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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 help investors who want access to our expertise on a more modular basis. In these services and any future ones, Areté will always focus on conducting good research, thinking independently, 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 things I think about almost everyday is how to best serve investors in this investment environment. Another thing I think about almost everyday is how to do so in a way that is socially useful.

I've written many times about the challenges of this investment environment dominated by low rates, low expected returns, and high levels of policy intervention. In a sense, this is only partly a challenge because short-term interests can be served simply by completely ignoring risk.

Such a course of action, however, only enables the worst tendencies of investors and therefore does not serve long-term interests or provide any function of value. It's like a doctor who tells patients to keep on smoking, drinking, and overeating, and not to worry about exercising.

Inside This Issue

The challenge is being exacerbated by the reaction function of major investment groups. In the absence of immediate threats, many groups of investors are migrating to investment options that primarily serve short-term interests. They may (or may not) be a touch better than overpriced actively managed funds, but they also fall far short of what can objectively be considered good value.

For example, many mainstream investors have flocked to passively managed funds for the benefit of lower management fees. Many younger investors are expressing a great deal of interest in "impact" funds whereby their investments can have a positive effect on society. Many institutions, such as pension funds, are increasing allocations to riskier investments such as private equity, real estate and other alternatives in order to boost returns. Technology worshipers think technology can solve all problems and naturally migrate to offerings that incorporate new technology.

Each of these groups provides a clear pocket of demand for certain types of investment services and therefore also creates clear opportunities for providers to make money. I would argue, however, that most of these opportunities do a much better job of pandering to specific interests than they do of really helping investors improve their long-term welfare.

Take passive funds, for instance. I don't think there is anything inherently wrong with passive funds and they serve some investors well. But I also think they are wildly over-marketed. With such a prominent focus on low fees, there is far too little scrutiny of the underlying assets. Sometimes those assets are hugely overvalued and sometimes they do not provide the intended exposure. As an analyst, I am frequently shocked by the quantity of truly awful investments that are included in major indexes. I can't in good conscience recommend many of these things to my friends and family.

Impact investing and ESG (environmental, social, governance) criteria are also currently hot investment themes that I believe have a great deal of potential to hurt investors. Way back in business school I did a research project on what was then called socially responsible investing. My conclusion was that ESG considerations should figure into a company's discount rate. In other words, every stock involves a series of tradeoffs. Typically, companies with good governance and environmental records have lower discount rates and therefore higher valuations. All of these factors must be considered holistically.

Many ESG efforts miss a couple of hugely important points. For one, to the degree ESG efforts are prioritized at the expense of investment merits, they are not really investments at all but rather allocation decisions. Any such process would therefore be inappropriate for people whose primary intent is to derive adequate returns in order to fund some long term goal like retirement.

In addition, ESG considerations are often complex and involve many different factors and many shades of gray. Overly simplistic evaluations can miss important nuances. For example, it can be counterproductive to ban all major oil companies from portfolios if one's goal is to promote sustainable energy. What if one or more of those companies rigorously adhere to environmental standards and are progressive about transforming to more sustainable energy forms over time? Such a company could be a valuable ally for the cause and should not be rejected out of hand.

As it turns out, exchange-traded funds (ETFs) are almost perfect vehicles by which to cater to investors with very targeted interests such as ESG (but also countless others). That emphatically does not make them good investments though. Hester Peirce, a commissioner at the US Securities and Exchange Commission, expressed his general concern about specialized ETFs in the *Financial Times*: "I feel investors are getting misled — and I think it's a sign of our times where we get all fired up about stuff without really thinking about what's behind it." I couldn't agree more.

Another trend has been for pension plans to ride further and further out on the risk curve by increasing allocations to private equity and other alternative investments.

Unfortunately this has nothing to do with discovering an under-appreciated investment niche. Far from it. All evidence suggests that private equity returns are coming down and very close to that of public stocks, although with far greater risk. What is not coming down are management fees for private equity. As a result, it is extremely hard to make the case that the explosion in private equity funds under management is serving the long-term interests of investors more than it is lining the pockets of private equity managers.

Finally, there has also been a trend in the development of technology-infused investment products and services. These are targeted at technology worshipers who believe technology is the solution to all of the world's problems. They include apps that facilitate tracking your portfolio on your mobile phone to automated recommendation criteria for investment ideas. More often than not, these services are manifestations of cool (or simply widely available) technological functionality far more than they are thoughtful applications to solve real investment problems. While such offerings often improve convenience, mobility, and efficiency, they rarely improve investors' long-term welfare.

Each of these investor groups is looking for something better. Each is has its own idea of what makes the investment option better. Cost. Societal impact. Higher returns. Efficiency. Each of these is a good thing by itself. But that is the whole problem. Each of these investment options must be considered as a package of tradeoffs and none of the highlighted qualities should be judged in abstraction of other important considerations. Investors who focus on one criterion simply make profitable targets for providers who do not care about their long-term welfare.

The one thing that I have not seen happen yet to any great degree is for investors to demand structurally better investment services rather than just marginally better ones. By that I mean something like research-intensive active management at a fair price. I mean service providers that genuinely want to help their clients get ahead through the exercise of investing. I mean investment industry leaders that are not only paragons of excellence, but also excellent role models.

In general, I absolutely believe that the future of investment services is the ongoing development of knowledge and clever application of technology. These things can produce superior long term results in forms that can be truly useful. Conversely, many of today's offerings have no good reason to exist in their current form.

All of that said, I have seen a handful of providers explore similar paths to what I have done with Areté. Some asset managers are expanding their business model by increasing the distribution of their research. Other industry professionals are increasingly marketing more directly to advisors and individual investors. Ultimately, the job is still about knowledge development and management. What is changing is the audience who finds that knowledge valuable.

In the meantime, I am continuing to do the things that I believe build knowledge and add value. I am continuing to develop and refine my valuation model. Most recently I have been updating the model to compare operating lease assets, which are now required to be reported, to the estimates that I have been using all along. I am also continuing to update my technology roadmap. Most recently I have been exploring ways in which machine learning and other forms of artificial intelligence can be incorporated into my research process.

Finally, I am also in the process of relocating to Philadelphia. In my efforts to find ways to expand the reach of my valuation work, market insights and research development, I am excited about the prospects of being part of a broader investment community. If you have any ideas of people I should talk to, I would very much appreciate hearing about it.

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.

Portfolio Characteristics (6/30/19)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	9,271	10,680
Median Market Cap ($ mil.)	7,535	8,263
Minimum Market Cap ($ mil.)	394	248
Maximum Market Cap ($ mil.)***	46,548	52,864
Number of holdings	16	804
Valuation		
P/E current year	25.8	26.2
P/B	2.3	5.5
P/S	1.3	2.7
Yield (%) ****	4.2	2.7
Valuation drivers		
ROE (%)****	6.4	12.0

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

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.

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 slightly lower now than the mid cap index as is the median. 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 16 currently.

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 fairly 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.

Sector exposure (percent of assets on 6/30/19)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.2	11.5	1.7%
Consumer Staples	0.0	3.9	0.0%
Energy	0.0	4.4	0.0%
Financials	3.0	13.1	22.9%
Health Care	3.6	10.3	34.9%
Industrials	0.0	13.6	0.0%
Information Technology	1.9	17.8	10.7%
Materials	5.7	5.2	109.0%
Real Estate	6.5	9.3	70.1%
Communication	0.0	4.3	0.0%
Utilities	4.3	6.7	64.3%
Equity exposure	25.2	100.0	
Cash and equivalent	74.7	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.

Active share* (6/30/19)

Period	Percent**
Q219	95.6
Q119	95.5
Q418	95.8
Q318	96.2
Q218	96.4

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

Transactions review – Areté Mid Cap Core

There were no trades in the quarter.

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* (3/31/19 - 6/30/19)

Best performers

Company	Return in quarter (%)
Detour Gold Corp	34.7
Royal Gold	12.7
The Saint Joe Company	4.8
Davita	3.6
Capitol Federal Financial	3.2

Worst performers

Company	Return in quarter (%)
Mylan Inc	-32.8
Lands End	-26.4
NRG Energy	-17.3
Owens Illinois	-9.0
Annaly Capital Management	-8.6

**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 0.28% (net of fees) for the quarter versus 4.13% for the Russell Midcap Index® (RMC) (see pages 7 – 9 for performance and related disclosures). Major indexes continued with strong performance on expectations of looser monetary policy and despite eroding fundamentals. As a result, AMCC's defensive positioning led to underperformance in the quarter while opportunities to buy cheap stocks further diminished.

The dominant theme among the top performers in the quarter was the expression of inflation concerns expressed in the outperformance of real assets. Gold stocks DRGDF and RGLD performed well as did JOE which focuses on real estate development.

MYL topped the list of underperformers when it disappointed investors with weak earnings and seemingly little handle on what the problems were or what could be done about them. MYL has never had a good management team and has not been shy about piling up debt for acquisitions. Interestingly enough, the market looked right though these things when the stock reached a high in the low 70s in 2015.

LE's fundamental performance has actually been decent but the stock has gotten caught up in the retail apocalypse thesis and often trades based more on general views of traditional retail than any company-specific reasons. NRG was down on the basis of lower natural gas prices. OI sold off after modestly disappointing in the quarter and NLY was weak as the yield curve flattened and inverted.

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, 2019

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	-2.06	-3.03	-9.06	4	NA	954,785	954,785	100%	1,152,786
2019									
January	3.37	3.13	10.79	4	NA	984,623	984,623	100%	1,184,800
February	0.21	0.21	4.30	4	NA	986,645	986,645	100%	1,187,424
March	0.54	0.54	0.86	4	NA	991,993	991,993	100%	1,193,131
April	0.13	-0.12	3.81	4	NA	990,777	990,777	100%	1,191,761
May	-2.46	-2.46	-6.14	4	NA	966,369	966,369	100%	1,167,153
June	2.94	2.94	6.87	3	NA	994,399	994,399	100%	1,198,127
Q1	4.15	3.90	16.54	4	NA	991,993	991,993	100%	1,193,131
Q2	0.53	0.28	4.13	3	NA	994,399	994,399	100%	1,198,127
YTD	4.70	4.19	21.35	3	NA	991,993	991,993	100%	1,198,127

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

Areté Asset Management Mid Cap Core performance composite disclosures follow:
Compliance statement

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

Definition of the firm

Areté Asset Management, LLC (Areté) was established in 2008 and is registered as an investment adviser in the state of Maryland. Areté is defined as an independent investment management firm and is not affiliated with any parent organization. Areté currently manages one strategy, the U.S. equity mid cap core strategy, which it markets to individual and institutional clients.

Benchmark

The benchmark is the Russell Midcap® Index and its performance is reported in U.S. dollars.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

Calculation methodology

Portfolio valuations are calculated as of calendar month-end and are computed in U.S. dollars and performance is also reported in U.S. dollars. Time-weighted rates of return are used which adjust for external cash flows. Our smaller, retail accounts contain fee structures in which one flat, per-transaction fee is charged for trading expenses and which embeds an implicit charge for custody. Since trading and custody charges cannot be directly segregated in these cases, they constitute "bundled fees". Gross-of-fees performance returns are presented before management and custodial fees when custodial fees can be segregated from trading, but are presented before management fees and after bundled (trading and custodial) expenses for our retail accounts. Net-of-fees returns are presented after management fees, trading expenses, and custodial expenses are deducted or after management fees and bundled (trading and custodial) fees for retail accounts. There are no instances in which management fees are bundled with trading or custodial fees. Returns are presented net of nonreclaimable withholding taxes when applicable. Areté does not use leverage or derivatives in the management of portfolios. Additional information regarding policies for calculating and reporting returns is available upon request.

The composite

This U.S. Equity Mid Cap Core composite was created in August, 2008 and includes all fee-paying, taxable and non-taxable, discretionary, long only, fully invested portfolios benchmarked to the Russell Midcap Index. Every new portfolio is added to the composite in the first complete calendar month that it is "fully invested". For purposes of composite construction, a portfolio is "fully invested" if its equity composition is greater than 90% of the equity composition of the composite. Each portfolio will remain in the composite until its equity composition becomes less than 90% of that of the composite. A complete list and description of firm composites is available upon request.

*As of March 31, 2012, the composite has been redefined in order to clarify policy in light of unusually high cash positions recently. Prior to March 31, 2012, a portfolio was considered to be "fully invested" if greater than 90% of portfolio assets were invested in equity securities which implicitly assumed a nearly 100% equity position in the composite.

Fee schedule

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

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.