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THE ARETÉ QUARTERLY

Welcome

The investment landscape is changing and so are the needs of investors – and Areté is here to help however we can. While we do actively manage stocks in our mid cap core strategy, we have also introduced a Personal CIO Service [here] in order to make our expertise more accessible to a broader audience. In these services and any future ones, Areté will always focus on conducting good research, independent thinking, and putting our clients' interests first.

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 most influential books I have ever read was the *Origin of Wealth* by Eric Beinhocker. The reason is because I found its thesis so compelling: The origin of wealth is knowledge that serves a useful purpose. This encapsulated my own thinking in a very concise and articulate way and in doing so also highlighted knowledge development as a productive activity.

It also happens to be a pretty good guide for investment management. After all, a huge part of the exercise of selecting good long term investments is figuring things out. And in order to do that you need knowledge. Indeed, many recommendations of how to be successful with investing emphasize reading as an efficient means by which to gain knowledge.

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For the last several years however, knowledge has not been the "origin of wealth", at least not in regards to the markets. If anything, it has seemed that the most thoughtful, considered, and informed investment decisions have performed the worst. As I reported last quarter, "it's pretty clear to anyone paying attention, that the traditional practice of conducting in-depth research in order to reveal underappreciated stocks and to better manage risk doesn't work in a world awash in liquidity from central banks."

This creates quite a quandary for conscientious service providers. You can stick with the "knowledge" strategy believing it will work in the long run, but underperforming during the interim and risking loss of business for as long as it does. Or you can nervously follow trends you don't trust (in order to retain business) knowing they can blow up at any time. As Rusty Guinn summarized in a note for

Epsilon Theory [here]: "We can do the right things for ourselves and our clients. But not both".

Of course it's not hard to find providers who opt for doing the right thing for themselves. Guinn describes one approach: "We can recognize the overwhelming influence of abstractions and continue to sell products and ideas that don't." In other words, as money managers and advisors, we can recognize that old approaches don't work, but continue to talk about them and sell them as if they do. It's disingenuous and does not help clients.

Guinn describes another similar approach: "We can recognize the overwhelming influence of abstractions and DESIGN new products and ideas that don't." This involves the same basic logic except it incorporates the "smoke and mirrors" of new product design to distract from the reality that such products are unlikely to work for the same reasons. It too is disingenuous and does not help clients.

What *should* money managers and advisors do in such a hostile environment? In an important sense, my choices have been less fraught because I have never considered it an option to anything that would come at the expense of clients' welfare. That's not why I got into the investment business to begin with and it's not why I founded Areté.

In order to determine the best course of action for the business that is also consistent with Areté's pledge to help investors invest better, I have come to realize that the decision really comes down to a couple of major assumptions. One is about the sustainability of central banks' efforts to keep the world "awash in liquidity". If you believe that central banks can continue on the path of liquidity infusion indefinitely, then I think Guinn's assessment is basically correct; you can either do what's right for your business or your clients, but not both. Conscientious managers who believe this often close their funds until better conditions prevail.

I don't believe central banks can continue to intervene successfully forever, though. Continued success is contingent upon an improbable set of conditions. Notably, the intended benefits of intervention must clearly outweigh the increasingly visible costs in the forms of misallocated capital and increasing wealth inequality. As such costs mount over time, so too will the legitimacy of central bank interventions diminish.

The implications for investment strategy are enormous. Market valuations imply that rates are expected to stay low for a long time. When markets finally succumb to the reality of a higher rate environment, valuations can fall substantially. Declines will be exacerbated by a number of strategies that will be forced to sell into declining markets.

I'm not the only one who is reading the potential for a severe market correction. *RealvisionTV* interviewed a number of top investors in September 2017 [here] which revealed that many shared the same concerns. Kyle Bass said, "If you look at all of the different constituencies of the market today, it resembles the portfolio insurance debacle of '87 on steroids." Jesse Felder noted, "Buying the stock market today is essentially taking an incredible amount of risk ... for the prospect of I see it as zero reward." Jim Rogers declared bluntly, "We're going to have the worst bear market of your lifetime, of my lifetime even, next time around."

All of this points to the notion that the knowledge strategy is still the best means for creating wealth (and avoiding massive losses) over the long term. There has been an important change though. Whereas the knowledge strategy used to be effective in generating wealth by way of identifying attractive individual securities, that is no longer the case in “a world awash in liquidity”. As I discussed [here], the knowledge strategy is now more narrowly effective in managing systemic risk.

This has created a great deal of pressure on money managers who have primarily focused on stock picking and this has certainly affected Areté’s mid cap core strategy. As such, I have adapted Areté’s practices in some important ways. For one, I have oriented existing portfolios to defensive positions that are well placed to preserve capital and to take advantage of cheaper prices when the downturn arrives. In addition, I have waived fees for new client portfolios that are not yet fully invested in an effort to make it as palatable for them as possible to maintain a defensive position. I do this even though I absolutely believe that there is significant value in managing systemic risk right now.

In addition, since systemic risk has become a greater investment concern, I have reasoned that it makes sense to have a service option better suited to dealing with it directly than the core mid cap stock strategy. I did this by creating the Personal Chief Investment Officer (PCIO) service. My rationale is that people may want/need more modular access to high level investment expertise in order to manage through systemic risk or to just help navigate the investment landscape. These were easy things to do because I already do all of the same research as a function of my work on Areté's mid cap core strategy.

So I have developed an approach that still focuses on knowledge development as its philosophical anchor for value creation, that still puts clients first, and that I have adapted to the current market environment. While it is still a tough slog operating in an environment that does not reward knowledge, I am reasonably certain that this is only a temporary condition and insofar as it is, Areté can benefit in a couple of ways.

The first is through investing. By preserving client wealth through a market downturn and by maintaining my focus on valuation, I will be both willing and able to productively deploy money into investments with attractive expected returns after the fallout. Indeed, history and experience suggest that there are usually only a handful of occasions over a lifetime for which investment outcomes are materially affected. I strongly suspect this is one of them.

Another is through increased credibility. When you maintain a position and the market works against you, it is easy for people to take potshots and think that you are missing the boat. When you maintain your position in the face of such adversity and end up being right for the right reasons and saving your clients money, things change in a big way.

After all, it was not that long ago, after the financial crisis, that investors felt so betrayed by the media and by Wall Street (which had served as primary sources of investment information). None of them warned about the potential for crisis. This vacuum created an opportunity for alternative investment research providers such as *RealvisionTV* which "realized the media had let people down and the banks had let people down. They just didn't want to tell people the bad things were out there and that they should pay attention." Here we are again and there still seems to be a market for knowledgeable insights and honest assessments.

Of course it is possible that this won't work out or that it won't pan out soon enough to be a viable business opportunity. But I think one thing is clear regardless: Older investors who have realized great benefits from appreciating financial assets over their careers may be willing to overlook some shortcomings in financial service providers, but younger investors will have no such tolerance. Investment firms of the future will have to clearly provide value AND demonstrate a record of honest dealings with clients. I am also quite certain that list of providers will be much shorter than today's list.

If you have any suggestions for me or know of someone I should get in contact with, please let me know. I strongly suspect there is a lot of potential in brainstorming and leveraging resources. Let's see what we might be able to accomplish together!

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 more cheaply in the future.

Portfolio Characteristics (6/30/18)

	Arete MCC*	Midcap Index**
<u>Size</u>		
Average Market Cap ($ mil.)	10,302	10,296
Median Market Cap ($ mil.)	6,063	7,935
Minimum Market Cap ($ mil.)	257	310
Maximum Market Cap ($ mil.)***	41,125	64,957
Number of holdings	19	793
<u>Valuation</u>		
P/E current year	23.6	26.2
P/B	2.9	5.2
P/S	1.5	2.7
Yield (%) ****	3.5	2.5
<u>Valuation drivers</u>		
ROE (%)****	9.5	12.1

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

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 very similar to the mid cap index and the median is a little lower. Although AMCC is much cheaper on the basis of P/S and P/B, it is important to note that valuation metrics have become less informative as the number of holdings has declined to just 19 currently.

Sector exposure (percent of assets on 6/30/18)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.7	14.3	4.9%
Consumer Staples	0.0	4.5	0.0%
Energy	0.0	5.3	0.0%
Financials	9.0	13.8	65.2%
Health Care	4.9	9.6	50.9%
Industrials	0.0	13.6	0.0%
Information Technology	2.3	18.2	12.7%
Materials	5.2	5.4	96.7%
Real Estate	7.2	8.9	81.2%
Telecommunications	0.0	0.4	0.0%
Utilities	3.8	6.0	62.9%
Equity exposure	33.1	100.0	
Cash and equivalent	66.9	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.

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 high but stable levels over the last several quarters.

Active share* (6/30/18)

Period	Percent**
Q218	96.4
Q118	94.9
Q417	95.0
Q317	95.2
Q217	94.9

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

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.

Transactions review – Areté Mid Cap Core

We made two transactions in the quarter. The first was the purchase of Detour Gold. We have been researching gold companies and looking to add for a few years now. Not long after we started getting familiar with the company, it reported disappointing numbers and lowered its forecast for its Detour Lake mine project. The stock immediately dropped by about 30% which created one of the rare opportunities (of late) to buy something on sale. While there are still plenty of questions about the ability of the company to meet operational expectations, the quality of the asset and the price decline created a significant margin of error.

The second purchase was of the Invesco exchange traded fund, CLTL. This is a treasury fund and is intended as a cash proxy and not a core stock holding. The fund will allow portfolios to realize the benefits of increasing short term rates without taking on credit risk or duration risk.

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.

Stock performance* (3/31/18 - 6/30/18)

Best performers

Company	Return in quarter (%)
Lands End	19.5
Seritage Growth Properties	19.4
Detour Gold	14.2
Exelon Corp	9.2
Royal Gold	8.1

Worst performers

Company	Return in quarter (%)
Owens Illinois	-22.4
Mylan Inc	-12.2
Sears Holdings	-11.2
TD Ameritrade	-7.5
The Saint Joe Company	-4.8

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

Our investment process is designed to discover, analyze, and assemble stocks into a diversified portfolio that consistently outperforms its benchmark over time. Specifically, our investment objective is to outperform the benchmark Russell Midcap® Index by 200-400 basis points per year, net of fees, over the course of a market cycle.

Our target of 200-400 basis points of outperformance is based upon our experience with the strategy and upon our judgment of value creation. 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 0.75% (net of fees) for the quarter versus 2.82% for the Russell Midcap Index® (RMC) (see pages 9 – 11 for performance and related disclosures). Although the defensive positioning of AMCC held back performance relative to the Russell midcap index in the quarter, its risk adjusted performance has been solid year-to-date.

Among outperformers, LE popped after quarterly results showed better than expected revenue growth and a lower than expected loss. Strong performance by SRG was partly a rebound from a weak first quarter and partly a response to new ventures to redevelop Sears stores. EXC seemed to benefit generally from higher oil and power prices.

Interestingly, the one common theme among top performers was that two were gold companies, despite the fact that gold prices were down in the second quarter. Certainly the performance of DGRDF seemed to be company-specific as it jumped after a big hedge fund publicly called for an acquisition of the company.

OI's underperformance did not seem to be driven by company specific news, although its US business was weak due to weak sales to the mega beer brands. Mainly OI was hurt by its exposure to Europe and emerging markets as well as its high debt load in a rising rate environment. Likewise, there was little information content to be derived from the other underperformers. MYL continued its roller coaster performance, reacting to whatever the news of the day is, and there was little to explain the moves of SHLD, AMTD, or JOE.

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 - June 30, 2018

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	4.07	3.02	13.80	4	NA	946,825	946,825	100%	1,142,297
2017	5.03	4.00	18.52	4	NA	984,681	984,681	100%	1,181,490
2018									
January	1.55	1.30	3.76	4	NA	997,473	997,473	100%	1,194,573
February	-1.60	-1.60	-4.13	4	NA	981,536	981,536	100%	1,177,451
March	0.74	0.74	0.06	4	NA	988,813	988,813	100%	1,185,130
April	-0.07	-0.32	-0.15	4	NA	985,649	985,649	100%	1,182,360
May	1.06	1.06	2.27	4	NA	996,142	996,142	100%	1,193,657
June	0.01	0.01	0.69	4	NA	996,192	996,192	100%	1,194,502
Q1	0.67	0.42	-0.46	4	NA	988,813	988,813	100%	1,185,130
Q2	1.00	0.75	2.82	4	NA	996,192	996,192	100%	1,194,502
YTD	1.67	1.17	2.35	4	NA	996,192	996,192	100%	1,194,502

**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.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

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.

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.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

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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