First quarter 2024
Volume 17, Issue 1

The Areté Quarterly

Welcome

As it becomes progressively more apparent that the investment landscape presents unique challenges, it is also becoming progressively more apparent that conventional investment approaches are not sufficient for meeting those challenges.

Areté is a unique organization for unique times. With an orientation to research and analysis, these activities are applied for the purpose of solving problems and helping investors do the best they can. Each investment decision and communication is made with the mindset of having skin in the game.

If you are interested in getting more insightful analysis and/or a different perspective, please take a look at the blog [here]. Content for the posts is selected and created on the basis of being important, relevant, and useful.

In addition, *Observations by David Robertson* provides a weekly collection of insights and analysis that are intended to be especially relevant for long-term investors. You can find the letters on the substack platform at: https://abetterwaytoinvest.substack.com

Finally, please always feel free to reach out with questions or comments. A big part of why I founded Areté was to be better able to help investors. Let's see if I can help you!

Inside This Issue

Business Update

When I started Areté over fifteen years ago, one of the founding premises was that investors should be able to have access to high quality investment services at a *fair* price. One of the determinants of fairness was the minimization of unnecessary sales, marketing, and distribution fees. My thinking was (and is) that such fees only hurt investment performance. Further, investors who do just a little bit of work can avoid them almost completely.

Recently, a blog post by Wes Gray of AlphaArchitect brought a lot of memories flooding back. In characterizing the model of distributing financial services by big banks, he draws an analogy between big bank investment platforms and the railroad monopolies of the past. Both monopolize proprietary platforms in order to extract high rents from consumers.

In particular, Gray notes, "banks, and their powerful distribution capabilities, have managed to limit the competition's advance. They continue to push high-fee, tax-inefficient, opaque, non-clientfriendly products into the financial services marketplace." In other words, they don't care nearly so much about clients meeting retirement goals as themselves meeting profit goals. As Gray puts it, "From the bank's perspective, the quality of a product is secondary to its profitability."

To be fair, things are better today than they used to be. Fee-only advisors have displaced some of the worst advisory practices. Further, access and information are both better as well.

That said, things could be so much better than they are. Arguably most fintech has been designed to gamify investing, enable speculative activity, or both. Efforts to "democratize" finance have mainly had the same effects. Further, the big banks still run platforms that still charge excessive middle man fees for access.

The causes of this suboptimal situation can be debated, but I think there are just a few key factors. One is that most people don't feel comfortable pressing hard on the business models of advisors and other providers. Another is that extraordinary monetary policy and strong markets have undermined the desire and the need to pushback against such deleterious practices.

As a result, this discussion is both timely and relevant. Increasingly, it is looking as if the environment that proved so amenable to the 60/40 (stock/bond) strategy is in the process of changing dramatically. Indeed, strategist Russell Napier recently described "a profound structural change in geopolitics and in how the international monetary system works".

The main antidote, as I have been saying for some time, is to find the "anti 60/40" in the form of active strategies and diversifying asset classes that are often well off the worn path. By the same token, they are often NOT on big bank platforms.

The goods news is finding such investment services is eminently doable. The other good news is such services are often a good deal because they don't involve excessive middle man fees. The only bad news is that some modicum of effort is required.

Very few investors made that effort after the GFC largely because the market rebounded so quickly and strongly they never felt compelled to follow through. I think the forces this time will be stronger and last longer.

While I have believed in the notion of providing very high quality investment services at a fair price for a long time, I am thrilled to hear someone of Wes Gray's stature and expertise also making the same case very publicly. Maybe it's finally time for this very basic consumer proposition to take off!

If you have any questions about what I do or just want to learn more about the All-Terrain strategy, please reach me at drobertson@areteam.com. I look forward to it!

Thanks for your support!

David Robertson, CFA
CEO and founder, Areté Asset Management

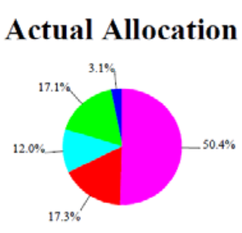
Asset Allocation

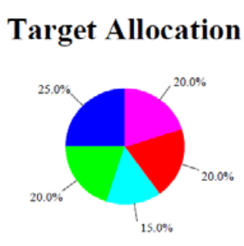
The most important differentials between the current allocation and long-term target allocation continue to be the extremely low weight in stocks and the extremely high weight in cash. While fixed income has become less unappealing as long-term yields have risen, it has yet to appear more compelling than cash. The low allocation to stocks reflects extremely high valuations and therefore extremely low expected returns.

As a reminder, the easiest way to think about the strategic priorities of the All-Terrain strategy is as an effort to get the most out of the valid market opportunities that exist. In other words, it is more about finding attractive assets and creating thoughtful diversification than about speculating which hot stock might do well.

As a clarification, the strategy does also hold stocks outside of the “Stocks” category. Stocks are only included in the “Stocks” category if they move broadly in line with major stock indexes like the S&P 500. Gold stocks, for example, are not included in the “Stocks” category because gold prices have a much greater impact on these stocks than whatever happens with the S&P 500.

The chart below refelcts a representative account from the All-Terrain composite.





The main effort continues to be establishing an allocation very different from the conventional 60/40 (stocks/bonds) strategy. The rationale is neither stocks nor bonds are attractive for long-term investors at this point.

That being the case, cash is essentially the benchmark for any new investment. That explains the large allocation. With the prospect of cash yields coming down this year, however, the idea pipeline is actively being filled with stocks and funds that can benefit from rising prices, decent economic growth, or can provide return streams uncorrelated with stocks.

The main macro theme remains higher inflation (longer-term) and therefore also higher long rates. This has mainly been right and served the strategy well in the first quarter. One of the greatest beneficiaries was gold.

Thus far, the increase in long-term rates this year has not materially affected major stock indexes. While that very much remains a risk for stocks and for 60/40 strategies, it is unlikely to cause any change to the strategic direction of the All-Terrain strategy.

Transactions review

There were no transactions in the quarter, but that inactivity belies the potential for some moves in the not-too-distant future. As the prospect for lower short-term interest rates increases, so too does the attractiveness of several assets increase relative to cash. Stay tuned.

Performance review

With the All-Terrain strategy now being the sole focus, here are some of the general principles that guide its management.

The search for undervalued assets remains the same, although the scope of that search expands now encompasses a broad universe of publicly traded securities and funds.

The overarching goal of providing attractive returns to investors on an absolute basis also remains the same. As many markets became significantly overvalued, this is especially important to keep in mind.

Finally, the major change features a greater emphasis on diversification. This new focus will elevate the importance of uncorrelated return streams and reduce the importance of individual security performance.

For the fourth quarter, the ATA strategy returned 2.45% (net of fees) while VBIAX returned 5.74%. It was another unusually strong quarter for VBIAX which has not yet suffered from rising inflation or rising long-term yields.

The All-Terrain strategy was solid in the quarter. The large cash position continued to insulate the portfolio from wild variations while other holdings provided decent incremental appreciation.

One of the key features (and benefits!) of the All-Terrain strategy is its lack of correlation with the conventional 60/40 strategy. While this positioning has generally served it well, it's lack of exposure to Magnificent 7 stocks caused it to trail the benchmark VBIAX performance in the quarter.

Holdings performance in the quarter was interesting. The best performer was the Simplify interest rate hedge as long-term yields continued to rise. The trend-following fund also performed well. Gold stocks did well in general, but at the same time, NEM and PAAS were the two worst performing stocks in the strategy. Obviously, the demand for gold stocks has not yet caught up to the demand for gold bullion.

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.

Asset allocation is a key funciton of wealth management

One of the most important functions for long-term wealth accumulation is to have access to certain asset classes when they are attractive and to be able to minimize exposure to other asset classes when they are extremely unattractive. In short, diversification moderates the long-term swings in portfolio performance and therefore significantly increases the chances of wealth accumulation over a reasonably long investment horizon.

Mispriced assets are an important source of performance

One of the keys to investment performance is finding and exploiting market inefficiencies. While such inefficiencies can arise in the form of mispriced securities, they can also arise in the form of over- or under-valued industries or asset classes.

Identifying such opportunities begins with the assessment of underlying intrinsic value.

When disparities with market prices exist and clear rationale for such mispricing can be identified, there are opportunities to take advantage of the differential.

Information management is a core skill of investment management

Analyzing investment opportunities and developing portfolio construction is a dynamic exercise that involves a constant and ongoing process of gathering information, processing it, analyzing it, developing knowledge, and applying it for the benefit of clients.

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. This approach is notably distinct from the common practice of simply gathering assets.

The first key to execution is structural in nature and involves a firm's independence. By maintaining independent ownership, an investment firm eliminates agency effects which can present a conflict of interest between clients and certain of its ownership groups.

The 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 All-Terrain Composite

Arete Asset Management, LLC
All Terrain Composite
August 31, 2021 - March 31, 2024

Period	Gross-of-Fees Return (percent)	Net-of-Fees Return (percent)	Vanguard balanced Index Fund (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 ($)
2021	0.06	-0.20	2.22	3	NA	841,887	841,887	100%	1,460,255
2022	3.26	2.26	-16.89	5	NA	1,491,824	1,491,824	100%	1,778,478
2023	3.19	2.24	17.56	6	NA	2,438,540	2,438,540	100%	2,438,540
2024									
January	-1.25	-1.50	0.63	6	NA	2,401,963	2,401,963	100%	2,401,963
February	1.05	1.05	2.72	6	NA	2,427,208	2,427,208	100%	2,427,208
March	2.93	2.93	2.30	7	NA	2,498,297	2,498,297	100%	2,894,873
Q1	2.71	2.45	5.74	7	NA	2,498,297	2,498,297	100%	2,894,873
YTD	2.71	2.45	5.74	7	NA	2,498,297	2,498,297	100%	2,894,873

Areté Asset Management All-Terrain performance composite disclosures follow:

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 Vanguard Balanced Index Fund Admiral Shares (VBIAX), and its performance is reported in U.S. dollars.

Areté Asset Management All-Terrain 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 All-Terrain allocation strategy composite was created in August 2021 and includes all fee-paying, taxable and non-taxable, discretionary, long only, fully invested portfolios benchmarked to the Vanguard Balanced Index Fund. 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" when it breaches the threshold of 90% similarity with core composite portfolios. Each portfolio will remain in the composite until its similarity with core composite portfolios falls under 90%. A complete list and description of firm composites is available upon request.

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

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.

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Areté Asset Management All-Terrain performance composite disclosures continued:

Verification
Areté has not been verified by an independent verifier.

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