Third quarter 2023
Volume 16, Issue 3

THE ARETÉ QUARTERLY

Welcome

As it becomes progressively more apparent that the investment landscape presents unique challenges, it is also becoming progressively more apparent that conventional investment approaches are not sufficient for meeting those challenges.

Areté is a unique organization for unique times. With an orientation to research and analysis, these activities are applied for the purpose of solving problems and helping investors do the best they can. Each investment decision and communication is made with the mindset of having skin in the game.

If you are interested in getting more insightful analysis and/or a different perspective, please take a look at the blog [here]. Content for the posts is selected and created on the basis of being important, relevant, and useful.

In addition, *Observations by David Robertson* provides a weekly collection of insights and analysis that are intended to be especially relevant for long-term investors. You can find the letters on the substack platform at: https://abetterwaytoinvest.substack.com

Finally, please always feel free to reach out with questions or comments. A big part of why I founded Areté was to be better able to help investors. Let's see if I can help you!

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Business Update

One of the painful lessons of being a research-focused, valuation-based investor in the decade and a half after the GFC is it didn't matter. Actually it did matter; having those traits was a distinct disadvantage in a market flooded with liquidity and one the Fed was determined to support. The more you tried to invest prudently, the more you fell behind.

The number and type of hedge fund closures was also remarkable. The vast majority of investment luminaries I respected and followed shut down, sold out, or converted to a family office. There just wasn't a business, or at least not a good business, in doing the hard fundamental work of investing.

After the pandemic, things changed. A big swoon followed by a big recovery followed the same basic playbook involving Fed support, but it also unleashed inflation. Even more importantly, an inflationary mindset was unleashed. Everybody knew

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that everybody knew that prices were going up.

This has fundamentally changed the constraints on the Fed, and as a result, it has changed the entire complexion of the investment – and investment advisory - landscape.

Inflation is bad for bonds and bad for multiples on stocks. It is also poses a serious challenge to a large group of investors who have become habituated to investing in a very low rate environment. Now, all the rules and heuristics that worked so well from 2009 through 2021 are no longer working with any consistency.

The other side of that coin is things are getting so much more interesting (and rewarding!) for those of us who still have the skills and muscle memory to do good old fashioned investment analysis. It's funny how a little adversity can change the game!

It is also personally gratifying to be able to help clients navigate what is by most standards an extremely difficult investment environment. I founded Areté to help people achieve better investment outcomes – and it's nice to be in a position to do that!

Finally, if you ever have questions, or want to follow up on something, you can always reach me at drobertson@areteam.com.

Thanks for your support!

David Robertson, CFA
CEO and founder, Areté Asset Management

Asset Allocation

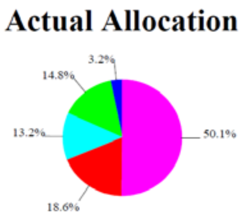
The most important differentials between the current allocation and long-term target allocation are the extremely low weight in stocks and the extremely high weight in cash. While fixed income has become less unappealing as long-term yields have risen, it has yet to appear more compelling than cash. The low allocation to stocks reflects extremely high valuations and therefore extremely low expected returns.

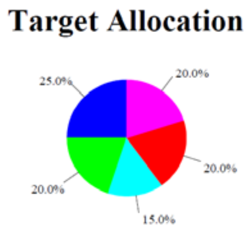
As a clarification, the strategy does also hold stocks outside of the "Stocks" category. Stocks are only included in the "Stocks" category if they move broadly in line with major stock indexes like the S&P 500. Gold stocks, for example, are not included in the "Stocks" category because gold prices have a much greater impact on these stocks than whatever happens with the S&P 500.

Interestingly, as longer-term yields jumped up in the quarter, a couple of the design features of the All-Terrain strategy really proved themselves. First, the higher yields, which drove higher real yields, caused gold stocks to underperform. PFIX, the interest rate hedge, and CTA, the commodity trend fund, were both up, however, which provided strong diversification.

In addition, PFIX was a star performer by rising over 50% in the quarter. The PFIX fund was designed to do well in the event longer-term interest rates went up. They did, and it did. PFIX is unique in that the fund just came into existence about two and a half years ago. It also provided an expression of a phenomenon (rising longer-term interest rates) that would have been inaccessible to the old mid-cap strategy.

The chart below refelcts a representative account from the All-Terrain composite.





As a reminder, the easiest way to think about the strategic priorities of the All-Terrain strategy is as an effort to get the most out of the valid market opportunities that exist. In other words, it is more about finding attractive assets and creating thoughtful diversification than about speculating which hot stock might do well.

The main efforts continue to be avoiding assets that depend on leverage or structured finance and to find ideas that can perform well independently of what the major stock indexes do.

While that did not work in the second quarter, it worked quite well in the third quarter. The liquidity drain from increased Treasury supply, or the prospect thereof, did finally "become noticeable" in the form of rising longer-term interest rates, just as described in last quarter's report.

A couple of lessons can be taken from this. For one, the rapid rise in rates gives an indication of just how many investors were "offsides", i.e., poorly positioned. For another, it is an indication of how poorly some large chunks of money have been reading the economic and financial tea leaves.

Transactions review

Once again, there were no transactions in the quarter.

Performance review

With the All-Terrain strategy now being the sole focus, here are some of the general principles that guide its management.

The search for undervalued assets remains the same, although the scope of that search expands now encompasses a broad universe of publicly traded securities and funds.

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

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

For the first quarter, the ATA strategy returned 2.50% (net of fees) while VBIAX returned -3.24%. VBIAX was driven by weak equity performance but also by just as weak bond performance.

The large cash postion of the All-Terrain strategy and extremely low exposure to stocks and no exposure to bonds were key drivers of relative performance. Both factors contributed to the avoidance of negative results in the quarter.

In addition, while gold stocks were down, PFIX, the interest rate hedge ETF, was up over 50% on the basis of higher long-term yields and higher bond volatility.

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.

Asset allocation is a key funciton of wealth management

One of the most important functions for long-term wealth accumulation is to have access to certain asset classes when they are attractive and to be able to minimize exposure to other asset classes when they are extremely unattractive. In short, diversification moderates the long-term swings in portfolio performance and therefore significantly increases the chances of wealth accumulation over a reasonably long investment horizon.

Mispriced assets are an important source of performance

One of the keys to investment performance is finding and exploiting market inefficiencies. While such inefficiencies can arise in the form of mispriced securities, they can also arise in the form of over- or under-valued industries or asset classes.

Identifying such opportunities begins with the assessment of underlying intrinsic value. When disparities with market prices exist and clear rationale for such mispricing can be identified, there are opportunities to take advantage of the differential.

Information management is a core skill of investment management

Analyzing investment opportunities and developing portfolio construction is a dynamic exercise that involves a constant and ongoing process of gathering information, processing it, analyzing it, developing knowledge, and applying it for the benefit of clients.

Execution is crucial for investment success.

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

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

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

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

Areté All-Terrain Composite

Arete Asset Management, LLC
All Terrain Composite
August 31, 2021 - September 30, 2023

Period	Gross-of-Fees Return (percent)	Net-of-Fees Return (percent)	Vanguard balanced Index Fund (percent)	Number of Portfolios	Internal Dispersion (percent)	Total Composite Assets ($)	Composite Assets With Bundled Fees ($)	Percentage of Composite Assets With Bundled Fees	Total Firm Assets ($)
2021	0.06	-0.20	2.22	3	NA	841,887	841,887	100%	1,460,255
2022	3.26	2.26	-16.89	5	NA	1,491,824	1,491,824	100%	1,778,478
2023									
January	1.01	0.78	5.42	5	NA	1,503,449	1,503,449	100%	1,792,950
February	-0.85	-0.85	-2.43	5	NA	1,490,656	1,490,656	100%	1,776,620
March	0.23	0.23	2.65	5	NA	1,494,119	1,494,119	100%	1,783,954
April	1.56	1.31	0.87	5	NA	1,513,680	1,513,680	100%	1,807,935
May	-1.40	-1.40	-0.20	5	NA	1,492,481	1,492,481	100%	1,781,468
June	-0.09	-0.09	3.93	5	NA	1,491,165	1,491,165	100%	1,778,368
July	2.34	2.09	2.13	5	NA	1,522,308	1,522,308	100%	1,814,888
August	-0.71	-0.71	-1.43	5	NA	1,511,496	1,511,496	100%	2,411,817
September	1.12	1.12	-3.89	5	NA	1,528,463	1,528,463	100%	2,443,315
Q1	0.38	0.15	5.59	5	NA	1,494,119	1,494,119	100%	1,783,954
Q2	0.05	-0.20	4.63	5	NA	1,491,165	1,491,165	100%	1,778,368
Q3	2.75	2.50	-3.24	5	NA	1,528,463	1,528,463	100%	2,443,315
YTD	3.19	2.45	6.89	5	NA	1,528,463	1,528,463	100%	2,443,315

Areté Asset Management All-Terrain performance composite disclosures follow:

Definition of the firm

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

Areté Asset Management All-Terrain performance composite disclosures continued:

Benchmark

The benchmark is the Vanguard Balanced Index Fund Admiral Shares (VBIAX), 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 All-Terrain allocation strategy composite was created in August 2021 and includes all fee-paying, taxable and non-taxable, discretionary, long only, fully invested portfolios benchmarked to the Vanguard Balanced Index Fund. 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" when it breaches the threshold of 90% similarity with core composite portfolios. Each portfolio will remain in the composite until its similarity with core composite portfolios falls under 90%. 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.

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.

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Areté Asset Management All-Terrain performance composite disclosures continued:

Verification
Areté has not been verified by an independent verifier.