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THE ARETÉ QUARTERLY

Welcome

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

In order to stay apprised of our latest thinking on the investment landscape, please take a look at our blog [here]. Finally, please always feel free to contact us with questions or comments.

Business Update

As I have mentioned several times in Areté blog posts and most recently in the market overview for the third quarter [here], the landscape for investing has been transformed under the reign of massive and persistent monetary stimulus from central banks.

All of this has affected stock prices, but it has also affected the business of managing money in important ways. As Christopher Cole describes in a wonderful analysis of volatility [here], "The alpha from active management often comes down to two factors: (1) asset selection and (2) short volatility or short correlation exposure. When markets become more correlated, asset selection becomes increasingly irrelevant. The only thing that remains is the short volatility exposure."

And more correlated markets is exactly what has happened – partly as a result of central bank policies and partly as a function of strong money flows into passively managed funds. Regardless, the effect has been to temporarily deprive the market of what is normally a healthy array of opportunities for money managers to produce alpha by way of asset selection.

Denied of this conventional avenue of alpha generation, managers have instead been forced to allocate more attention to the "short volatility" channel. As long as markets are rising, it is very difficult for most managers to do anything other than be fully exposed to the market. As a practical matter, any significant reduction in exposure in this landscape, regardless of long term investment merits, runs the risk of losing clients. It's really not much of a choice at all.

Inside This Issue

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It is in the midst of such a dilemma for the money management industry that Areté really shows its independent colors. Unlike many of my peers, I have been unwilling to acquiesce to these challenges, and have responded to them with what amounts to three different initiatives.

One is to not give up on the the potential for asset selection, and more specifically, for valuation, to matter again. My belief is that because high correlations have persisted for so long, there are vanishingly few managers who retain deep institutional ability to incorporate valuation modeling.

As a result, when things turn (and I think they will since current conditions are unsustainable), there will be significant opportunities for those of us still around.

In order to prepare for this, I have further developed and built out Areté's in-house valuation modeling capabilities. This has been a big project but is finally coming into service. This effort serves to avoid stocks most subject to valuation risk during this period of strong market sentiment while also serving as a powerful means by which to exploit opportunities in the event of a downturn.

The second initiative has been to very deliberately reduce the Mid Cap Core's exposure to volatility selling by reducing overall exposure and by seeking out stocks with low correlations. This decision explicitly recognizes the increasing level of systemic risk in the market and expresses my sense of fiduciary duty to make the best investment calls I can in any given environment. This is really just another way of saying that I am not going to forsake the long term goal of attractive *absolute* returns for the purpose of trying to keep up with short term *relative* returns.

Conversely, many money managers simply cannot afford to exhibit the patience to make the better investment decision of avoiding volatility selling. Although a handful of managers may be able to successfully navigate this high risk/low reward game, the vast majority will not. It makes me wonder what these managers get paid for and I'm sure their clients will be wondering the same soon enough.

The third initiative was to launch the Personal CIO service, which I believe has great potential. In the event that volatility continues to remain suppressed and valuation elevated, there really is no useful purpose for conventional money management, per se. However, investment expertise can still be redirected in a way that is useful by highlighting sytemic risks and recommending alternatives. For many reasons, I believe few providers will be able to adapt in this way and even fewer who can do so on an a-la-carte, hourly basis.

Finally, there is no doubt that conditions have been tough on active managers the last several years. However, there is also no doubt that there has never been a greater need for objective investment expertise to help navigate an increasingly treacherous investment landscape. I founded Areté to do just that and look forward to the challenge.

Thanks for your interest and take care!

David Robertson, CFA
CEO, Portfolio Manager

Portfolio Characteristics – Areté Mid Cap Core

A key proposition for Areté's Mid Cap Core strategy is that it is a truly representative mid cap portfolio. In general, this suggests that over time, you can expect to see the aggregate characteristics and sector exposures of the strategy migrate to those of the Russell Midcap Index®. During intervening periods, however, sector exposures and other characteristics will reflect the opportunities we find in the market at that point in time.

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

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

All of that said, our overarching goal is to provide attractive returns to investors on an *absolute* basis. During most times, the stock market provides an attractive vehicle through which to realize those returns. In unique periods of significant overvaluation, however, when our valuation and other analyses suggest attractive returns are less likely, we may allow the cash portion of the portfolio to increase so as to preserve investors' capital and retain the option to buy more cheaply in the future.

Portfolio Characteristics (09/30/17)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	9,607	9,527
Median Market Cap ($ mil.)	6,723	7,195
Minimum Market Cap ($ mil.)	424	250
Maximum Market Cap ($ mil.)***	36,167	59,683
Number of holdings	18	783
Valuation		
P/E current year	28.1	25.5
P/B	3.0	5.3
P/S	1.5	2.5
Yield (%) ****	3.4	2.6
Valuation drivers		
ROE (%)****	5.9	10.4

Source: Calcbench
**Note:* Excludes positions which are less than 0.1% weights.
***Note*: Arete currently does not subscribe to the Russell Indexes and therefore the statistics presented here represent approximations of the Russell Midcap® Index.
****Note*: Stocks with low floats are excluded
*****Note*: The measure of ROE was changed from the average to the median as of 3/31/14.
*****Note:* Average of available yields

General portfolio characteristics for the quarter continue to confirm that the equity portion of AMCC is a representative mid cap portfolio. The average market cap for AMCC is very similar to the mid cap index and the median is a little lower. Although AMCC is much cheaper on the basis of P/S and P/B, it is important to note that valuation metrics have become less informative as the number of holdings has declined to just 18 currently.

As a note, we recently started using financial data provided by Calcbench. Historically we used data from our valuation vendor, Applied Finance Group. As a result, there may be some modest differences that cause imperfect comparisons.

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 fairly high but stable levels over the last several quarters.

Sector exposure (percent of assets on 09/30/17)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.8	14.2	5.6%
Consumer Staples	0.0	4.0	0.0%
Energy	0.0	5.8	0.0%
Financials	10.6	14.5	73.2%
Health Care	4.3	9.9	43.4%
Industrials	0.0	13.9	0.0%
Information Technology	1.4	15.7	8.9%
Materials	4.3	5.8	73.7%
Real Estate	5.9	9.7	61.1%
Telecommunications	0.0	0.5	0.0%
Utilities	3.3	6.1	54.1%
Equity exposure	30.6	100.0	
Cash and equivalent	69.6	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.

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.

Active share* (9/30/17)

Period	Percent**
Q317	95.2
Q217	94.9
Q117	96.0
Q416	96.3
Q316	96.3

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

Transactions review – Areté Mid Cap Core

We did not implement any transactions in the quarter. We continue to find most valuations excessive but are modestly encouraged by some recent instances of value starting to perform better.

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.

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.

Stock performance* (06/30/17 - 09/30/17)

Best performers

Company	Return in quarter (%)
NRG Energy	48.6
TD Ameritrade	13.5
Royal Gold	10.1
Seritage Growth Properties	9.8
Yamana Gold	9.1

Worst performers

Company	Return in quarter (%)
Mylan Inc.	-19.2
Sears Holdings	-17.6
Seagate Technology	-14.4
Lands End	-11.4
Davita	-8.3

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

Areté's Mid Cap Core (AMCC) strategy returned 0.69% (net of fees) for the quarter versus 3.47% for the Russell Midcap Index® (RMC) (see pages 7 – 9 for performance and related disclosures). AMCC continues to underperform when the market presses higher (due to its high cash position), but that cash also provides a significant buffer against material downside at a time when we view that downside potential as substantial.

Themes were again the dominant explanatory factor behind most individual stock performance, although that dominance was somewhat diminished this quarter. Rising rates and the belief in reflation spurred the advances in AMTD, SRG, RGLD and AUY and also probably explained most of the decline in DVA, which had been a beneficiary of an extended period of low rates. The top performer NRG, however, did that mainly on its own with the announcement of a transformation plan focusing on simplifying the portfolio and changing the focus of capital allocation. Improvements in the regulatory outlook also provided a boost.

On the downside, SHLD and LE continued to suffer from the fallout in the retail sector and the narrative that Amazon is going to destroy all bricks and mortar retail. Although Amazon is a strong competitor, we believe the imminent eradication of conventional retail is overdone. MYL was the worst performer in the portfolio on the news of increasing competition in generic drugs, delayed launches of major new products, and greater competition for its key product, Epi-pen. STX stock got clocked when its second quarter results inflamed pre-existing concerns about its competitive positioning in high capacity hard drives and its ability to grow revenues.

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

July 31, 2008 - September 30, 2017

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									
January	1.21	0.96	2.41	4	NA	955,884	955,884	100%	1,151,614
February	0.35	0.35	2.83	4	NA	959,248	959,248	100%	1,155,102
March	0.52	0.52	-0.16	4	NA	964,207	964,207	100%	1,160,504
April	-0.25	-0.49	0.77	4	NA	959,478	959,478	100%	1,155,546
May	-0.19	-0.19	0.91	4	NA	957,634	957,634	100%	1,153,535
June	0.78	0.78	0.99	4	NA	965,081	965,081	100%	1,161,186
July	0.91	0.66	1.47	4	NA	971,465	971,465	100%	1,168,565
August	-0.49	-0.49	-0.78	4	NA	966,677	966,677	100%	1,164,413
September	0.52	0.52	2.77	4	NA	971,749	971,749	100%	1,168,806
Q1	2.09	1.84	5.15	4	NA	964,207	964,207	100%	1,160,504
Q2	0.34	0.09	2.70	4	NA	965,081	965,081	100%	1,161,186
Q3	0.94	0.69	3.47	4	NA	971,749	971,749	100%	1,168,806
YTD	3.40	2.63	11.74	4	NA	971,749	971,749	100%	1,168,806

**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.

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.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

*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.

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.