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THE ARETÉ QUARTERLY

Inside This Issue

Welcome

Please remember that the *Areté Quarterly* now contains primarily a quantitative description of the Arete Mid Cap Composite. For our views on the markets and investment industry, please check out the Areté blog at www.areteam.com/blog.

Business Update

When I graduated from college and entered the work force, I knew there were a couple of things that I would need in a career: I would need to be constantly challenged and I would need to be constantly learning. Without those, I would get bored and lose interest.

Fortunately I came across investment management and quickly became captivated. The analysis of securities and markets was inherently challenging, but even more so since prices kept changing. I immediately set off to learn everything I could about the profession.

The good news is that I still harbor the same enthusiasm for the exercise of investing and have become even more optimistic about the potential for technology to facilitate interesting and new types of analysis. For the intellectually curious, it really is like being a kid in a candy shop!

Well it would be anyway, if there were a payback for doing quality analysis. Unfortunately, as I described in the market overview [here], markets have effectively become "hijacked" by central banks. An important consequence of their aggressive interventions has been that prices have come to resemble the outcome of central planning more closely than the result of free markets.

As I've argued many times, the single most important consequence of securities prices being artificially inflated is that they present an ongoing risk of a significant collapse down to, or beyond, their intrinsic values. While monetary policy can certainly maintain the charade for some period of time, as we have seen, it is virtually impossible to maintain an unnatural state of affairs indefinitely. This reality casts a pall of ever-present danger to any investment consideration.

Another consequence which rarely gets mentioned, however, but one that certainly affects me personally is that policy driven markets are boring; they simply aren't intellectually challenging. The notion of hanging on every word that gets uttered by a Fed governor or parsing Fed minutes for minuscule changes in language strikes me as something akin to watching soap operas.

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It may be entertaining, and it may even provide some superficial, short term benefits, but it does nothing to improve things longer term.

This state of affairs is especially frustrating for someone like me who became so enamored of the investment business because of the intellectual challenge. Even more important than my individual sentiment, however, is the implication for the entire investment services industry. So many smart people have been rendered almost completely helpless to accomplish anything socially useful with their skills in the presence of these centrally planned interest rates.

If these conditions were to continue for very much longer, they would present an unpleasant list of options. As I also mentioned in the market overview for the first quarter, however, I think there are good reasons to believe that some opportunities will be emerging for engaged active managers who can take long term positions.

If and when that happens, it will be fun to apply the slew of cheap data, new resources and creative analytical tools to inefficiently priced securities. Further, new tools to build and share knowledge and fresh thinking about organizational structures promise to re-define what relatively small, focused research groups are able to accomplish.

I continue to believe that the investment services industry is ripe for fundamental reform and improvement. Further, the tools and capabilities for such reform are over-abundant, if anything. It seems to me long overdue that investors should start benefitting from the same scale of improvement that technology has already delivered to almost every other industry. While it is often natural for people to resist change, sometimes change is for the better!

Thanks for your interest and take care!

David Robertson, CFA
CEO, Portfolio Manager

Portfolio Characteristics – Areté Mid Cap Core

A key proposition for Areté'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.

All of 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 and retain the option 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 fairly similar to the mid cap index although the median is now considerably smaller. AMCC is considerably cheaper on the bases of Price-book and Price-sales which tend to be more stable metrics. Notably, Price-book still compares well despite a substantial rise from the inclusion of an anomalously high figure from GLPI.

As a note, we changed the calculation of ROE from an average to a median some time ago. 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.

Portfolio Characteristics (03/31/16)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	6,932	7,942
Median Market Cap ($ mil.)	2,933	6,065
Minimum Market Cap ($ mil.)	2	171
Maximum Market Cap ($ mil.)***	32,991	30,267
Number of holdings	22	820
Valuation		
P/E current year	18.4	23.3
P/E forecast Y1	18.9	19.4
P/B	2.1	4.2
P/S	1.0	2.0
Yield (%)	2.2	2.8
Valuation drivers		
ROE (%)****	8.9	12.4
LT eps growth forecast (%)	8.5	11.5

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.

Sector exposure (percent of assets on 3/31/16)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	1.5	16.7	9.0%
Consumer Staples	0.0	6.4	0.0%
Energy	0.0	4.6	0.0%
Financials	15.2	22.7	66.9%
Health Care	5.7	9.0	63.5%
Industrials	2.1	13.1	16.0%
Information Technology	1.5	14.2	10.6%
Materials	3.3	5.6	58.5%
Telecommunications	0.0	1.0	0.0%
Utilities	2.8	6.7	41.6%
Equity exposure	32.1	100.0	
Cash and equivalent	67.8	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.
****Note*: Economic sector classifications were changed from Russell to GICS beginning Q414.

Sector exposures are all below benchmark weights due to the high cash position. Cash has remained at fairly high but stable levels over the last several quarters.

As a quick reminder, active share highlights the degree to which a portfolio's holdings differ from its benchmark. A portfolio must differ significantly from its benchmark in order to significantly outperform it — and therefore to justify charging active management fees. Areté's Mid Cap Core portfolio consistently exhibits active share well above the 80% level considered to be very active.

Active share* (3/31/16)

Period	Percent**
Q116	96.2
Q415	96.6
Q315	92.3
Q215	93.0
Q115	94.2

**Note*: Computed for AMCC composite
***Note*: Active share > 80% is considered "very active"

Transactions review – Areté Mid Cap Core

There were no transactions in the quarter. We continue to be encouraged by the emergence of some more interesting values arising from recent market turmoil in industrial, commodity, and energy stocks. To date, however, we have not found valuations compelling enough so as to provide a reasonable margin of safety.

Performance review – Areté Mid Cap Core

The Areté 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. 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.

Areté's Mid Cap Core (AMCC) strategy returned 1.49% (net of fees) for the quarter versus 2.24% for the Russell Midcap Index® (RMC) (see pages 7 – 9 for performance and related disclosures). AMCC substantially outperformed in the tumultuous month of

January but underperformed in March as the market roared back, both reflecting the defensive positioning of the strategy.

The most useful information from performance came from the top performers. First and foremost, gold staged a big recovery that was reflected in the performance of AUY and RGLD. ITG continued its impressive rebound after a difficult first three quarters of 2015 and EXC rebounded powerfully since the end of 2015 based on increases in oil prices more than anything company-specific. Finally, SRG, which had performed poorly due to its association with SHLD, popped in December 2015 when Warren Buffett disclosed a position and has continued running since.

Stock performance* (12/31/15 - 3/31/16)

Best performers

Company	Return in quarter (%)
Yamana Gold	63.4
Royal Gold	40.6
Investment Technology Group	29.9
Exelon	29.1
Seritage Growth Properties	24.2

Worst performers

Company	Return in quarter (%)
Peabody Energy	-69.8
Genworth Financial	-26.8
Sears Holdings	-25.5
Dex Media	-24.8
Mylan Inc.	-14.3

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

The list of worst performers again revealed some broad trends in the market, but in a more selective way than in recent quarters. While many commodities stocks turned around in the first quarter, general concerns about credit risk did not dissipate so quickly. BTU, which has continued to struggle under a perfect storm for coal, suffered the most, but GNW, SHLD, and DXMM all fell disproporionately due to obvious credit risks. MYL took a hit in February when the company announced yet another attempt make a questionable acquisition.

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.

Areté Mid Cap Core Composite

Arete Asset Management, LLC
Mid Cap Core Composite
July 31, 2008 - March 31, 2016

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	4.01	2.99	13.22	4	NA	1,003,729	1,003,729	100%	1,200,564
2015	-7.56	-8.44	-2.44	4	NA	919,035	919,035	100%	1,206,652
2016									
January	-3.21	-3.46	-6.55	4	NA	887,219	887,219	100%	1,172,245
February	1.48	1.48	1.13	4	NA	900,330	900,330	100%	1,188,694
March	3.60	3.60	8.19	4	NA	932,773	932,773	100%	1,223,729
Q1	1.76	1.49	2.24	4	NA	932,773	932,773	100%	1,223,729
YTD	1.76	1.49	2.24	4	NA	932,773	932,773	100%	1,223,729

**Note*: Peformance through 12/31/08 is from inception of composite on 7/31/08.

Areté Asset Management Mid Cap Core performance composite disclosures follow:

Compliance statement

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

Definition of the firm

Areté Asset Management, LLC (Areté) was established in 2008 and is registered as an investment adviser in the state of Maryland. Areté is defined as an independent investment management firm and is not affiliated with any parent organization. Areté 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.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

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. Areté 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. 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.

Areté 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

Areté has not been verified by an independent verifier for its compliance with GIPS.

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