

THE ARETÉ QUARTERLY

Welcome

Investing is easy when times are good - all you need to do is ride the wave. When things get tougher, though, a number of pressures can come together all at once to make decision making that much harder. These are the types of situations in which Areté's research, experience and expertise most clearly prove their value.

In order to stay apprised of our latest thinking on the investment landscape, please take a look at our blog [\[here\]](#). Finally, please always feel free to contact us with questions or comments.

Business Update

One of the bigger projects I have been working on the last couple of months has been reviewing all of the content on the Areté website. While I have shared thoughts on a wide array of topics over time, it became abundantly clear in the review that the vast majority of writings have related in some way or another to my vision for the investment industry.

In an important sense this shouldn't be too surprising. After all, a big part of the motivation for founding Areté was my belief that a large population of investors was being underserved and that the industry could do better. Areté is very much an expression of this belief.

As such, virtually everything Areté does and every business decision I make is done so

with the intent of both creating outstanding value for investors and an economically attractive business model for Areté. Indeed, these actions and decisions, and their rationale, have been the frequent subjects of my writings.

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Pulling these ideas together into a single vision statement for the industry accomplishes a couple of things. One is to show how all of the pieces fit together into a cohesive view. An investment service, for example, constitutes a "package" comprised of several components, many of which include business tradeoffs. As a result, the only way to get an accurate assessment is to look at the whole.

A second benefit of this exercise is that by analyzing the capital markets, the ecosystem of investment service providers, and investors themselves, it is quite clear to me that some things need to change. Much of this involves matching services with investors in a more cost-effective manner. For certain, providers need to make some important changes and I continue to believe that many of them will find it exceptionally difficult to do so. I also believe, however, that investors

themselves need to re-evaluate some of their practices in order to get more out of the industry.

Yet another potential benefit of this exercise is that it burnishes Areté's reputation as a thought leader in the industry. Just as a critical mass of investors are beginning to seriously consider the consequences of a financial system that was never really fixed, there appears to be a fresh effort to determine sustainable solutions. The CFA Institute, for example, recently highlighted some of the important problems in the industry in a publication entitled "Future State of the Investment Profession" [here]. Areté has been doing this all along.

While Areté is all about helping people and organizations improve their investment outcomes through solid research, these things don't happen just because it's a good idea. Ultimately change happens because it has to; people simply can no longer afford to do things in the same old, inefficient ways.

Several years of strong markets and an acquiescent Federal Reserve have masked the immediate need for things to change, but this can't last forever. Indeed the increasingly imminent prospect of major changes in the investment services landscape seems to be creating some serious concern among incumbent providers. Regardless, when the opportunity arises, Areté will be ready to pounce.

On a different front, I have also made good progress on the proprietary valuation model I mentioned last quarter. As I also mentioned, the primary application of the model will be to provide a sound and even

more flexible model for valuing stocks for the mid cap core strategy.

Due to the power and flexibility of the model, however, I also believe there is potential far beyond this immediate application. It can easily be applied to a broader universe of stocks and also provides a terrific platform for a host of other interesting research projects. If you know of anyone who might be interested in working together in some capacity, please let me know, I'd love to hear about it. There is more opportunity to exploit than I can realize on my own.

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 sustainable 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 (03/31/17)

| | Arete MCC* | Midcap Index** |
|---------------------------------|---------------|-------------------|
| Size | | |
| Average Market Cap (\$ mil.) | 10,006 | 8,977 |
| Median Market Cap (\$ mil.) | 5,232 | 6,818 |
| Minimum Market Cap (\$ mil.) | 664 | 72 |
| Maximum Market Cap (\$ mil.)*** | 33,247 | 63,724 |
| Number of holdings | 18 | 796 |
| Valuation | | |
| P/E current year | 28.1 | 26.6 |
| P/B | 2.4 | 4.8 |
| P/S | 2.9 | 2.3 |
| Yield (%)**** | 4.0 | 2.8 |
| Valuation drivers | | |
| ROE (%)**** | 5.9 | 10.5 |

Source: Calcbench

*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.

****Note: Average of available yields

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 more cheaply in the future.

Sector exposure (percent of assets on 03/31/17)

| Economic sector*** | Arete MCC* | Midcap Index** | Percentage Comparison |
|------------------------|---------------|-------------------|--------------------------|
| Consumer Discretionary | 1.2 | 15.0 | 8.0% |
| Consumer Staples | 0.0 | 5.0 | 0.0% |
| Energy | 0.0 | 5.9 | 0.0% |
| Financials | 9.3 | 13.1 | 70.9% |
| Health Care | 5.0 | 9.3 | 53.9% |
| Industrials | 0.0 | 13.8 | 0.0% |
| Information Technology | 1.9 | 15.2 | 12.5% |
| Materials | 3.7 | 5.7 | 65.0% |
| Real Estate | 5.6 | 10.1 | 55.4% |
| Telecommunications | 0.0 | 0.7 | 0.0% |
| Utilities | 3.0 | 6.2 | 48.5% |
| Equity exposure | 29.7 | 100.0 | |
| Cash and equivalent | 70.3 | 0.0 | |

Source: Calcbench

*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.

General portfolio characteristics for the quarter continue to confirm that the equity portion of AMCC is a representative mid cap portfolio. The average market cap for AMCC is a little higher than the mid cap index and the median is a little lower. Of particular note, however, the valuation metrics have become considerably less informative as the number of holdings has declined to just 18 currently.

As a note, we recently started using financial data provided by Calcbench. Historically we used data from our

valuation vendor, Applied Finance Group. As a result, there may be some modest differences that cause imperfect comparisons.

Sector exposures are quite different from benchmark weights, in part due to the high cash position but in part due to different exposures. 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* (3/31/17)

| Period | Percent** |
|--------|-----------|
| Q117 | 96.0 |
| Q416 | 96.3 |
| Q316 | 96.3 |
| Q216 | 96.1 |
| Q116 | 96.2 |

*Note: Computed for AMCC composite

**Note: Active share > 80% is considered "very active"

Transactions review – Areté Mid Cap Core

We implemented two transactions in the quarter, both of which were sales to opportunistically reduce exposure even further.

In the first case, we sold the entire position of OSK. We have owned OSK since the

inception of the mid cap strategy and it had remained fairly persistently undervalued. While it was never clear why this was the case despite decent improvements at the company, nor was it clear why the stock took off last year and popped another 15% in the fourth quarter after the election. While we certainly understand the logic of the reflation trade, our research indicates the market has been overly enthusiastic in regards to growth opportunities. Therefore, as the stock bumped right up against our price target we took the chance to sell.

We also sold the entire position of GNW in the quarter. GNW had also been in the portfolio since inception and was one of the more problematic holdings over that time. While the buyout offer from China Oceanwide is comfortably above the current stock price, as we mentioned last quarter, there are still considerable hurdles to overcome. The net effect is that the potential for significant downside outweighs the upside potential.

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 1.84% (net of fees) for the quarter versus 5.15% for the Russell Midcap Index® (RMC) (see pages 7 - 9 for performance and related disclosures). AMCC continues to underperform when the market races higher (due to its high cash position), but that cash also provides a significant buffer against material downside.

SHLD and LE rebounded nicely in the first quarter after a difficult fourth quarter last year. Other top performers largely reflected continued enthusiasm at the prospects for improved growth. STX and OI, for example, both regularly track growth expectations. NRG often tracks growth forecasts as well but also benefitted from an improved political outlook for coal-based power generation and interest from activist investors.

There was virtually no company-specific news that drove the performance of the worst performing stocks. The worst

performers were each negatively affected by lowered expectations for rates after realizing strong appreciation in the fourth quarter after the election. Neither of the moves in AUY or SRG were very large or especially informative.

Stock performance* (12/31/16 - 03/31/17)

Best performers

| Company | Return in quarter (%) |
|--------------------|-----------------------|
| NRG Energy | 52.5 |
| Land's End | 41.6 |
| Sears Holdings | 23.7 |
| Seagate Technology | 20.3 |
| Owens Illinois | 17.1 |

Worst performers

| Company | Return in quarter (%) |
|----------------------------|-----------------------|
| Capitol Federal Financial | -11.1 |
| TD Ameritrade | -10.9 |
| The Saint Joe Company | -10.3 |
| Yamana Gold | -1.8 |
| Seritage Growth Properties | 1.0 |

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

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, 2017

| Period | Gross-of-Fees Return (percent) | Net-of-Fees Return (percent) | Russell Midcap® | | Internal Dispersion (percent) | Total Composite Assets (\$) | Composite Assets With Bundled Fees (\$) | Percentage of Composite Assets With Bundled Fees | Total Firm Assets (\$) |
|----------|--------------------------------------|------------------------------------|------------------------------|----------------------------|-------------------------------------|--------------------------------------|--|---|---------------------------------|
| | | | Index Return (percent) | Number of Portfolios | | | | | |
| 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 | 4.07 | 3.02 | 13.80 | 4 | NA | 946,825 | 946,825 | 100% | 1,142,297 |
| 2017 | | | | | | | | | |
| January | 1.21 | 0.96 | 2.41 | 4 | NA | 955,884 | 955,884 | 100% | 1,151,614 |
| February | 0.35 | 0.35 | 2.83 | 4 | NA | 959,248 | 959,248 | 100% | 1,155,102 |
| March | 0.52 | 0.52 | -0.16 | 4 | NA | 964,207 | 964,207 | 100% | 1,160,504 |
| Q1 | 2.09 | 1.84 | 5.15 | 4 | NA | 964,207 | 964,207 | 100% | 1,160,504 |
| YTD | 2.09 | 1.84 | 5.15 | 4 | NA | 964,207 | 964,207 | 100% | 1,160,504 |

*Note: Performance 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®).

Areté Asset Management Mid Cap Core performance composite disclosures continued:

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.

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.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

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

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