

THE ARETE QUARTERLY

Welcome

When your eyes are open to a theme, it's amazing how often you see it. One of the theme's that has always driven Arete is that of creative destruction.

This theory was espoused by Joseph Schumpeter and describes how an economy actually grows – not as one monolithic entity plodding forward, but as a diverse group of businesses competing for prominence. New businesses with better ideas that operate more efficiently gain ground at the expense of older ones with stale ideas that operate less efficiently.

The phenomenon of creative destruction also rings out in other spheres of thinking. Robert Pirsig, who became famous for his philosophical ponderings in *Zen and the Art of Motorcycle Maintenance*, touched on the notion in his follow-up book, *Lila*.

In that book, Pirsig introduces a concept he calls Dynamic Quality. According to him, "What makes the marketplace work is Dynamic Quality." As he elaborates, "the free market makes everybody richer by preventing static economic patterns from setting in and stagnating economic growth." In short, this sounds like another take on the theme of creative destruction.

This idea was also taken up recently by George Gilder in his new book, *Knowledge and Power: The Information Theory of Capitalism and How it is Revolutionizing our World*. As Gilder puts it, "The key to economic growth is not acquisition of

Inside This Issue

Welcome	1
Business Update	2
Portfolio Characteristics	3
Transactions Review	4
Market Overview	5
Performance Review	7
Investment Philosophy	9
Arete Mid Cap Core Composite	11

things by the pursuit of monetary rewards but the expansion of wealth through learning and discovery. The economy grows ... by accumulating surprising knowledge through the conduct of falsifiable experiments of free enterprises."

According to the information theory model, information is created through economic activity and transmitted through the various channels of the economic landscape. Once again, we have a framework that sounds a lot like creative destruction.

Gilder's approach is interesting also because it clearly identifies an important potential obstacle to the process of economic growth. As he describes, "The most common and destructive source of noise, however, is precisely the institution on which we most depend to provide a clear and stable channel in the first place. When government either neglects its role as guardian of the channel or, worse, tries to help by becoming a transmitter and turning up the power on certain favored signals, the noise can be deafening."

While Gilder makes little effort to hide his political leanings, this is a risk endemic to evaluating economic theories which inevitably also intersect with political ideologies. Nonetheless, it is difficult to reject on an intellectual basis the notion that new information and ideas are good or that clear channels are the best way for them to be transmitted. As such, it is striking the degree to which many institutions are actively pursuing policies in direct contradiction to the theory.

Regardless of whether the issue is the debt ceiling, the Fed's quantitative easing program, or something else, the inflammatory rhetoric surrounding these issues is making the economy's information channels extremely noisy right now. Insofar as noisy channels reduce the efficiency and accuracy of messages sent (think bad cell phone connections), political squabbling is directly worsening the conditions for economic growth.

For now this is the world we live in and we must manage to it. The good news is that there is a useful model for how to move things forward. The challenge is that we have to find a way to follow the model. Until we do, it is quite likely that the process of creative destruction, and ultimately economic growth, will be a quite a bit slower than any of us would like.

Business Update

One of the goals I have always had is to make Arete's work as accessible as possible for investors. Part of the goal is to make it cheap and easy to do basic research on Arete, its research process, and value proposition. These things shouldn't require a great deal of effort or be shrouded in

mystery. I hope the contrast with many large fund families will be obvious.

Part of the goal has also been to make Arete's commentary and insights available for better understanding and ultimately resolving investment challenges. I know I have lots of sources of data and commentary as an analyst, but precious few sources that I can really trust. Lots of companies sell "products" and encourage "transactions". In contrast, I want Arete to help improve client outcomes; I want you to be better off.

In particular, one significant technology implementation I completed at the end of the summer was a refreshing of the Arete website. The primary objective of the project was to make the content, most in the form of newsletters, much more accessible to interested parties. Now, all past newsletter content is easily accessible to major search engines and can also be searched within the Arete website. Before, this content resided in pdfs which made it difficult to home in on specific topics.

My hope is that the aggregation of these articles will make it a lot more useful as a research source and a knowledge base. If a specific issue comes up and you'd like to pull up past comments, it's extremely easy to do. Whether you're doing work on "valuation", "proxies", some other issue, or just want to delve deeper into Arete's thinking, the latest refinements will make it really easy for you.

Of course I also have a goal of growing Arete and one of the best ways I can do that is by establishing my expertise. I try to do that through my writing in the newsletters and I try to do that through my other communications with investors. I

hear from many people that they would like to have better and more trusted sources of information so they can get more confident in their investing. This is one of many efforts to address that demand.

While I see the website as a valuable and cost-effective way to share investment insights with people, I have no intention of stopping there. If you find Arete's material useful and would like to discuss how to employ it more broadly, let's talk. As an independent business owner, I have a great deal of flexibility in talking to individuals or groups, presenting investment topics, and considering anything else that may make sense.

Finally, if you get a chance, please let me know what you think of the new website format. I don't do things like this as academic exercises; I do them to try to help investors. If there is a tweak here or there that could make it a lot more useful, I'd love to hear it. If there are larger issues that make it cumbersome; I'd like to hear that too. It doesn't do Arete any good if we're not helping people out.

Thanks and take care!

David Robertson, CFA
CEO, Portfolio Manager

Portfolio Characteristics – Arete Mid Cap Core

A key proposition for Arete's Mid Cap Core strategy is that it is a truly representative mid cap portfolio. In general, this suggests that over time, you can expect to see the aggregate characteristics and sector

exposures of the strategy migrate to those of the Russell Midcap Index®. During intervening periods, however, sector exposures and other characteristics will reflect the opportunities we find in the market at that point in time.

We believe maintaining a truly representative mid cap portfolio is important for two reasons. First, a truly mid cap portfolio faithfully plays its role in a broader asset allocation scheme. Second, it allows for accurate assessment of performance. Without an appropriate benchmark it is difficult, if not impossible, to judge whether performance differentials are due to skill or luck, and are sustainable or transient.

For example, many fund managers attempt to beat their benchmark by timing the market and/or migrating style. These tactics rarely generate sustainable out-performance. To us, such activities usually just serve to obfuscate the underlying inability of the manager to add value through a coherent and disciplined investment process.

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 as well as options to buy cheaper in the future.

Portfolio characteristics for the quarter continue to confirm that the equity portion of AMCC is a very representative mid cap portfolio. Market caps for AMCC are extremely similar to the mid cap index and AMCC is considerably cheaper on the bases of Price-book and Price-sales which tend to be more stable metrics. ROE is noticeably lower, but is subject to many distortions and has not been especially reliable.

Portfolio Characteristics (9/30/13)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap (\$ mil.)	7,360	7,261
Median Market Cap (\$ mil.)	5,205	5,503
Minimum Market Cap (\$ mil.)	140	744
Maximum Market Cap (\$ mil.)	25,389	27,535
Number of holdings	34	808
Valuation		
P/E current year	23.3	19.9
P/E forecast Y1	21.5	20.1
P/B	2.0	3.7
P/S	1.2	1.6
Yield (%)	1.5	2.4
Valuation drivers		
ROE (%)***	11.2	25.4
LT eps growth forecast (%)	7.6	12.1

Source: The Applied Finance Group™

*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.

Sector exposures, with the exception of utilities, are all below benchmark weights due to the high cash position. All sectors, with the exception of consumer staples and consumer discretionary, are still within our general guidelines of 50% - 150% of benchmark weights. Three sectors are currently close to benchmark weights including Utilities, Health Care, and Materials & Processing.

Since cash started accumulating three years ago, we have been fairly aggressively researching new names. With valuation as a significant consideration, however, we have found few opportunities to deploy it. As a result, we should be in a good position to act fairly quickly when valuations approach more reasonable levels.

Sector exposure (percent of assets on 9/30/13)

Economic sector	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	5.5	18.5	29.8%
Consumer Staples	0.0	5.4	0.0%
Energy	4.7	6.6	70.7%
Financial Services	15.0	21.1	71.2%
Health Care	8.9	10.3	86.2%
Materials & Processing	5.5	6.3	86.6%
Producer Durables	10.4	13.0	79.8%
Technology	7.9	11.9	66.3%
Utilities	6.4	6.7	95.0%
Equity exposure	64.3	100.0	
Cash and equivalent	35.7	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.

Transactions review – Arete Mid Cap Core

Several transactions occurred in the third quarter representing another reduction in stock exposure as valuations stretched beyond what we could consider reasonable. Each of the sales came from the consumer discretionary sector which significantly reduced the sector's weight for AMCC relative to its benchmark.

THO was sold (in two tranches) after a strong run of appreciation. THO is a well-run company that has been a good steward of capital for shareholders and which has benefited from a strong secular growth

thesis. As a result, it was a tough decision to sell, but the stock's valuation is extremely stretched and since RVs are fairly expensive purchases, the stock is also extremely sensitive to credit conditions. Things are good now, but there is no room in the stock price for deterioration.

A similar story holds for KMX. We still believe in the secular growth story for KMX, but the stock appears priced for perfection. Increasing reports of 96 month car loans gives an indication of how easy credit is now, but we know that can change quickly. At current prices, the stock is not discounting any possibility of such adverse conditions.

MHK is a very well-managed company that has benefited strongly from the rebound in both residential and commercial construction. For better and worse, it is an extremely cyclical company and as such suffers significant contraction in its operating margins when revenues decline. Even though margins have not fully recovered from the last downturn, current prices imply continued revenue increases, full margin recovery, and no chance of a normal cyclical downturn.

Finally, it's appropriate to document the post mortem analysis on EK. While our analysis revealed a good chance of value eventually accruing to shareholders, we were clearly wrong this time. Despite waves of negative publicity about the retail film business, commercial printing was the lynchpin. Management certainly did not cover itself in glory, but public policy decisions (and non-decisions) which forestalled capital spending recovery across the economy, were especially ill-timed and painful for EK.

The case of Kodak also reveals a great deal about Arete's investment style. We never like to lose money, but when it happens, it happens in relatively small bites. We pursue ideas like this because the potential for negative outcomes often drives many other potential investors away. When this happens, it creates opportunities for outsized returns. Sometimes, as in the case of EK, it doesn't work out. But the success of other undervalued opportunities tends to more than make up for it.

Market Overview

After a brief glitch in the market at the end of the second quarter, stocks quickly resumed their upward trajectory in the third quarter. Markets had initially been spooked by the prospect of the Fed tapering its quantitative easing (QE) program, but Fed governors responded quickly to the commotion by talking down the prospect of reducing monetary assistance.

So the story goes and so it has gone for the last three years. If the economy slows down, throw some money at it. Voila. Threat of a Eurozone crisis? Throw some money at it. Declining labor force participation? Throw some money at it. We've documented a number of times now how this progression has led to an ever greater disparity between economic fundamentals and stock prices, so we won't repeat that exercise here. Make no mistake, though, the divergences continue to grow ever larger.

What we can do is try to understand the mechanisms generating the stock market reactions and to evaluate their implications. In this regard, Ben Hunt from

[Epsilon Theory](#) has done some very nice work weaving game theory and history into a perspective on behavioral economics.

According to his analysis, "Like all effective Narratives it's simple: central bank policy WILL determine market outcomes." In addition, "Like all effective Narratives it has a great deal of 'truthiness' ... it rings true to our intellect even as it appeals to our emotions."

As Hunt clarifies, though, "But here's the crucial point ... whether these opinion-leaders and Narrative creators thought open-ended QE was a wonderful thing or a terrible thing, they ALL agreed that Fed policy had been responsible for the current stock market level."

Insofar as investors buy into the Narrative, then, it doesn't matter whether they believe policy is good or bad. According to the Narrative, the rational action is to keep buying stocks.

In fact, many retail investors have done just that. As noted in a recent article entitled "Investors flock to high-yield bonds and stocks" in the *Financial Times*, "Equity funds saw their biggest weekly inflows on record, according to Bank of America Merrill Lynch, with \$25 bn sent largely into exchange traded funds."

In one sense, it is easy to intellectualize this course of action. Debt costs are extremely low and the Fed has committed itself to preventing any major disaster. Given these facts, and according to this logic, it is either silly or complacent to NOT leverage up and buy stocks. Indeed, record high margin debt indicates this is precisely what a number of market participants are doing.

Further, this isn't even really a decision for many participants; it is an automatic response. For managers that depend on gathering assets, managers in publicly owned companies that need to show increasing earnings, people worried they might get fired if they don't keep up, and large banks that can make more money buying market futures on their proprietary trading desks than from making loans, there isn't a decision to make. They have to participate. These groups create a self-reinforcing loop which feeds momentum and keeps stocks headed higher. Nothing much has changed in five years.

Of course an investor can take a different course of action by challenging the veracity of the Narrative of the "All powerful Fed". The logic behind this course of action is that Narratives are inherently fragile and eventually will crumble. Hunt clearly warns, "Still, the assignment of value to any symbolized asset [stocks in this case] is inherently a social construction and will inevitably change over time, occasionally in sharp and traumatic fashion."

It's hard to say what the proximate cause of a change in Narrative might be, but there are a lot of candidates. Higher interest rates could seize up a number of businesses and we have already seen this happen with residential mortgages. There are still plenty of opportunities for sovereign debt crises, Eurozone issues, and war erupting in Syria or any number of other places. In addition, something as mundane as an especially weak quarter of revenue or earnings growth could finally break the Narrative. When it does break, there is a long way for stocks to fall in order to reach attractive valuations.

Both paths have their challenges. If you follow the Narrative, you do fairly well for a while, but face ever increasing risks of significant losses at some indeterminate point in time. If you resist the Narrative, you wait some indeterminate period of time for the Narrative to break and then you need to be nimble enough to buy stocks cheaply during whatever window of opportunity presents itself afterwards.

Neither position is strikingly attractive. Both depend significantly on good timing which is virtually impossible to develop a reliable process around. Arete has opted for the latter largely because it is more amenable to valuation discipline.

Nonetheless, the Fed's policy of quantitative easing has certainly changed the nature of the investment proposition for everyone. As one strategist remarked, "There may be no buy and hold assets for the next ten years." If true, this would imply lower returns and higher risk — important variable changes for the retirement equation.

Although we don't follow other managers closely and certainly don't try to emulate their investment decisions, we do pay attention to a handful of managers for whom we have a great deal of professional respect in order to gain insights and perspective.

One of these, the hedge fund, Baupost Group, recently announced it was returning capital to investors by the end of the year. Baupost covers all major asset classes around the world and determined it didn't see enough attractive opportunities to invest capital its clients had already given it. This decision powerfully underscores the

many challenges in the current investment environment.

Performance review – Arete Mid Cap Core

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

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

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

Arete's Mid Cap Core (AMCC) strategy returned 3.41% (net of fees) for the quarter versus 7.70% for the Russell Midcap Index® (RMC) (see pages 11 - 13 for performance and related disclosures). As has often been the case over the past three years, the AMCC strategy tends to perform relatively well when the market prices in significant concerns, as it did in regards to tapering in the second quarter, and tends to underperform when concerns dissipate and momentum returns.

As we noted last quarter, there was very little in the best and worst stock performances for the quarter that reveal much about the stocks themselves. The best performer was Sears Holdings for which nothing has changed fundamentally. Some stories circulated regarding the value of Sears' real estate, but that has been well documented for several years.

Stock performance* (6/30/13 - 9/30/13)

Best performers

Company	Return in quarter (%)
Sears Holdings	41.4
Oshkosh Corp.	29.0
Capitalsource	26.7
Mylan Inc.	23.0
Foster Wheeler	21.3

Worst performers

Company	Return in quarter (%)
Dex Media	-53.8
NII Holdings	-8.9
Pepco Holdings	-8.4
Annaly Capital Management	-7.9
The Saint Joe Company	-6.8

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

Dex Media stood out among the worst performers. Although the company reported weak revenue growth for the

second quarter, part of the stock decline was simply a give back from being a top performer last quarter. Part of the decline also appeared to be caused by being a convenient short candidate in an environment of mainstream stocks levitating higher due to inflows to indexes and ETFs.

The remaining poor performers were all stocks that are sensitive to either interest rates, interest rate volatility, or both. These stocks performed poorly when the Fed announced the potential for tapering at the end of June, but did not benefit from the momentum trade after the prospect of tapering was downplayed.

It is useful to note that the AMCC typically performs very differently from the market during periods when momentum takes over. This was clearly the case in the third quarter when stocks rebounded sharply after their swoon in June. The main reason for this disparity is Arete's valuation discipline. The valuation discipline has caused the AMCC to have lower exposure to momentum stocks and a much greater cash position.

Similarly, there also seems to be a connection between the strength of the Narrative of the Fed and AMCC's relative performance. As such, we will be watching for indications of doubt about the omnipotence the Fed as a potential hint to better relative performance. The Fed's latest decision to avoid tapering in September seems to have damaged its credibility which could be one sign of change to come. Nonetheless, the period of quantitative easing has lasted far longer than we ever thought possible so we aren't necessarily forecasting imminent change on this front.

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, 2013

Period	Gross-of-Fees		Net-of-Fees		Russell Midcap®	Number of Portfolios**	Internal Dispersion (percent)	Total Composite Assets (\$)**	Composite Assets With Bundled Fees (\$)	Percentage of Composite Assets With Bundled Fees	Total Firm Assets (\$)
	Return (percent)	Return (percent)	Return (percent)	Return (percent)	Index Return (percent)						
2008*	-37.97	-38.16	-35.01	3	NA	207,031	207,031	100%	207,031		
2009	48.63	47.83	40.48	3	NA	471,867	471,867	100%	673,806		
2010	16.86	15.78	25.48	3	NA	546,315	546,315	100%	877,368		
2011	-8.20	-8.88	-1.55	3	NA	497,767	797,767	100%	897,918		
2012	15.20	13.84	17.28	4	NA	798,766	798,766	100%	897,341		
2013											
January	5.17	4.92	6.84	4	NA	838,074	838,074	100%	1,036,725		
February	0.28	0.28	1.41	4	NA	840,390	840,390	100%	1,038,478		
March	3.54	3.54	4.25	4	NA	870,137	870,137	100%	1,069,209		
April	1.27	1.03	1.28	4	NA	879,095	879,095	100%	1,081,449		
May	2.05	2.05	2.15	4	NA	897,114	897,114	100%	1,099,687		
June	-0.70	-0.70	-1.21	4	NA	890,790	890,790	100%	1,092,129		
July	3.07	2.83	5.80	4	NA	915,968	915,968	100%	1,117,887		
August	-2.66	-2.66	-2.66	4	NA	891,573	891,573	100%	1,090,838		
September	3.32	3.32	4.58	4	NA	921,138	921,138	100%	1,121,065		
Q1	9.20	8.94	12.96	4	NA	870,137	870,137	100%	1,069,209		
Q2	2.62	2.37	2.21	4	NA	890,790	890,790	100%	1,092,129		
Q3	3.65	3.41	7.70	4	NA	921,138	921,138	100%	1,121,065		
YTD	16.15	15.32	24.32	4	NA	921,138	921,138	100%	1,121,065		

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

**Note: One new account contributed additional funds which were not at least 90% invested by the end of the quarter.

Per our rules for inclusion, this account was excluded from the composite and will be added once the funds are fully invested.

Arete Asset Management Mid Cap Core performance composite disclosures follow:

Compliance statement

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

Definition of the firm

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

Arete 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. 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. 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.

Arete 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

Arete has not been verified by an independent verifier for its compliance with GIPS.