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THE ARETE QUARTERLY

Welcome

Whether assets are part of a personal retirement plan or part of an institutional plan such as a pension, endowment, or foundation, we are all trying to do the same thing. We are all trying to get the most out of investments given our limited set of resources. What can be learned from recent experiences to help us balance these competing demands? Let's start with the results and work backwards.

One of the most popular investment strategies in recent years has been that of absolute returns. These strategies offer arguably the most alluring value proposition in the business: Excess returns without market volatility.

While absolute return strategies have been fantastically successful in accumulating assets, all evidence points to the claims being overstated. A recent report in the *New York Times* noted that the benchmark return for absolute return strategies for endowment funds last fiscal year was a decline of 13.2%. In other words, neither the claims of *excess returns* or *without market volatility* held true for the approach as a whole.

What does this experience teach us? For those very familiar with market opportunities, it was pretty clear that demand for absolute return strategies far exceeded realistic opportunities for such approaches. Such familiarity, however, comes with a cost. David Swensen, the exemplar of Yale University's endowment has always said investing in complex strategies like absolute returns is appropriate only for the few who have the resources, experience, and expertise to fully understand them and to establish realistic expectations for them.

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If adequate resources are not available to thoroughly assess investment options, there is always the possibility of hiring assistance. While this is certainly a valid approach, the benefits of advice also need to be carefully weighed against the additional costs of such services.

Finally, if one does not have the resources to devote to assessing investments, there are few sensible alternatives than to avoid active management options. In short, there is no easy way to make a fortune. Without a firm understanding of reasonable risk and return expectations, it is far too easy to fall prey to sales pitches imbued with unrealistic expectations.

With that context, Arete's mid cap core strategy is designed to provide excellent investment value based on what we believe to be very realistic expectations. We also believe the better you understand what we do, the clearer the value proposition will be. In order to facilitate your understanding, we disclose our philosophy, mental models, value proposition and other aspects of our approach to investing on our website at www.areteam.com. We are also always happy to discuss these items in person.

As always, we appreciate your comments and suggestions regarding any aspect of the business which might make our services more useful to you. We hope you find our proposition compelling and always look forward to talking with you!

Business Update

As we have now passed the first anniversary of Arete's Mid Cap Core composite performance, this marks an appropriate occasion to discuss marketing and business development for the company. In the process, I will touch on the premises behind the marketing effort, I will discuss the positioning of the offering, and I will outline my roadmap for the future of the marketing effort.

My main premise for founding Arete was that there will always be demand for outperformance. In addition, given both my personal and professional investing experiences, I believe I can deliver that performance.

With these premises, the primary uncertainty for managing the business is timing. I know it takes time for prospective clients to conduct due diligence and to get comfortable with people and processes. Consequently, I have placed a very high priority on carefully managing expenses in order to provide prospective clients as much time as they need to appreciate the value Arete can deliver. So far, so good.

In the process of raising the awareness of Arete, I have given a great deal of thought about how to position the company and the Mid Cap product. In many respects, I have found it easier to describe what it is not. Arete's Mid Cap Core product is not exotic or unusual. The process is not built by PhD mathematicians. I have not tried to build a big brand name for Arete. I do not have any catchy, sexy taglines for the product.

Arete does "stand upon the shoulders of those who have gone before us" in the sense of making the most of the teachings of luminaries such as Miller and Modigliani and Graham and Dodd. In doing so, we put more effort into implementing and adapting these insights than to creating "new and improved" strategies.

Perhaps the clearest analogy of Arete's investment process is to manufacturing. We view the process as taking the raw material of information and intellect and shaping it into something that can be called knowledge that is advantaged relative to the market. As such the pursuit is somewhat philosophical in that it goes back to first principles and asks what is knowledge and how do we attain it? If you have any ideas on how this can be better-articulated, I would love to hear them!

I believe a big part of the difficulty I have in positioning Arete relative to many contemporary competitors is that over the last twenty to thirty years, the industry has become progressively more driven by asset gathering and marketing. In this context, Arete is a throwback to times of greater emphasis on pure investing and fiduciary standards.

Finally, with a one year track record I decided it was an appropriate time to step-up Arete's marketing effort by further institutionalizing its organization. Specifically, I have more fully implemented Arete's customer relationship management (CRM) system in order to better organize, segment, contact and follow up with various prospects, clients, and constituents. This effort will facilitate a progressively more complex sales process and will increase the efficiency and flexibility of resources devoted to marketing. As Arete targets a progressively more institutional client base, these tools will be essential for maintaining and even improving on Arete's high standards of quality.

With all of that said, as always, I enjoy talking about stocks, the business, and the market. If you are going to be in Baltimore, please stop by or if you have a few minutes, give me a call. I'd love to talk about what Arete can do for you.

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.

Portfolio Characteristics (9/30/09)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	5,189	4,125
Median Market Cap ($ mil.)	4,746	3,207
Minimum Market Cap ($ mil.)	530	307
Maximum Market Cap ($ mil.)	14,284	15,746
Number of holdings	50	771
Valuation		
P/E current year	11.4	15.0
P/E forecast Y1	17.6	20.4
P/B	2.3	2.5
P/S	0.7	0.9
Yield (%)	0.9	2.6
Valuation drivers		
ROE (%)	16.9	15.6
LT eps growth forecast (%)	12.6	12.1

Source: The Applied Finance Group™
**Note:* Excludes ASCMA allocation resulting from DISCA corporate action.
***Note*: Arete currently does not subscribe to the Russell Indexes and therefore the statistics presented here represent approximations of the Russell Midcap® Index.

We believe maintaining a truly representative mid cap portfolio is important for two reasons. First, a purely 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, the "games" that so many fund managers play such as timing the market through changing cash allocations and allowing style to drift 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.

Portfolio characteristics for the quarter confirm our claim that AMCC is a very representative mid cap portfolio. Market caps are a little bit higher for AMCC than for the mid cap index and valuation metrics are modestly lower. The valuation drivers of ROE and forecast growth are also just modestly higher for AMCC than for the index.

Sector exposures for the strategy were affected by the re-balancing of the Russell Midcap Index and by some sector reclassifications. These reclassifications significantly reduced AMCC's weight in Autos and Transportation and reduced the index weight as well.

Sector exposure (percent of assets on 9/30/09)

Economic sector	Arete MCC*	Midcap Index**	Percentage Comparison
Autos & Transportation	0.0	0.2	0.0%
Consumer Discretionary	20.3	16.3	124.6%
Consumer Staples	3.2	5.7	56.3%
Financial Services	18.9	20.6	91.9%
Health Care	9.5	8.5	112.0%
Energy	7.4	7.6	97.7%
Materials & Processing	11.5	7.6	151.2%
Producer Durables	13.5	12.5	108.0%
Technology	7.3	12.5	58.5%
Utilities	6.5	8.6	75.3%
Equity exposure	98.1	100.0	
Cash and equivalent	2.0	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.

Nonetheless, AMCC sector weights were again for the most part well within our general guidelines of 50% - 150% of benchmark sector weights. The only exception in the quarter was Materials and Processing which finished just slightly above our 150% guideline.

While we don't manage the portfolio from the top-down by targeting certain sector weights, we do regularly review those weights to reconcile them to our botton-up perspectives. In that effort, we have noticed a couple of interesting things.

One issue that stands out is our underweight position in Utilities. In one sense, we would like to have a higher weight in the utility sector in order to benefit from its stability and higher dividend yield. The bottom-up perspective provides a starkly different view of the sector, however.

The view of individual utility stocks reveals that these companies have been hit just about as hard as any by the economic downturn. Retail and industrial consumers alike have been pressed to be more frugal and have been conserving electricity consumption as one way to achive that. At the same time, many need to consider large construction projects in a difficult environment to raise capital. Finally, the entire generation structure needs to be re-evaluated in light of the increasing participation of alternative energy.

Another issue that stands out from review of sector weights is the underweight position in Consumer Staples. Again, the conventional view is that staples stocks can provide an important degree of diversification with the stable stream of cash flows they produce.

Analysis of the individual staples stocks, however, reveals that in many cases, the streams of cash flows are anything but stable. Many of these stocks are large food companies whose brand names don't deliver as high a value to economically-pressed consumers. Many others are much more directly associated with the commodity chain and their results reflect volatility that is comparable to the underlying commodity prices.

The lesson we take from all this is that we all need to be thoughtful about the limits of conventional forms of diversification. The ultimate goal is to diversify streams of cash flows so as to reduce overall portfolio volatility. To the extent historical proxies for diversification become less effective in this regard, we need to be ever-vigilant in our search for new methods.

Transactions review – Arete Mid Cap Core

The continued strength of the market through the third quarter presented us the opportunity to modestly re-balance the portfolio relative to our stock selection standards and portfolio construction guidelines.

The first transaction in the quarter was prompted by the unusually weak performance of Eastman Kodak through the summer. Despite our confidence in the underlying value of the business, the stock crept lower through the end of July. At that point we made the contrarian call to add to the position by deploying cash held in the portfolio.

The enormous run in Oshkosh stock pushed its weight over four percent in the portfolio and prompted us to re-evaluate the stock relative to its potential. While we still very much like the long-term potential for the stock, we judged that the recent wins in the defense business were fortuitous, but not likely sustainable at the same rate. As a result, we took the opportunity to reduce the position size.

The proceeds from the Oshkosh sale were immediately reinvested in Heinz. We like potential of Heinz stock which is also a solid dividend payer. Importantly, this addition helped reduce our under-weight position in consumer staples where we have found a dearth of attractive opportunities.

Finally, in our regular process of reviewing the portfolio, we decided to sell out of our position in J.B. Hunt. This was a difficult decision, because we still very much like the company's strong competitive position. Nonetheless we see the company's value proposition of increased transportation efficiency as somewhat compromised given the business exposure to weak consumer spending and economic growth. For this reason we viewed the appreciation potential as limited relative to opportunities we are seeing elsewhere.

Market Overview

Strong performance by the market as a whole was led by mid cap stocks which performed especially well in each month of the quarter. Overall performance was punctuated by incredibly large returns from a number of individual stocks.

We found the extreme returns telling in a couple of respects. First, the extremely high returns in the second and third quarters of this year were in many cases mirror images of the prior two quarters. In other words, stocks became oversold last year and into the first quarter of this year and then recovered. While this understates what actually happened, it does highlight the greater volatility in stock prices than in underlying intrinsic values.

The second telling aspect of the extreme returns is that such volatility seems to encourage what we call "factor" trading. We define factors as exposures such as size or leverage or correlation with oil prices. In an environment of high volatility, opportunities to profit from "factor" moves seem to overwhelm other opportunities. The consequences are that several significant disparities in competitive positioning remain inefficiently priced.

The improvement in market sentiment since the end of the first quarter has also spawned some acquisitions. These transactions also created a virtuous cycle which has fueled further positive sentiment in the markets. While acquisitions often serve as a vehicle by which the intrinsic value of mid cap stocks can be realized, we have not been impressed by the quality of the deals done in the last quarter or two.

Looking ahead, our view of the economic and market landscape has changed very little over the last quarter. In particular, our view remains moderated by the financial retrenchment of U.S. consumers. The combination of excessive debt and high unemployment is forcing significant changes in spending patterns that we suspect will last for several years. Many businesses will have to endure both a lower organic revenue growth rate and a substantially more difficult environment for securing financing.

Despite these shorter-term headwinds, we remain generally positive about the economy and the markets as a whole. We believe the challenges of the last couple of years will, on the margin, serve to improve corporate governance and quality of operations. These improvements will ultimately increase the efficiency of capital allocation which is a big part of what makes the U.S. capital markets so powerful. These factors combined with reasonable market valuations and numerous instances of company-specific opportunities continue to support our longer-term optimism.

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, 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. A 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.

Stock performance* (6/30/09 - 9/30/09)

Best performers

Company	Return in quarter (%)
Oshkosh Corp.	112.7
Genworth Financial	71.0
Thor Industries	68.5
Eastman Kodak	61.5
United Rentals	58.7

Worst performers

Company	Return in quarter (%)
Sears Holdings	-1.8
Penn National Gaming	-5.0
Capitalsource Inc.	-11.1
Amerigroup Corp.	-17.4
Energy Conversion Devices	-18.2

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

The market continued its strong perfomance in the third quarter and Arete's Mid Cap Core (AMCC) strategy continued its strong performance as well. Specifically, the AMCC composite returned 24.34% (net of fees) which beat the 20.61% return of the Russell Midcap Index (RMC) by 3.73%. AMCC outperformed RMC by over 100 basis points in both July and August, but modestly underperformed in September.

The best and worst performing stocks again tell an interesting part of the performance story for the quarter. The best stocks showed very large returns with the top performer more than doubling. The worst performers were not bad and largely reflected only transient weakness relative to a strong market.

Importantly, each of the four top performers had greater than average weights in the portfolio. Part of the reason for this was the recovery of some stocks like Oshkosh and Thor which we retained confidence in even when they became significantly oversold. Another part of the reason for this was that when we saw stocks we really liked get oversold, as in the cases of Genworth and Eastman Kodak, we added to our positions. Each case was a good example of managing the difference between prices and intrinsic values that is endemic to our investment process.

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 - September 30, 2009

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									
January	-7.54	-7.62	-7.4	3	NA	191,258	191,258	100%	191,258
February	-11.02	-11.02	-9.95	4	NA	318,767	318,767	100%	318,767
March	8.67	8.67	9.15	4	NA	346,401	346,401	100%	346,401
April	20.86	20.86	15.37	4	NA	418,645	418,645	100%	418,645
May	4.72	4.68	4.34	4	NA	438,238	438,238	100%	438,238
June	1.80	1.80	0.35	4	NA	446,106	446,106	100%	446,106
July	9.90	9.69	8.85	4	NA	489,344	489,344	100%	489,344
August	7.37	7.37	4.86	4	NA	525,423	525,423	100%	525,423
September	5.39	5.39	5.67	4	NA	553,725	553,725	100%	553,725
Q1	-10.60	-10.67	-8.98	4	NA	346,401	346,401	100%	346,401
Q2	28.83	28.78	20.80	4	NA	446,106	446,106	100%	446,106
Q3	24.36	24.12	20.61	4	NA	553,725	553,725	100%	553,725
YTD	43.23	42.79	32.61	4	NA	553,725	553,725	100%	553,725

**Note*: Composite returns for September 2008 have been corrected for an error that occurred in the calculation of accrued income. The new, corrected performance is higher by 10 basis points, which equals our threshhold for materiality. The error occurred due to an ex-post post adjustment made by our reporting software. We have identified the source of the problem and have created procedures designed to avoid recurrence.
***Note*: Peformance through 12/31/08 is from inception of composite on 7/31/08.

Arete Asset Management Mid Cap Core performance composite disclosures:

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

Arete Asset Management Mid Cap Core performance composite disclosures continued:

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.

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. For purposes of composite construction, "fully invested" is defined as having greater than 90% of portfolio assets invested in equity securities. Every new portfolio is added to the composite in the first complete calendar month that it is "fully invested". A complete list and description of firm composites is available upon request.

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

Arete Asset Management, LLC, Business address: 729 E. Pratt St., Suite 700, Baltimore, MD 21202
http://www.areteam.com drobertson@areteam.com 410/649-0086 Toll Free: 866/526-6008

Arete Asset Management Mid Cap Core performance composite disclosures continued:

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. Please note that the initial minimum period for which verification can be performed is one year.

To receive a copy of the firm's Form ADV Part II, please contact David Robertson at 410/649-0086 x710, by email at droberston@areteam.com, or by mail at the address listed below.