

THE ARETÉ QUARTERLY

Welcome

The investment landscape continues to evolve and as it does, fresh approaches are needed in order for investors to be able to derive the greatest benefit at the lowest cost. At Areté we are constantly challenging conventions, leveraging technology and creatively seeking new solutions such that investors have the greatest chance possible to get ahead. Please take a look at our blog [\[here\]](#) where we regularly post our thoughts and also please always feel free to contact us with questions or comments.

Business Update

As most of you know, valuation has always been a core focus of efforts and a core area of expertise given Areté's value-oriented investment philosophy. As a result, it was a big decision to terminate a relationship with a vendor last year that provided a valuation model and to bring that functionality in-house.

As with anything that plays such central role in activities, it was a hard decision at first. Many things would have to change and it would take work to evaluate and incorporate new alternatives.

While there is still work to be done, things are progressing nicely. One of the most valuable aspects of the old relationship was the access to data - not just for valuation but for portfolio analysis and reporting as well. This is one, area, however where

tremendous progress is being made by a number of startups working with XBRL data.

For those not familiar with XBRL, it is the data tagging protocol implemented by the SEC in 2009 for public companies. One of the most important aspects of XBRL is that it is cheap. The actual data is free to consumers since reporting companies produce it. The only cost is to access the raw data in a user-friendly format which a number of providers are starting to do.

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As a result, the total cost to access corporate financial data through XBRL is almost an order of magnitude lower than it is through historical methods from legacy providers. In addition, data accessed through XBRL is typically available within minutes of its being filed with the SEC.

When I first started researching different providers, my biggest concern was that data quality may not be as good. What I have found through my own tests is that there were initially some data issues, but that they have been substantially cleared up. The data now is actually quite good.

A bit of investigative work revealed why the high data quality shouldn't be much of a surprise. Since a large chunk of companies outsource the tagging to the big accounting firms, the numbers are subject to an array of standardized quality checking processes that highlight anomalies and correct errors.

Areté's current provider of financial data is Calcbench and they provide yet another benefit; they make sure each of the data items it reports are traceable to the SEC document where it was reported. As a result, there is absolutely no mystery about the numbers.

By contrast, some other providers are not nearly so transparent. While some of those providers try to "add value" to the underlying data by making adjustments to better reflect operating numbers, it can be difficult or impossible to reconcile "operating numbers" to anything in the reported financial statements.

While such efforts are standard analytical fare and laudable as such, they also expose consumers of the data to risks. Without being able to easily and regularly audit the data, it is virtually impossible to monitor the quality of the key input (i.e., data) to any valuation model. The risk is, "garbage in, garbage out."

Regardless, now that I have much more control over the data, and as the XBRL ecosystem continues to get built out, it is now also becoming clear that there is a long runway for continued improvement. One effort in particular will be exploring ways to combine XBRL's cheap access to data with our analytical expertise in order to provide useful, data-driven insights for investors.

Finally, with the valuation model work in progress and as a purveyor of good old fashioned security analysis, I am encouraged by what seems to be a shift in the market back to a valuation focus after several years. If that holds, it may be a nearly perfect time to be stocking up Areté's analytical toolkit!

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 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.

Portfolio Characteristics (12/31/16)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap (\$ mil.)	8,341	8,629
Median Market Cap (\$ mil.)	3,997	6,544
Minimum Market Cap (\$ mil.)	485	430
Maximum Market Cap (\$ mil.)***	32,767	57,586
Number of holdings	20	796
Valuation		
P/E current year	22.9	23.8
P/B	2.8	4.4
P/S	1.1	2.2
Yield (%)****	3.7	2.8
Valuation drivers		
ROE (%)****	8.2	10.8

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 cheaper in the future.

General portfolio characteristics for the quarter continue to confirm that the equity portion of AMCC is a representative mid cap portfolio. Market caps for AMCC are fairly similar to the mid cap index although the median is now considerably smaller. AMCC is considerably cheaper on the bases of Price-book and Price-sales which tend to be more stable metrics.

Sector exposure (percent of assets on 12/31/16)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.9	15.2	5.9%
Consumer Staples	0.0	5.0	0.0%
Energy	0.0	6.5	0.0%
Financials	11.0	13.5	81.6%
Health Care	4.9	9.0	54.6%
Industrials	3.3	13.6	24.2%
Information Technology	1.6	14.6	10.9%
Materials	3.6	5.7	63.5%
Real Estate	5.2	9.8	52.9%
Telecommunications	0.0	1.0	0.0%
Utilities	2.7	6.1	44.5%
Equity exposure	33.2	100.0	
Cash and equivalent	66.8	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 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.

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* (12/31/16)

Period	Percent**
Q316	96.3
Q216	96.3
Q216	96.1
Q116	96.2
Q415	96.6

*Note: Computed for AMCC composite

**Note: Active share > 80% is considered "very active"

Transactions review – Areté Mid Cap Core

Once again there were no transactions in the quarter. With prices continuing to rise after the election in the fourth quarter, our discipline suggests we will be more inclined to further reduce holdings than to add to them in the immediately foreseeable future.

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.

Areté's Mid Cap Core (AMCC) strategy returned -.53% (net of fees) for the quarter versus 3.21% for the Russell Midcap Index® (RMC) (see pages 7 - 9 for performance and related disclosures). AMCC continues to underperform when the market races higher (due to its high cash position), but that cash also provides a significant buffer against material downside.

Broad market trends continued to dominate performance relative to stock-specific developments, although many of the trends

changed after the election. Financials such as AMTD, CFFN and ITG were beneficiaries of the market's recalibration of interest rates. OSK benefitted from newly optimistic views about infrastructure and defense spending as well as the potential for lower US tax rates. Finally, NRG gained on the spike in natural gas prices in the fourth quarter.

Both of the gold holdings, AUY and RGLD, performed poorly in the quarter driven by lower gold prices and partly as a correction after a very strong start to the year. SHLD suffered from a very difficult retail environment in the quarter which was exacerbated by its own credit concerns. We will be watching this closely. SRG declined partly due to its association with SHLD, and partly due to the prospect for higher rates.

Stock performance* (9/30/16 - 12/31/16)

Best performers

Company	Return in quarter (%)
TD Ameritrade	23.7
Capitol Federal Financial	17.0
Oshkosh Corp	15.4
Investment Technology Group	15.2
NRG Energy	9.4

Worst performers

Company	Return in quarter (%)
Yamana Gold	-34.8
Genworth Financial	-23.2
Sears Holdings	-18.9
Royal Gold	-18.2
Seritage Growth Properties	-15.7

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

Once again, GNW made the list of worst performers - and for reasons both broad-based and company-specific. Part of the decline was give-back after a strong third

quarter run and part was the net effect of poor third quarter results which revealed additional charges being taken and a clear indication that the long-term care business has not yet been stabilized.

These effects were offset by an acquisition offer from China Oceanwide for \$5.43 per share. Despite being a cash offer, the stock fell after the announcement reflecting the considerable hurdles to overcome in completing the deal and the incremental erosion in business and financial condition. The proposition for the stock has clearly changed and can no longer be considered a long-term holding.

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 - December 31, 2016

Period	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 (\$)
	Gross-of-Fees Return (percent)	Net-of-Fees 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	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									
January	-3.21	-3.46	-6.55	4	NA	887,219	887,219	100%	1,172,245
February	1.48	1.48	1.13	4	NA	900,330	900,330	100%	1,188,694
March	3.60	3.60	8.19	4	NA	932,773	932,773	100%	1,223,729
April	1.43	1.18	1.06	4	NA	943,800	943,800	100%	1,238,672
May	-0.57	-0.57	1.64	4	NA	938,449	938,449	100%	1,230,777
June	0.59	0.59	0.46	4	NA	944,009	944,009	100%	1,238,757
July	2.16	1.92	4.57	4	NA	962,120	962,120	100%	1,259,212
August	-1.87	-1.87	-0.25	4	NA	944,144	944,144	100%	1,238,454
September	0.82	0.82	0.20	4	NA	951,865	951,865	100%	1,247,116
October	-2.05	-2.30	-3.17	4	NA	929,989	929,989	100%	1,222,809
November	2.43	2.43	5.39	4	NA	952,581	952,581	100%	1,246,338
December	-0.60	-0.60	1.14	4	NA	946,825	946,825	100%	1,142,297
Q1	1.76	1.49	2.24	4	NA	932,773	932,773	100%	1,223,729
Q2	1.46	1.20	3.18	4	NA	944,009	944,009	100%	1,238,757
Q3	1.08	0.83	4.52	4	NA	951,865	951,865	100%	1,247,116
Q4	-0.28	-0.53	3.21	4	NA	946,825	946,825	100%	1,142,297
YTD	4.07	3.02	13.80	4	NA	946,825	946,825	100%	1,142,297

*Note: Performance 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®).

Areté Asset Management Mid Cap Core performance composite disclosures continued:**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.

*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.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

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.