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THE ARETÉ QUARTERLY

Welcome

The investment landscape is changing and so are the needs of investors — and Areté is here to help however we can. While we do actively manage stocks in our mid cap core strategy, we have also introduced a Personal CIO Service [here] in order to help investors who want access to our expertise on a more modular basis. In these services and any future ones, Areté will always focus on conducting good research, 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

It feels like we are on the cusp of major changes in the investment services industry. Of course one should always be cautious in making such a claim because the industry is notoriously reluctant to reform itself in substantive ways.

However — a wave of changes is coursing throughout society that is likely to pull a lot of things, including the investment services industry, along with it. Many institutions are being challenged like never before, and for good reason; they have failed to adapt to the changing needs of people. As a result, trust in many institutions is the lowest it has been in many decades. That record low level of trust is fomenting desire for meaningful change across many dimensions of society.

Inside This Issue

These trends were highlighted in recent coverage of the tenth anniversary of the finacial crisis of 2008. One of the key insights arising from the retrospectives is exactly how little has really changed. Exceptionally few financial executives went to jail for their misdeeds. Public policy doubled down on debt, which was the same tool that created the problems. Calls for a fiduciary rule for brokers has been deferred and diluted. In short, very little has changed in terms of how the industry operates.

One of the ways in which underlying desire for change has been meaningfully addressed, however, is in the area of investment research. Since the financial crisis in 2008, several people have created offerings that are independent, analytical and accessible to a wide audience. In short, they have been designed as antidotes to many of Wall Street's failings.

Among the new offerings, zerohedge, a financial blog, is one of the most prominent. Begun in 2009, it is regularly infused with insightful and deeply analytical research which often challenges conventional perspectives. While it can certainly lean in a conspiratorial direction at times, it is staunchly independent and widely recognized as a top investment site. The fact that Bank of America actually blocked employee access to the site after several critical posts indicates both the politicized nature of financial information and zerohedge's role as a useful alternative.

Another new offering is *RealVision* which was founded by industry veterans Grant Williams and Raoul Pal. The two came up with the idea because they "realized the media had let people down and the banks had let people down." They believed that existing sources of financial information "just didn't want to tell people the bad things were out there and that they should pay attention."

The results make it pretty clear that these relatively new efforts have hit on something that investors want. For example, zerohedge.com enjoys 37.7 million sessions per month as of August 2018, according to wikipedia [here], and is regularly featured as a top investment site. Further, the success of *Realvision* was highlighted in a *New York Times* story [here].

It seems to me that a big part of what these "alternative" sources of research are providing is credible and high quality research. In other words, they are trustworthy in ways that so much Wall Street research is not. I think there are a lot of different trends that are affecting this, but it is analogous to the trends towards "craft" and "local" in food, beer, spirits and many other products and services. Interestingly, in many of these cases, quality is associated with smaller "craft" names *because* they are small, not *in spite* the fact that they are small.

While I highlight zerohedge and *Realvision* as being two of the more prominent providers of alternative research, they are emblematic of an increasingly long list of researchers who are doing the same thing: They are all trying to do investment research in a way that is different and better and ultimately more useful to investors.

Fortunately, Areté has also been able to share in this success. I recently started distributing Areté blog posts to the investment site realinvestmentadvice.com and in doing so enjoyed an increase in readership from hundreds to thousands. Further, the most recent posts were also picked up by zerohedge and when that happened, readership increased from thousands to tens of thousands.

In addition, I was also very pleased to learn that the posts have been performing well on the Financial Advisor IQ Think Tank repository of investment research. The site targets financial advisors and attracts over 100,000 visitors per month. It also accredits research for continuing education for Certified Financial Planners (CFPs). I was especially pleased to learn that Areté had topped the Think Tank leaderboard for engagement in September.

I take several messages from these accomplishments, all of which are very positive. First and foremost is that the content is useful and valuable. Of course Areté's investors always have access to this content and can follow up on it with me at any time. Nonetheless, it is good to know that it also has much broader appeal. Related is the message that Areté can compete with the biggest and best financed investment companies in the world for quality research.

Finally, the content is resonating with exactly the right people — individual investors and conscientious advisors — the people who care most about what actually happens with the investments because they have skin in the game.

I also suspect the positive reception is due at least partly to the approach I take with investment commentary. It is NOT about peppering people with more facts. I think they are overwhelmed already.

Rather, I make a deliberate attempt to make things easier. I do that by distilling the many elements of the investment landscape and synthesizing them into understandable narratives about what it means. I firmly believe that there is a lot of great research out there, but precious little of it combines deep insight into a an accessible narrative that most investors can easily grasp.

So these very positive things have been happening with investment research, but elsewhere little else has really changed in terms of how investment services get delivered. In my opinion, whatever broad-based energy existed for fundamental change in the immediate aftermath of the financial crisis quickly dissipated as the market continued its upward march behind the power of continued quantitative easing.

Now with rates rising and the Fed's balance sheet shrinking, it seems to be just a matter of time before the market's run gets interrupted. When it does, not only will it (finally) provide opportunities to buy undervalued stocks, but it will also reveal a lot of unhealed wounds from the financial crisis. Demands for change will be reawakened and investors will (finally) push for investment services that are better and more efficiently delivered. All of this has the potential to be enormously beneficial to Areté and its investors.

In the meantime, I am always interested in talking to people who have similar interests in creating investment services that do a better job of serving investors. If you have any suggestions for me or know of someone I should get in contact with, please let me know. I strongly suspect there is a lot of potential in brainstorming and leveraging resources. Let's see what we might be able to accomplish together!

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.

Portfolio Characteristics (9/30/18)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	9,993	10,723
Median Market Cap ($ mil.)	5,037	8,400
Minimum Market Cap ($ mil.)	106	311
Maximum Market Cap ($ mil.)***	42,171	74,588
Number of holdings	19	789
Valuation		
P/E current year	21.1	26.9
P/B	2.6	5.4
P/S	1.5	2.8
Yield (%) ****	3.7	2.5
Valuation drivers		
ROE (%)****	9.5	11.3

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

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

General portfolio characteristics for the quarter continue to confirm that the equity portion of AMCC is a representative mid cap portfolio. The average market cap for AMCC is very similar to the mid cap index and the median is 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 19 currently.

Sector exposure (percent of assets on 9/30/18)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.4	14.0	2.8%
Consumer Staples	0.0	4.1	0.0%
Energy	0.0	5.1	0.0%
Financials	8.8	13.1	67.2%
Health Care	5.0	10.3	48.5%
Industrials	0.0	14.2	0.0%
Information Technology	1.9	19.2	9.9%
Materials	4.7	5.1	92.5%
Real Estate	7.0	8.4	83.7%
Telecommunications	0.0	0.5	0.0%
Utilities	4.3	6.0	71.4%
Equity exposure	32.1	100.0	
Cash and equivalent	67.9	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.

Sector exposures are quite different from benchmark weights, in part due to the high cash position but in part due to different exposures. Cash has remained at high but stable levels over the last several quarters.

Active share* (6/30/18)

Period	Percent**
Q218	96.4
Q118	94.9
Q417	95.0
Q317	95.2
Q217	94.9

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

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.

Transactions review – Areté Mid Cap Core

The only transaction made in the quarter was to fill out the position in the cash proxy, CLTL. Increasingly attractive short-term rates increase the opportunity cost of holding cash and with broadly excessive market valuations, there are not enough immediate prospects for purchase to warrant foregoing those higher rates.

Performance review – Areté Mid Cap Core

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

Stock performance* (6/30/18 - 9/30/18)

Best performers

Company	Return in quarter (%)
NRG Energy	21.8
Seritage Growth Properties	11.9
Owens Illinois	11.8
Investment Technology Group	3.5
Davita	3.2

Worst performers

Company	Return in quarter (%)
Sears Holdings	-59.2
Lands End	-37.1
Royal Gold	-17.0
Seagate Technology	-16.2
Yamana Gold	-14.1

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

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

Our target of 200-400 basis points of outperformance is based upon our experience with the strategy and upon our judgment of value creation. Our goal is to outperform by a large enough margin relative to risk to clearly merit the cost in time and resources to evaluate investing with us.

Areté's Mid Cap Core (AMCC) strategy returned -0.85% (net of fees) for the quarter versus 5.00% for the Russell Midcap Index® (RMC) (see pages 8 – 10 for performance and related disclosures). Although the defensive positioning of AMCC was especially noticeable in contrast to the significant appreciation in the Russell midcap index in the quarter, we continue to believe that substantial risk is embedded in current stock prices for long-term investors.

Among outperformers, NRG was the strongest on the back of rising energy prices. SRG was boosted when they sealed a $2.0 billion term loan facility with Berkshire Hathaway. Not only did the facility provide them with useful access to capital but it also enhanced credibility. OI rose due to strong operational performance and indications of activist interest. The moves in ITG and DVA were not especially noteworthy. Interestingly, outperformance had more to do with company-specific happenings than broad trends for a change.

SHLD led the list of underperformers as the company failed to realize the benefit of increasing wages and liquidity concerns increased even further. LE has been extremely volatile and after popping on strong first quarter results, dropped on poor second quarter results. Both RGLD and AUY suffered from overal weakness in gold stocks which was the mirror reflection of a strong US dollar and strong markets more than anything. STX dropped on some negative comments from the sell-side.

Investment Philosophy

We firmly believe in the critical importance of a cogent investment philosophy for any investment operation. In order to emphasize this point, and to assist you in understanding how we work, we provide an abbreviated version of our investment philosophy here. The text of our investment philosophy is also provided, in its entirety, in our Form ADV, Part II which is available upon request at any time.

Performance derives from exploiting mispriced securities.

The key to investment performance is finding and exploiting market inefficiencies in the form of mispriced securities. There are two components to this. One component involves determining the fair price of securities in the form of underlying intrinsic value, which we do primarily through calculating discounted cash flows.

The second component of exploiting mispriced securities is establishing a clear understanding as to the various mechanisms at work that allow mispricing to occur. By understanding the mechanisms and motivations of the marginal buyer and seller, we believe we can more accurately estimate the probabilities and expected values of investment opportunities.

Nobody has perfect information.

Competitive pressure and technological development have conspired over the years to make most data and analysis commodities which no longer provide a meaningful competitive advantage. What can provide an advantage, however, is *how* that information is used and *how* it gets interpreted in making investment decisions.

In order to convert the raw material of information into the useful output of a good investment decision, it is necessary to assimilate and synthesize the information into some meaningful form. We believe the most effective way to accomplish this is to thoughtfully deploy resources available according to the nature of the research tasks at hand.

Research culture and research prioritization are also important in relation to analyzing and synthesizing information. We believe that the best way to leverage the collective knowledge and experience of a research team is to encourage active and open dialogue designed to explore multiple perspectives and to challenge individual assumptions, biases, and beliefs. Only by enduring such scrutiny do the best ideas rise to the top. Further, in order to fully leverage these ideas, we believe research efforts must be dynamic and flexible in allocating resources such that ideas receive attention in proportion to the expected benefit to the portfolio.

Execution is crucial for investment success.

In order to create value, an investment strategy needs to be implemented continuously and comprehensively. Actions speak louder than words. We believe the most effective efforts focus on a few simple, but key concepts that work to ensure proper execution of a firm's investment strategy.

The first key to execution is structural in nature and involves a firm's independence. By maintaining independent ownership, an investment firm eliminates agency effects which can present a conflict of interest between clients and certain of its ownership groups. Independent ownership ensures that client and manager interests are optimally aligned.

The second key to execution is temperament. The best investors tend to have a temperament that provides them the courage and initiative to act, often going against the grain, when opportunities arise. However, the same temperament provides balance such that decision-making is not simply a risk-taking activity, but a very conscious and targeted effort to engage in propositions with high risk-adjusted expected returns.

Finally, another important element of execution is simply doing what you say you do in your investment process. Too often, perfectly acceptable investment processes fail when actual investment activities bear little resemblance to the process described in the marketing presentation. We call this the “marketing gap;” the difference between what is said and what is done. Execution is optimized when the marketing gap is minimized.

Areté Mid Cap Core Composite

Arete Asset Management, LLC
Mid Cap Core Composite
July 31, 2008 - September 30, 2018

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									
January	1.55	1.30	3.76	4	NA	997,473	997,473	100%	1,194,573
February	-1.60	-1.60	-4.13	4	NA	981,536	981,536	100%	1,177,451
March	0.74	0.74	0.06	4	NA	988,813	988,813	100%	1,185,130
April	-0.07	-0.32	-0.15	4	NA	985,649	985,649	100%	1,182,360
May	1.06	1.06	2.27	4	NA	996,142	996,142	100%	1,193,657
June	0.01	0.01	0.69	4	NA	996,192	996,192	100%	1,194,502
July	0.15	-0.10	2.49	4	NA	995,220	995,220	100%	1,193,658
August	0.19	0.19	3.11	4	NA	997,062	997,062	100%	1,195,225
September	-1.18	-1.18	-0.64	4	NA	985,289	985,289	100%	1,182,831
Q1	0.67	0.42	-0.46	4	NA	988,813	988,813	100%	1,185,130
Q2	1.00	0.75	2.82	4	NA	996,192	996,192	100%	1,194,502
Q3	-0.85	-1.09	5.00	4	NA	985,289	985,289	100%	1,182,831
YTD	0.81	0.07	7.46	4	NA	985,289	985,289	100%	1,182,831

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.

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.