Second quarter 2021
Volume 14, Issue 2

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 (or different) investment insights, please take a look at our blog [here]. Content for the posts is selected and created on the basis of being important, relevant, and useful.

In addition, *Arete's Observations* 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 contact us with questions or comments.

Business Update

The really big news is the reformulation of Arete's investment strategy continues apace. As a result, this report will reflect a number of the changes. In preview, the portfolios remain unchanged from last quarter, but I will lay out the roadmap for how I expect them to change. The new name for the strategy, All Terrain, captures the essence of these changes.

One of the key characteristics that will remain the same is cash will be used strategically to avoid excessive risk and to provide a valuable option to buy attractive assets at a cheaper price in the future. Since nearly all asset prices are inflated right now, I expect cash to remain at higher than targeted levels.

Inside This Issue

One of the key characteristics that will change is the breadth and type of securities held in portfolios. Most importantly, this will now include mutual funds and exchange-traded funds (ETFs) in addition to common stocks.

This should produce a number of desirable effects. One is the portfolio will be more diversified than it has been in the past. Another is the universe of potential holdings will be much larger which will create new opportunities for accessing various exposures. Yet another is it will facilitate a

Areté Asset Management, LLC: 956 N. Leithgow St., Philadelphia, PA 19123
http://www.areteam.com drobertson@areteam.com 410/241-1092

faster response time when macroeconomic or market conditions change suddenly.

The foundation of the approach will be a conventional allocation of stocks, bonds, and cash. Because the investment environment is especially risky for stocks and bonds, however, the most notable aspect of the allocation will be the inclusion of two new asset "classes". These are designed to harvest returns that are either uncorrelated with the market or inversely correlated. I have assigned them the labels of "Nonmarket" and "Positive convexity". I should also mention "Gold" will also be considered its own asset class due to its unique characteristics through history.

This approach is designed to produce a number of important incremental benefits relative to the Mid Cap Core strategy.

One is there will be a lot more opportunities to gain exposure to unique return opportunities. Another is the portfolio will be much more diversified which should provide more protection against negative market events. As a result of having more downside protection, it will be easier to accept risk in certain areas as well.

At the same time, the strategy will still have the capacity to invest in attractive stocks whenever and to whatever extent those opportunities arise.

Before I wrap up, it makes sense to to revisit the catalyst for these changes. Notably, the ongoing migration to passive investing combined with persistent central bank intervention since the financial crisis has meaningfully altered the distribution and timing of investment returns. In doing so, these forces have transferred a great deal of idiosyncratic risk to systemic risk. This is a subject I broached in the market review for the second quarter.

The most notable effect from these changes has been to vastly undermine the potential to generate outsized returns through security selection, at least in the short- to intermediate term. Unfortunately, this was a major premise upon which the Areté Mid Cap Core strategy was based.

The good news is the vast major of Areté's investment philosophy and founding principles still hold. I still think it is important to help investors get the most out of their experience with investing and there are still enormous opportunities to create a portfolio of uncorrelated assets. Further, when the carry regime finally does end, there will again be incredible opportunities for stock picking.

I said it last quarter and I'll say it again: I am both excited and anxious about these changes. While I still hate to "quit" the midcap strategy, the investment landscape has changed and we need to adapt. I still believe there is a lot of risk in overvalued markets, but I am encouraged by the prospect of being able to do more about it.

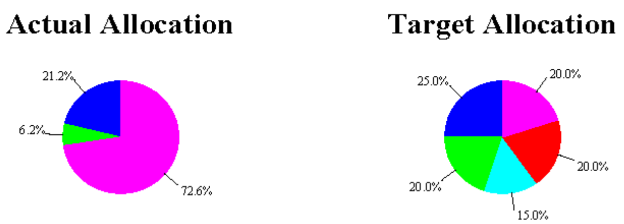
As always, thanks for your support!

David Robertson, CFA
CEO, Portfolio Manager

Portfolio characteristics/ Asset allocation

As the number of AMCC strategy holdings declined over time and as larger market forces came to dominate returns, portfolio characteristics became progressively less important in portraying overall risk. As a result, those numbers are excluded from this report. Since the portfolio did not change in any material way from last quarter, the characteristics from that report can serve as a useful guideline.

Going forward, as the Mid Cap Core strategy transitions to the All Terrain strategy, risk will be captured more meaningfully through a chart of the asset allocation. An example of what to expect is shown below:



In the current actual allocation, cash is by far the largest position followed by stocks and gold. While the target allocation suggests significant transactional activity, it is more useful to consider that allocation as "aspirational" for now since the universe of assets that are either uncorrelated with, or negatively correlated with, the S&P 500 are very limited.

Transactions review

There were no transactions in the quarter. Over the next few quarters, it is fair to expect a somewhat higher level of transactions as portfolios transition to the All Terrain strategy and holdings are added and subtracted to reflect that change. Once the targeted allocation is achieved, however, it is fair to expect turnover to revert to similarly low levels.

Performance review

As investment strategy transitions over to the All Terrain strategy, there will be some changes in performance evaluation, but many of the general principles will remain the same.

For example, the search for undervalued assets will remain the same, although the scope of that search will expand significantly from the universe of US mid cap stocks to a much broader universe of publicly traded securities and funds. As a result, the table of stock performance will be discontinued after this report.

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

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

Areté's Mid Cap Core (AMCC) strategy returned 1.50% (net of fees) for the quarter versus 7.50% for the Russell Midcap Index® (RMC) (see pages 7 – 8 for performance and related disclosures). With markets continuing to cruise along through the second quarter, the large cash position hindered performance.

Stock performance* (3/31/21 - 6/30/21)

Best performers

Company	Return in quarter (%)
Lands End	65.5
Kirkland Lake	14.3
Davita	11.8
Owens Illinois	10.8
Gaming & Leisure Properties	9.2

Worst performers

Company	Return in quarter (%)
Capitol Federal Financial	-11.1
Weyerhaeuser	-3.3
Yamana Gold	-2.8
Seritage Growth Properties	0.3
Exelon	1.3

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

As has been the case frequently over the past several years, there were few idiosyncratic explanations for the performance of the best performing stocks. In the second quarter in particular, good performance primarily reflected rebounds from earlier periods of underperformance. The key theme among underperformers was most of them reflected the unwinding of the reflation trade in the second quarter.

Investment Philosophy

Please note: In association with Areté transitioning its primary investment strategy, the investment philosophy is also being updated and refreshed. Below is a draft of the changes.

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 Mid Cap Core Composite

Arete Asset Management, LLC
Mid Cap Core Composite
July 31, 2008 - June 30, 2021

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	10.73	9.65	30.54	3	NA	1,046,822	1,046,822	100%	1,257,036
2020	2.36	1.34	17.10	3	NA	1,060,915	1,060,915	100%	1,271,549
2021									
January	-0.36	-0.61	-0.26	2	NA	589,353	589,353	100%	1,163,973
February	-0.68	-0.68	5.57	2	NA	585,340	585,340	100%	1,155,976
March	1.03	1.03	2.71	2	NA	591,373	591,373	100%	1,167,661
April	1.54	1.29	5.10	2	NA	598,975	598,975	100%	1,183,267
May	1.30	1.30	0.80	2	NA	606,733	606,733	100%	1,198,498
June	-1.07	-1.07	1.47	2	NA	600,250	600,250	100%	1,185,577
Q1	-0.02	-0.27	8.14	2	NA	591,373	591,373	100%	1,167,661
Q2	1.75	1.50	7.50	2	NA	600,250	600,250	100%	1,185,577
YTD	1.73	1.23	16.25	2	NA	600,250	600,250	100%	1,185,577

**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:

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.

Areté All Terrain Composite (illustrative)

Arete Asset Management, LLC
All Terrain Composite (illustration)
March 31, 2021 - June 30, 2021

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									
April	1.54	1.29	3.47	2	NA	598,975	598,975	100%	1,183,267
May	1.30	1.30	0.37	2	NA	606,733	606,733	100%	1,198,498
June	-1.07	-1.07	1.87	2	NA	600,250	600,250	100%	1,185,577
Q2	1.75	1.50	5.80	2	NA	600,250	600,250	100%	1,185,577
YTD	1.73	1.23	8.30	2	NA	600,250	600,250	100%	1,185,577