

# THE ARETE QUARTERLY

## Welcome

There are so many issues and options to consider when it comes to investing, it can overwhelm even the most diligent of souls. We believe we have a fairly decent understanding of the multitude of challenges facing investors partly because we study them: We attend conferences, read surveys and research, and listen to investors. Perhaps the most pervasive feeling we have heard expressed is that of what investors don't want – which is more of the same.

Indeed, a recent Gallup poll showed that stockbrokers (the professional group listed most closely related to investing) ranked near the bottom regarding perceptions of ethics and integrity. Only 12% of participants ranked the ethics of brokers as "very high" while 40% ranked them as "very low". Brokers ranked on a par with telemarketers, car salespeople and lobbyists. The highest rank went to nurses and the lowest rank went to members of Congress.

Arete was created to provide an antidote to "more of the same." We do this first and foremost by putting the interests of our clients first. As a result, we tend to talk in terms of solving problems and satisfying needs rather than increasing assets under management or adding distribution platforms. While it is important to grow the business, we want to do it in a way that retains its intense focus on serving investors.

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In our efforts to help solve what we broadly label the "investment challenge" for people, many of the unique characteristics of Arete become clearer. For example, many people are surprised to hear that as an active manager, we recommend the use of passive investment vehicles in many situations. We also discuss basic criteria for evaluating money managers in our *Arete Insights* newsletter.

We do this partly because we believe it is important to share some of our knowledge of the industry with investors whether they decide to become clients or not. Ultimately, there is far greater collective good (and less waste!) if everyone ends up with the investments and services that are best suited to them so as to solve their specific investment challenges.

We also do this partly because it serves Arete's interest. Arete's proposition (really that of every investment service) works best when clients fully understand and appreciate the strategy and its implications. Because Arete provides a niche service – active management of mid

cap stocks — it is only appropriate for certain types of investment situations. We don't want to dilute the value proposition for existing clients by chasing assets and clients who don't fit well. Eliminating confusion allows us to focus on what we do best.

We also believe that providing investor education regarding manager selection serves our interest in that better informed investors will have a much greater appreciation for all of the great things Arete does. When addressing the investment challenge, there are so many factors to consider and so many half-truths proffered that it is easy to get distracted or to give up altogether. Well-informed investors can better help themselves, and are also good for Arete.

In the end, a big part of what distinguishes Arete is that we aren't trying to build a really big firm. Historically size has been a much more common priority largely because it makes people richer. We are much more interested in building a firm of outstanding quality — and that changes almost everything.

## Business Update

When I founded Arete, one of the aspects of running a business that surprised me a bit was just how many decisions there were to make. Virtually each decision involves a tradeoff of competing pros and cons, opportunities and risks. The magnitude of these tradeoffs was far greater than anything I had ever experienced before. Indeed one of the bigger challenges I face now is figuring out how to best apply thoughtful and well-intended advice that sometimes does not fully incorporate the

multiplicity of tradeoffs I face as a business owner.

One huge tradeoff I made occurred when I founded Arete. It involved what I call the "classic conundrum" of money management: Which comes first, the money or the business? After all, you need a fair amount of money under management to pay the bills for several years while establishing a track record. But how do you get the money before the business?

Since I didn't have access to a big chunk of money, I took the somewhat unusual and risky path of founding Arete first and building the business from scratch. I did this partly because I was convinced, based on my skills and historical experience, that I would be able to continue generating good (and perhaps very good) performance and that would be allow me to build a sustainable business. I just needed a chance to show my stuff.

I also felt strongly that there was an opportunity to completely rethink the cost structure of a serious research effort and to reset it lower. By seriously scrutinizing the value of many services, remaining frugal with existing services, leveraging technology, and simply passing on many of the substantial reductions in operating costs that have occurred over the past twenty years, I thought I could keep expenses low enough to buy me the time to grow. It also helps that I am uniquely capable of doing nearly every job myself and don't pay for many outside services.

The good news is that much of this has worked. Technology has reduced baseline operating costs and vastly increased the opportunities to manage knowledge well and cheaply. The less good news is that it

is still very difficult to grow a money management business from scratch. Investors still often equate size with quality and security despite much evidence to the contrary.

As a result, the evidence still favors the path that one must have money in order to start a money management firm. It is interesting, though, that this path creates an enormous barrier to entry for firms that want to challenge the status quo. In a time of growing dissatisfaction with transaction-based business models, conflicts of interest, excess compensation, and insufficient security, how long can this last?

Arete offers an antidote to the status quo, but it comes with a tradeoff. I have created an investment service that combines a robust investment philosophy and process with many of the best features and safeguards in the business and all for a very fair price. The only tradeoff is that all of this comes in the package of a small firm. If you or someone you know is looking for something different, please let me know.

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.

### Portfolio Characteristics (6/30/12)

	Arete MCC*	Midcap Index**
<u>Size</u>		
Average Market Cap (\$ mil.)	6,088	5,562
Median Market Cap (\$ mil.)	3,953	4,134
Minimum Market Cap (\$ mil.)	47	671
Maximum Market Cap (\$ mil.)	32,068	18,558
Number of holdings	39	800
<u>Valuation</u>		
P/E current year	17.4	18.7
P/E forecast Y1	16.4	16.7
P/B	1.9	3.1
P/S	0.8	1.5
Yield (%)	1.3	2.6
<u>Valuation drivers</u>		
ROE (%)***	9.5	15.0
LT eps growth forecast (%)	12.7	12.2

Source: The Applied Finance Group™

\*Note: Excludes OSH and OSHSP 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.

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 for the quarter continue to confirm that AMCC is a very representative mid cap portfolio. Market caps for AMCC are extremely similar to the mid cap index and by all measures except yield, AMCC is cheaper. ROE is noticeably lower, but is subject to many distortions and has not been especially reliable.

**Sector exposure** (percent of assets on 06/30/12)

	Arete MCC*	Midcap Index**	Percentage Comparison
Economic sector			
Consumer Discretionary	9.9	16.8	58.8%
Consumer Staples	6.1	6.4	95.8%
Energy	4.4	6.9	64.1%
Financial Services	12.2	21.2	57.5%
Health Care	7.8	9.7	80.6%
Materials & Processing	5.2	6.8	76.4%
Producer Durables	9.0	12.9	69.6%
Technology	6.5	11.9	54.6%
Utilities	5.3	7.4	71.8%
Equity exposure	66.4	100.0	
Cash and equivalent	33.6	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.

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

be sensitive to these underweights as we deploy cash in upcoming quarters.

## Transactions review – Arete Mid Cap Core

Although we did not execute any transactions in the quarter, a couple of items are worth noting.

First, we remain extremely sensitive to the fact that we are holding substantially more cash than our long-term strategy prescribes. As we have mentioned in the past, this was partly due to receiving cash for a number of stocks that were acquired in the last year or so and partly due to maintaining our discipline of selling stocks when valuations become stretched.

An important part of our process is maintaining a “bullpen” of actively researched stocks that we find attractive. In normal circumstances, we readily turn to the bullpen in order to deploy excess cash. In these decidedly not normal times, we have become more cautious in our normal replacement process for a couple of reasons. One reason is that we have significant concerns regarding market risks and valuations. Cash serves as a useful insurance policy, but also serves as a real option in the event of a severe market dislocation.

Indeed, these concerns have been corroborated by our valuation work. Many of the best performing stocks in the mid cap universe (and elsewhere) are what we call “valuation time bombs.” These are stocks that can look attractive in many respects (e.g. growth, competitive advantage), but that also discount

extremely favorable conditions too far into the future. We wrote about one example, Tempur Pedic (TPX) in the latest edition of *Arete Insights* (mid Q2 12).

The second reason we still have more cash than we normally would is because valuation has not worked in the landscape of continued monetary interventions. This is not to say that it won't work, but in an environment so hostile to valuation, we believe it makes sense to adapt by being more patient and more selective.

## Market Overview

Over the second quarter, we have seen the continuation of relatively low market volatility (as measured by VIX), relatively high market valuations, and the confluence of several significant risk factors. The simultaneous presence of these conditions speaks to just how bizarre the current market environment is.

Corroborating our assessment, the headline, "Yield record in Treasury sale" was recently emblazoned across an article in the *Financial Times*, giving further indication of the massive demand for "risk-free" investments. At the same time, the S&P 500, although down modestly in the last few months, is still within clear sight of the record peak of 2007. The evidence that record risk aversion can occur simultaneously with near-record risk-seeking speaks to these unusual times.

What does all this mean? For one, we believe it signals the degree of excesses in virtually all markets now. Ten year Treasury yields don't even cover current inflation expectations, let alone the distinct possibility inflation could be much

higher in ten years. It's not hard to conclude there are excesses in the bond markets.

The stock market has its own version of excesses. It is currently bifurcated into two distinct groups. One is a group of cyclicals and companies which have missed earnings estimates. Many of these are selling at or below the levels of the liquidity crunch of the financial crisis. Many are at fractions of book value. In aggregate, most of these are quite viable long-term businesses that are excessively cheap right now.

The other group includes larger companies, more defensive businesses, and high dividend payers. These are perfectly reasonable investments for a weak economy, but only at reasonable prices. Many of these stocks are selling at record highs, despite valuations that imply ever-increasing growth and profitability.

We believe this unusual landscape can be explained in a couple of ways. We know that one of the really big economic problems is too much debt. Longer term, the only reasonable outcome is for debt (relative to income and assets) to be reduced significantly.

The Fed recognizes this problem and is trying to ease the pain of retrenchment through monetary easing. This provides a short-term boost to certain asset prices at the expense of future appreciation. As such, it also provides an opportunity for traders and managers to take the Fed's bait and buy stocks in the face of significant risks. In doing so, they are accepting a short-term game of guessing incremental monetary policy and chasing performance.



Longer term, economics and fair valuation will prevail.

Another possible explanation for the unusual landscape is that investors are responding to various risks by buying insurance. Due to escalating concerns about disparate risks, more and higher-priced insurance is being purchased. Some market participants may be buying stocks near record highs as protection against further monetary easing and future inflation. Treasuries are purchased to protect against the imminent threat of deflation as the economy appears to be cooling again.

While the idea of buying insurance makes sense in many situations, the idea of paying ever-higher prices for it defeats the broader goal of protection by eroding capital through premium payments. We believe this partly explains the rush for gold and commodities as well. We also believe investors pursuing this strategy will pay for their excesses.

What might cause this unusual environment to change? Judging by current practices of managing to short-term conditions irrespective of long-term consequences, one distinct possibility is that it will end with a significant market dislocation not dissimilar to Lehman Brothers, a "Thelma and Louise moment," if you will. This would be really bad for people chasing performance in the stock market and without any spare cash. It would also likely be painful for index investors who will have no protection and no chance to react.

It is also certainly possible (and preferable) for a more orderly transition to take place, but some important things would have to change. Primarily, the pricing mechanism

of the markets would have to improve and that will only really happen when long-term capital is attracted to the opportunities.

This can happen in a variety of ways. It could happen in the form of earnings and cash flows coming in better than the absolutely dismal expectations priced into cyclical and other value stocks. This may give long-term investors enough incremental confidence in the cash flow streams they are purchasing. Of course any constructive dialogue regarding the country's debt and deficit issues would be enormously beneficial as well. The good news is that plenty of cash is available when the conditions are right.

How long might it take for these changes to emerge? An optimistic view is that value has underperformed for years now and the pendulum is due to swing back, perhaps as soon as with this quarter's earnings reports. Even short of a broad swing, there are pockets of valuation succeeding that can be captured in a concentrated portfolio.

A particularly pessimistic view is expressed by Jamil Baz, the chief investment strategist at GLG Partners. He wrote recently in the Financial Times, "[Since] deleveraging has not even started yet, the crisis of the world economy has not begun either." He continues, "It [the investment situation] is hopeless in that virtue is not likely to be rewarded for a generation." We're not this pessimistic, but we are well aware that this dour assessment is distinctly possible.

Either way, it is clear that these market conditions warrant a great deal of caution and diligence. It will be extremely important to be patient and wait for

attractive opportunities. As tempting as it may be to just wait things out by holding cash, this strategy bears the potential cost of lost opportunity. It will also be important to continuously gauge the tradeoff in risks between action and inaction.

It will also be important to differentiate between the market indexes and active strategies. Passive funds have benefitted from Fed policy actions, high correlations, and strong inflows. The structural bias of most indexes to overweight overpriced stocks further exacerbates these trends. When any of these factors change, active funds will be far better placed to exploit stock-specific opportunities.

## Performance review – Arete Mid Cap Core

The Arete Mid Cap Core product is designed with the flexibility to invest in the most attractive mid cap stocks, regardless of any particular “style” designation. With that context, the primary criterion for selecting a stock in the Mid Cap Core strategy is that market value is significantly less than our estimate of intrinsic value. In other words, we try to find situations in which our research generates expectations for a company’s growth and profitability that justify substantially greater valuations than what the market discounts.

Our investment process is designed to discover, analyze, and assemble stocks into a diversified portfolio that consistently outperforms its benchmark over time. Specifically, our investment objective is to outperform the benchmark Russell Midcap®

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

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

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### Stock performance\* (3/31/12 - 6/30/12)

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#### Best performers

Company	Return in quarter (%)
Toll Brothers	23.9
NRG Energy	10.8
Ascent Media	9.4
Davita	8.9
Xcel Energy	7.3

#### Worst performers

Company	Return in quarter (%)
NII Holdings	-44.1
Health Net	-38.9
Dex One	-34.9
Genworth Financial	-32.0
Eastman Kodak	-30.1

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

Arete’s Mid Cap Core (AMCC) strategy was down 4.97% (net of fees) versus -4.40% for the Russell Midcap Index® (RMC) in the quarter (see pages 10 - 12 for performance and related disclosures). Certainly the relatively high cash position of AMCC helped insulate it from the market decline. Importantly, the greatest benefit occurred

in the weakest performing month (May) which corroborates the beneficial role of cash in risk management.

Individual stock performance reflected substantially similar market conditions as experienced over the last couple of years.

One of the positive takeaways from the performance table is the glimmer of recovery it suggests through the outperformance of TOL and NRG. Both stocks have suffered mightily since the financial crisis reflecting exposure to the weak economy in general, but also to housing and natural gas prices more specifically. While TOL has sustained a recovery having doubled from its bottom last fall, NRG has only just begun to rebound and still sells at a discount of 50% to book value.

In addition, ASCMA is worth noting not so much for making the best performer table this quarter (because the position is quite small), but for what it reveals about Arete's process. A small allocation of ASCMA was originally received by holders of Discovery Holdings as a result of a corporate event in the fall of 2008. Many portfolio managers sell small positions like this to "clean up" their portfolios. We liked the stock and our investors have enjoyed a near double in the stock price.

Along with the positives, some negatives are also borne out by the stock performances. First and foremost, AMCC underperformed the RMC in a down market, even with the high level of cash. This result suggests the magnitude of poor stock performance was even greater than the benefit of the cash cushion.

Perhaps the clearest indication of poor stock performance was the worst performer for the quarter, NIHD. This is a stock we added to just last quarter because it looked so compellingly cheap. It is no surprise to value investors that cheap stocks can become cheaper, but even by these standards the underperformance of NIHD has been extremely unusual. We will continue to seek evidence to disconfirm our thesis on NIHD, but right now it looks like a big, negative, but short-term move.

Performance of AMCC can also be partly explained by its strategy of taking relatively concentrated stakes in companies. This is a double-edged sword in that in times like these when macro factors drive performance, we can underperform. Our high active share relative to RMC, however, is also what allows us to significantly outperform when we are right on our research and market prices revert to warranted prices over time.

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Last quarter we discussed Eastman Kodak and its declaration of chapter eleven bankruptcy proceedings. We described the move as a "strategic" bankruptcy in the sense that it seemed to provide a pathway to selling a portfolio of patents which are ostensibly of great value. The bankruptcy court recently allowed an auction of the patents to proceed which is a significant step in the direction of value realization. The auction is to be completed in August and when it is, we should have a much better indication of the value of the underlying stock.



## 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 - June 30, 2012**

Period	Gross-of-Fees		Net-of-Fees		Russell Midcap®	Number of Portfolios**	Internal Dispersion (percent)	Total Composite Assets (\$)**	Composite Assets With Bundled Fees (\$)	Percentage of Composite Assets With Bundled Fees	Total Firm Assets (\$)
	Return (percent)	Return (percent)	Return (percent)	Return (percent)	Index Return (percent)						
2008*	-37.97	-38.16	-35.01	3	NA	207,031	207,031	100%	207,031		
2009	48.63	47.83	40.48	3	NA	471,867	471,867	100%	673,806		
2010	16.86	15.78	25.48	3	NA	546,315	546,315	100%	877,368		
2011	-8.20	-8.88	-1.55	3	NA	497,767	797,767	100%	897,918		
2012											
January	5.55	5.09	6.06	3	NA	523,081	523,081	100%	936,465		
February	4.32	4.32	4.15	3	NA	545,671	545,671	100%	970,094		
March	0.50	0.50	2.24	3	NA	548,446	548,446	100%	973,638		
April	-1.67	-1.67	-0.33	4	NA	760,009	760,009	100%	958,759		
May	-5.31	-5.54	-6.71	4	NA	717,926	717,926	100%	913,063		
June	2.31	2.31	2.81	4	NA	734,538	734,538	100%	930,858		
Q1	10.65	10.17	12.94	3	NA	548,446	548,446	100%	973,638		
Q2	-4.74	-4.97	-4.40	4	NA	734,538	734,538	100%	930,858		
YTD	5.41	4.69	7.97	4	NA	734,538	734,538	100%	930,858		

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

\*\*Note: One existing and two new accounts contributed additional funds which were not at least 90% invested by the end of the quarter. Per our rules for inclusion, these accounts were excluded from the composite and will be added once the funds are fully invested.

Arete Asset Management Mid Cap Core performance composite disclosures follow:

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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 follow:

#### **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.