected significant rebounds from oversold conditions. There is never a magical signal telling us when the market is going to change its mind from hating these stocks to loving them. As a result, we rely on the discipline of our investment philosophy and process which prevents us from selling on the basis of price movement alone.

The other top performers were SNV, ADSK, and IR. None of these companies reported results or other fundamental developments that warranted such disproportionate improvement, but then neither did most of the market during its rise the last six months. The appreciation was facilitated by cheap valuations, but was also probably correlated with improved sentiment regarding economic growth.

The common thread among the bottom performers was exposure to energy. Each of NRG, BTU, and DRC are affected by natural gas prices which hit ten year lows in the quarter. Energy prices have always been extremely volatile and we do not expect this condition to persist indefinitely.

Of the other two bottom performers, DEXO has been performing well fundamentally, but fighting the headwinds of a declining yellow pages industry. NIHD has been facing more competition in one of its major markets in Brazil. While we consider both to be extremely undervalued, both have significant amounts of debt which makes the stock prices vulnerable to short-term pressures when concerns arise.

Although they do not appear in the table of stock performance, it is important to mention both Eastman Kodak (EK) and Energy Conversion Devices (ENER). Both companies declared chapter eleven bankruptcy in the quarter. As a result, these two positions negatively affected performance, but the impact was relatively small in the quarter.

The cases of each are somewhat different. For EK, we would describe the action as a “strategic” bankruptcy. It has patents and other valuable assets, but was not able to realize full value before additional financing was necessary. It also has some attractive growth businesses, but the slow economic recovery has made it harder than ever to develop these businesses fully. Since liquidity, rather than solvency, seems to be more of an issue here, it is quite possible value will still be realized for shareholders.

In the case of ENER, we always viewed the investment thesis as somewhat speculative in the sense that the company did not have a long history of producing excess cash flow. That said, it also had great technology and valuable intellectual property which created enormous upside potential in the stock and also granted it significant protection. Unfortunately, following the financial crisis in 2008, ENER suffered an overwhelming succession of adverse events and conditions.

We could bemoan the losses we and our clients suffered on ENER, and we are not happy about it, but instances like this also provide opportunities to learn. One takeaway in our post-mortem analysis is we did not find significant flaws in our company analysis or investment process. This is not to say we did everything perfectly, but there were no glaring errors either.

An important lesson we take away from the ENER bankruptcy is the indication it provides of how fundamentally the market has changed since the spring of 2010. The absence of clear growth-oriented public policy combined with high uncertainty has made it doubly difficult for companies with new and often disruptive ideas to gain traction. Not only are incumbents favored for safety and defensiveness, but funding is often unavailable to smaller organizations developing new businesses.

A major change in the market then is that because the process of creative destruction has not been rekindled in a meaningful way, the economic recovery is unusually fragile. After all, it is the new companies with new ideas that ultimately drive economic and employment growth. With such harsh conditions for new businesses, it is hard to see how economic recovery will be sustained unless something changes. We were surprised at the near total failure of public policy to address growth.

The final, and very important takeaway, is that we are not going to change our approach to investing or taking risk. While EK and ENER did not work out as we would have liked, we have also had important successes. This is exactly why we construct a diversified portfolio. We don't know what the future holds, but we try to position ourselves well regardless.

While individual stock performance certainly matters, perhaps the single most important factor driving relative performance the last two years has been AMCC's short duration. This just means the portfolio is biased to stocks that tend to receive more of their stream of cash flows sooner rather than later.

The rationale for this bias is that short duration securities are less affected by increases in the cost of capital. We have believed interest rates are extremely low and that the market implied cost of capital is also extremely low. We also believe there is a significant risk that the cost of capital will increase to more normal levels sometime in the next few years. Since we have an investment horizon of three to five or more years, we wanted to protect the portfolio against this risk. This position makes perfect sense for longer-term risk management, but has come with the short-term expense of weak relative performance.

Since long duration tends to work well in an environment of monetary easing, one could fairly ask why we not shift the portfolio to long duration stocks while the Fed continues its loose monetary policy?

The main reason we don't manage to short-term Fed policy decisions is related to investment philosophy. In order to profit from managing to the Fed's policy, we would need to have some reason to believe we can guess such decisions better than others, and we don't. There are no magical signals as to when the Fed slows or stops easing and there are no magical signals as to when the market may lose confidence in the Fed's ability to manage rates.

As a result, we stick with what we know: We buy stocks that are undervalued and sell them when they are overvalued, if and when that happens. Sometimes it takes longer for the strategy to work. Sometimes it's not fun, like 1999 and early 2000 were not fun for us. But the strategy does work.

Investment Philosophy

We firmly believe in the critical importance of a cogent investment philosophy for any investment operation. In order to emphasize this point, and to assist you in understanding how we work, we provide an abbreviated version of our investment philosophy here. The text of our investment philosophy is also provided, in its entirety, 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, which we do primarily through calculating discounted cash flows.

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.

Competitive pressure and technological development have conspired over the years 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.

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.

Research culture and research prioritization are also important in relation to analyzing and synthesizing information. 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. Further, 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.

In order to create value, an investment 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.

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. Independent ownership ensures that client and manager interests are optimally aligned.

The second key to execution is temperament. 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.

Arete Asset Management

Arete Mid Cap Core Composite

Arete Asset Management, LLC
Mid Cap Core Composite
July 31, 2008 - March 31, 2012

Period	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 ($)
2008*	-37.97	-38.16	-35.01	3	NA	207,031	207,031	100%	207,031
2009	48.63	47.83	40.48	3	NA	471,867	471,867	100%	673,806
2010	16.86	15.78	25.48	3	NA	546,315	546,315	100%	877,368
2011	-8.20	-8.88	-1.55	3	NA	497,767	797,767	100%	897,918
2012									
January	5.55	5.09	6.06	3	NA	523,081	523,081	100%	936,465
February	4.32	4.32	4.15	3	NA	545,671	545,671	100%	970,094
March	0.50	0.50	2.24	3	NA	548,446	548,446	100%	973,638
Q1	10.65	10.17	12.94	3	NA	548,446	548,446	100%	973,638
YTD	10.65	10.17	12.94	3	NA	548,446	548,446	100%	973,638

*Note: Peformance through 12/31/08 is from inception of composite on 7/31/08.
**Note: One existing and two new accounts contributed additional funds which were not at least 90% invested by the end of the quarter. Per our rules for inclusion, these accounts were excluded from the composite and will be added once the funds are fully invested.

Arete Asset Management Mid Cap Core performance composite disclosures follow:

Arete Asset Management Mid Cap Core performance composite disclosures continued:

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.

Arete Asset Management Mid Cap Core performance composite disclosures continued:

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. Every new portfolio is added to the composite in the first complete calendar month that it is "fully invested". For purposes of composite construction, a portfolio is "fully invested" if its equity composition is greater than 90% of the equity composition of the composite. Each portfolio will remain in the composite until its equity composition becomes less than 90% of that of the composite. A complete list and description of firm composites is available upon request.

*As of March 31, 2012, the composite has been redefined in order to clarify policy in light of unusually high cash positions recently. Prior to March 31, 2012, a portfolio was considered to be "fully invested" if greater than 90% of portfolio assets were invested in equity securities which implicitly assumed a nearly 100% equity position in the composite.

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.

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.