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THE ARETE QUARTERLY

Welcome

Several years ago Monster.com firmly established its brand in job hunting with a famous television ad entitled, "When I grow up" (You can watch the video on youtube). It features several snippets of kids listing their career aspirations. It starts with, "When I grow up," and follows with statements like, "I want to file all day," and "I want to have a brown nose," and "I want to be a 'yes' man."

The humorous list touched on challenges all of us face in our careers and in doing so, was an effective reminder for the audience to, according to businessinsider.com, "seek better opportunities that live up to childhood dreams."

This ad came to mind as I was reading the latest Michael Lewis book, *Flash Boys: A Wall Street Revolt*. Perhaps nowhere have childhood dreams become more corrupted than on Wall Street and *Flash Boys* delivered the message loud and clear as it relates to high frequency trading (HFT). I doubt if there are many who think Wall Street is completely innocent, but the insights from *Flash Boys* reveal a magnitude of bad behavior that can be shocking even to seasoned finance veterans.

Even one of the central figures in the book, Brad Katsuyama, a seasoned trader, underestimated the degree of misconduct. He had worked for Royal Bank of Canada and left to build a team to create a new stock exchange.

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The new exchange was designed to ensure orders were matched fairly largely by confounding HFT efforts to cheat the system. As Lewis explains, however, “Brad’s biggest weakness, as a strategist, was his inability to imagine just how badly others might behave … He hadn’t imagined that they [big banks] would use their customers’ stock orders to actively try *at their customers’ expense* to sabotage an exchange created to help customers."

Interestingly, few of the key players seem to harbor any signficant resentment for individual behavior; people just respond to incentives as we all do. Lewis certainly directs some harsh criticisms to individuals, but reserves the harshest admonitions for the system as a whole. As he describes, "The deep problem with the system was a kind of moral inertia. So long as it served the narrow interests of everyone inside it, no one on the inside would ever seek to change it.”

One manifestation of this credo is the fragmentation of the big picture such that exceptionally few participants ever fully understand their contribution. One

example of many is, "The customer guy was better at his job - and had deniability - if he remained oblivious to whatever the prop guy [proprietary trader] was up to." This is a significant risk to investors at all levels. The person you know, the person you trust, may just not know, or not want to know, what is going on in the big picture.

Despite the increasingly obvious flaws to the market structure, change has been resisted because so many people benefit from the arrangement. As Lewis describes, "It wasn't easy … to try to effect some practical change without a great deal of fuss, when the change in question was, when you get right down to it, a radical overhaul of a social order."

Even this understates the challenge, however. During one meeting, Lewis described an investor's comments: "'It seems like there is a first mover risk for someone to behave the right way,' he said. He was right: Even banks that were behaving relatively well weren't behaving all that well."

While *Flash Boys* focuses on HFT, it is a microcosm that illuminates important realities of the broader financial industry. In doing so, it provides valuable lessons for those of us who participate in any part of the industry.

One lesson is to highlight the shocking extremes of bad behavior. Our mental models of behavior need to be re-calibrated to incorporate much more extreme behavior in the world of finance. Another lesson is to appreciate that it is exceptionally difficult to get good, complete information from a corrupted, insular system. Most of the time that can only happen from *outside* of the system as Katsuyama and his team have done. Best wishes to them!

Finally, one of the most telling insights of the book comes in its acknowledgements. Lewis describes, "The people who work in these firms have grown more cynical about them, and more willing to reveal their inner workings, so long as their name is not attached to these revelations." While the Wall Street "system" is still largely in place, cracks are appearing. Perhaps some day more finance industry participants will be able to live up to childhood dreams.

Business Update

For a math major with a distinctly quantitative bent, going to Kellogg, a business school renown for its marketing program, was not an immediately obvious fit. The school's orientation towards collaborating for "win-win" solutions, however, aligned well with my own beliefs and its program of strategic marketing struck me as eminently sensible.

Marketing, as I learned it, is about far more than just promoting products, persuading consumers, or closing a sale. Rather, marketing is fundamentally about solving customer problems and doing so in an economically viable way. As such, it is intimately entwined with operations, R&D, distribution, sales, finance and everything else that comprises a company's value proposition. This perspective has been incredibly useful to me as both an analyst of companies and as a CEO implementing a business plan.

Long before I founded Arete, it struck me that exceptionally few investment firms

came anywhere close to fulfilling a "strategic" perspective of marketing. A common flaw was having little more than a narrow focus on one strength or feature. Sure, there are great analysts, but what if the funds they work on have extremely high fees? It's like relishing in how friendly the service department is at your car dealership and disregarding the fact that you're there every other month because the car keeps breaking down.

Too few investment organizations seem to connect all of the business dots in a way that solve the most basic investment problems such as, "How do you get the most from the money you invest?" and, How do you give yourself the best chance of being better off?"

A couple of the most important and yet often neglected dots for a successful investment operation are curiosity and constant learning. In writing about *Flash Boys* recently in his New York Times column, David Brooks captured a big part of the problem. He explains that, "Most people on Wall Street are primarily motivated to make money, but a few people are primarily motivated by an intense desire to figure stuff out."

He continues the thought process, "If you are primarily motivated to make money, you just need to get as much information as you need to do your job. You don't have time for deep dives into abstract matters. You certainly don't want to let people know how confused you are by something."

The fact that many investment "professionals" are motivated more by money than by curiosity goes a long way to explaining the paucity of investment services that truly solve problems. Unfortunately, this situation is often exacerbated by a widespread habit of conflating financial success with investment acumen.

Brooks concluded by predicting that, "If market-rigging is defeated, it won't be by government regulators. It will be through a market innovation in which a good exchange replaces bad exchanges."

I think this is right and I also think it provides a useful analogy for money management. Managers that are motivated primarily by money won't fail because of regulations or a moral imperative. Ultimately, they will fail because new managers will emerge that offer much more compelling value propositions. Higher value will come in the forms of lower costs and greater effectiveness in solving investors' problems. The lens of strategic marketing will clearly differentiate this new breed from the mass of others that are much more narrowly focused.

In keeping with the themes of market innovation and focus on investors, Arete keeps making progress. At least partly in response to several comments I have heard that it is hard to really understand the investment environment, I am adding content to Arete's website in the "Ideas" section. This information is designed to provide constructive suggestions on how to make the most of your efforts and should be useful to both individual and institutional investors.

When conceptualizing Arete's research effort and service offering, I really do like to think in terms of ideas being the functional currency. In this vein, I always appreciate feedback and suggestions for what I can do better. Further, I always

enjoy discussing investment topics so please let me know if you would like to dig deeper into anything. I'd be happy to get together or to discuss making a presentation.

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.

Arete Mid Cap Core Composite
Active share
Q1 14
93.5%

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 (3/31/14)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	7,831	8,084
Median Market Cap ($ mil.)	5,127	5,936
Minimum Market Cap ($ mil.)	162	772
Maximum Market Cap ($ mil.)***	28,761	35,859
Number of holdings	33	820
Valuation		
P/E current year	21.5	22.3
P/E forecast Y1	21.6	21.2
P/B	2.4	4.3
P/S	1.2	1.9
Yield (%)	1.5	2.3
Valuation drivers		
ROE (%)****	8.5	12.6
LT eps growth forecast (%)	10.7	12.2

Source: The Applied Finance Group™
**Note:* Excludes positions which are less than 0.1% weights.
***Note*: Arete currently does not subscribe to the Russell Indexes and therefore the statistics presented here represent approximations of the Russell Midcap® Index.
****Note*: Stocks with low floats are excluded
****Note: The measure of ROE was changed from the average to the median as of 3/31/14.

That said, our overarching goal is to provide attractive returns to investors on an *absolute* basis. During most times, the stock market provides an attractive vehicle through which to realize those returns. In unique periods of significant overvaluation, however, when our valuation and other analyses suggest attractive returns are less likely, we may

allow the cash portion of the portfolio to increase so as to preserve investors' capital as well as options to buy cheaper in the future.

Portfolio characteristics for the quarter continue to confirm that the equity portion of AMCC is a very representative mid cap portfolio. Market caps for AMCC are extremely similar to the mid cap index and AMCC is considerably cheaper on the bases of Price-book and Price-sales which tend to be more stable metrics.

Sector exposure (percent of assets on 3/31/14)

Economic sector	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	4.1	18.2	22.5%
Consumer Staples	0.0	5.6	0.0%
Energy	4.3	6.7	64.1%
Financial Services	16.9	21.4	78.9%
Health Care	9.8	10.5	93.0%
Materials & Processing	5.2	6.7	77.7%
Producer Durables	8.4	13.1	64.3%
Technology	7.1	11.4	62.6%
Utilities	5.3	6.5	82.1%
Equity exposure	61.1	100.0	
Cash and equivalent	38.8	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.

We want to mention that we finally decided to change the calculation of the ROE metric from an average to a median. As it was, this particular measure was volatile and provided little information content. Indeed, as the markets have run up under the Fed's policy of quantiative easing, the benchmark's average ROE has become increasingly biased by a relatively small number of extremely high returns. Notably, the benchmark average ROE last quarter was 25.4% whereas the median ROE this quarter is less than half that at 12.6%.

Sector exposures are all below benchmark weights due to the high cash position. All sectors, with the exception of consumer staples and consumer discretionary, however, are still within our general guidelines of 50% - 150% of benchmark weights.

Since cash started accumulating three years ago, we have been fairly aggressively researching new names. With valuation as a significant consideration, however, we have found few opportunties to deploy it. As a result, we should be in a good position to act fairly quickly when valuations approach more reasonable levels.

Transactions review – Arete Mid Cap Core

In the first quarter of 2014 we acted opportunistically to modify a couple of portfolio positions. When SHLD sold off early in the quarter in response to weak holiday retail performance, we took the opportunity to increase the position. We continue to see the real estate holdings as undervalued and were well aware of the impending spinoff of Land's End and its potential for making underlying value more visible.

We also reduced our position in STX early in the quarter. It had run up substantially late in 2013 on the strength of momentum across the technology sector. Not only did the run push the weight in the portfolio over 5%, but it stretched valuation limits as well. We still like the company but reduced exposure under favorable conditions.

Market Overview

For those of us who invest on the basis of economic reality, the last few years have often been a bewildering mixture of surrealism, behavioral extremes, and outright fantasy. This isn't to say there aren't good companies out there or that significant progress isn't being made in a number of industries. It is to say, however, that levels of economic activity, as measured by sustainable free cash flows, have become seriously disconnected from market valuations and as such, have provided only extremely wobbly foundations for market recovery.

The notion of disconnectedness was captured beautifully in this recent snippet on Yahoo Finance: "The market pullback has been driven by well-connected insiders, hedge funds and private investors fleeing from winning risky trades, not by serious concerns about the economy." So let's get this straight, we as investors should not be worried in the least that "well-connected insiders, hedge funds and private investors" are running away from the market? Is it because these folks are so poorly informed they can't possibly have good insights?

We have mentioned catching glimpses of doubt creeping into the dominant market narrative several times over the past year or so. When tapering was first mentioned last spring, markets plunged violently before the Fed backpedaled with ameliorating language. A similar glitch occurred later in the year when the Fed committed to start tapering and yet again in January of this year when the pattern of tapering became established. The tight correlation between market selloffs and Fed statements, completely abstracted from underlying revenue growth and cash flow potential, highlight the weak rationale for continued market appreciation.

Grant Williams summed up the mentality nicely in his December 2013 letter, *Things that make you go Hmmm...*: "Throughout 2013, the distortions created by intervention in once-free markets have left many (myself included) scratching their heads. The interventions have worked - almost faultlessly - but for them to do so has required the suspension of one belief system (economic reality) and the adoption of another - namely, that everything will be OK because … well, just because. Can the fantasy persist into 2014? Yes. It most certainly can. Will it continue into 2014? Most likely. Will this new belief system become the new economic reality? Not a chance."

It's not hard to pinpoint the source of this sustained suspension of economic reality. Going back to October 2009, Gillian Tett reported in the *Financial Times*, "when money is virtually free - or, at least, at 0.5 per cent - traders feel stupid if they don't leverage up." The mindset is simple: "The longer that money remains ultra-cheap, the more traders will have an incentive to gamble (particularly if they privately suspect that today's boom will be short-lived and want to score big over the next year)." In short, cheap money incentivizes traders to keep leveraging up and riding the wave of asset appreciation. Needless to say, this activity can be quite harmful to other market participants.

Andrew Lo, a professor at MIT and an expert in complex systems, described (also in the *Financial Times*) what happens when unnaturally large amounts of money flow into a given strategy or asset class: "1. It

reduces the strategy's expected return owing to competition; 2. If there is expected return remaining, this portion will be a source of correlation or 'beta' among all investors in the strategy; and 3. If enough assets are invested in the strategy over a sufficiently short period of time, the strategy can become a 'crowded trade' that is illiquid and subject to large unpredictable swings in profits and losses."

Taken together, these insights provide a very useful context from which to understand what has happened in the market and to highlight viable scenarios for future action. It can be thought of as the unstoppable force of leveraged gambling (with cheap money) starting to butt heads with the immovable object of economic reality.

We have felt the tremors of this confrontation several times now with some small but abrupt selloffs. Most recently the selloff in biotech stocks in the first quarter (and continuing through in the second quarter) is an indication that the potential for a serious collision is increasing. While biotech stocks are certainly an extreme case, they are far from the only assets that have benefited from cheap money and that may be subject to "large unpredictable swings in profits and losses."

The levitation of nearly all financial assets from cheap money also reveals interesting insights about the nature of third party investment management. Managers face the quandary of either accepting low returns that may underperform benchmarks for a period of time, or accepting higher risk in the form of valuations that become ever more disconnected from economic reality.

One large investor admitted recently in the *Financial Times* in regards to biotech stocks that, "There has been a period of benign neglect where we know what we own is overvalued and today there was follow through on that sentiment." We wonder how much someone should pay a manager that continues to hold stocks he or she knows are overvalued?

There is no doubt that this period of artificially suppressed interest rates, commonly referred to as financial repression, creates a challenge for everyone trying to deploy capital productively. In trying to better understand this landscape and its implications, we can find some useful insights from the experience of Japan since the late 1990s.

In a *Financial Times* article about the experience of Japan's policy for dealing with bad home loans, Gillian Tett describes, "while nobody could quantify the scale of that quasi subsidy [to banks], there was a gnawing suspicion that prices might fall in the future if (or when) more bad news emerged. The consequence was a mood of corrosive distrust and unease, which was hard to articulate or measure but which fostered a deflationary mindset." Tett concluded, "Without clearing prices, it is hard to rebuild real trust and confidence. In the mortgage world, as elsewhere."

Given these lessons admonishing intervention, we cannot systematically exclude more constructive public policy options from the realm of possibility. Indeed as the Fed continues to withdraw from its program of quantitative easing, it does seem to be starting a long walk back to normality.

In addition, monetary policy has been structured in a way that provides great benefits to short term trading interests with very questionable benefits to the economy or the labor market. But this need not be the case either. More directed monetary policy could conceivably assist very specific parts of the market without incurring such large risks of excess.

Although reduced intervention may start paving the way to more reasonable asset prices, it is only one possibility and could well be a low probability one at that. In the absence of asset prices that give owners a good chance of realizing attractive returns, investors must seriously consider the possibility of allocating more to saving for the time being. Attractive returns are never guaranteed and sometimes you just need to say “No”. Of course this need not be a permanent position and should be reversed as soon as attractive opportunities arise.

Finally, there is nothing easy about slogging through periods of financial repression. Extra efforts should be made to find and engage resources that can help you cut through the noise by providing an antidote to the self-serving viewpoints, conflicting claims, and half-truths that unnecessarily complicate an already difficult task.

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.

Stock performance* (12/31/13 - 3/31/14)

Best performers

Company	Return in quarter (%)
Dex Media	35.9
Exelon Corp.	22.5
Oshkosh	16.9
Health Net	14.6
Genworth	14.2

Worst performers

Company	Return in quarter (%)
NII Holdings	-56.7
Spirit Aerosystems	-17.3
Peabody Energy	-16.3
Weyerhaeuser	-7.0
Synovus Financial	-5.8

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

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 returned 2.52% (net of fees) for the quarter versus 3.53% for the Russell Midcap Index® (RMC) (see pages 11 - 13 for performance and related disclosures). Although the strategy underperformed its primary benchmark, we saw several encouraging signs in the quarter's performance.

First, in both January and March, when the Russell Midcap performance was negative, the AMCC strategy performed notably better demonstrating some impressive defensive characteristics. This was especially apparent in the performance of AMCC's stocks which actually outperformed the Russell Midcap Index when adjusted for cash. This performance was demonstrative of the effects of our valuation discipline which tends to perform very differently from momentum strategies - on both the upside and the downside.

Another encouraging sign was that the AMCC strategy outperformed both the broader S&P 500 and Russell 1000 indexes for the quarter. The evidence in favor of mid cap stocks is substantial and we saw it again this quarter.

The top performers for the quarter were consistent in their contrarian character. All of these stocks have appeared as bottom performers at various times over the past few years so it is notable that a broad group performed so well in this quarter. We include it as additional evidence that the era of easy directional bets may be drawing to a close.

DXM reported solid improvement in its fourth quarter (in distinct contrast to its disappointing third quarter) and is proceeding nicely with its integration. Exelon has been out of favor due to its exposure gas prices which have been extremely low, but got a nice boost from unusually cold winter weather. Both OSK and HNT have been criticized for weak management, but still seem undervalued. GNW has performed well over the last year but is still fighting widespread perceptions that its long-term care business isn't viable and that its mortgage insurance business has no value.

Bottom performers contained some familiar names with NIHD at the top of the list. Management reported it was in danger of breaching loan convenants this summer and the stock got hammered again. While the company owns valuable assets, it has done a poor job of managing its large debt burden. While there is certainly downside risk, it is a small position now and contains enormous upside potential if it can work through its short term travails.

Two of the other bottom performers, BTU and WY, were clearly related in the sense that both are commodity producers and both have exposure to China. The pressure on their performance likely had a lot more to do with concerns about the tightening of credit in China and the likelihood of slower growth there than any company-specifc factors.

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 Mid Cap Core Composite

Arete Asset Management, LLC
Mid Cap Core Composite
July 31, 2008 - March 31, 2014

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	15.20	13.84	17.28	4	NA	798,766	798,766	100%	897,341
2013	23.18	22.00	34.76	4	NA	974,605	974,605	100%	1,172,496
2014									
January	-0.99	-1.23	-1.95	4	NA	962,606	962,606	100%	1,159,913
February	2.83	2.83	5.87	4	NA	989,831	989,831	100%	1,188,450
March	0.94	0.94	-0.27	4	NA	999,148	999,148	100%	1,199,683
Q1	2.77	2.52	3.53	4	NA	999,148	999,148	100%	1,199,683
YTD	2.77	2.52	3.53	4	NA	999,148	999,148	100%	1,199,683

**Note*: Peformance through 12/31/08 is from inception of composite on 7/31/08.
***Note*: One new account contributed additional funds which were not at least 90% invested by the end of the quarter.
Per our rules for inclusion, this account was 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.