Fourth quarter 2023
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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!

Inside This Issue

Business Update

Russell Clark ($) described in a recent Substack post, "Fund management is about two different things - making money and raising money." While he is mainly talking about the hedge fund business, the statement still provides useful perspective from which to assess other investment propositions.

The "raising money" part essentially boils down to solving an investment problem for a certain group of investors. In the hedge fund world this can include strategies like short selling, various arbitrage strategies, and carry trading. Each of these can help diversify large portfolios and can also provide their own return streams.

The proposition for individual investors has always been far more pedestrian. Way back in the day, brokers simply provided access to financial assets. Since then, discount brokers, internet trading, and mobile apps have simply advanced the same basic proposition: improving access.

On the product side, mutual funds provided access to professional managers and the potential for better diversification, but costs tended to be high and performance unexceptional. Since then, index funds have helped trim excess costs, but have done nothing to help on performance.

The disproportionate focus on "raising money" vs. "making money" for retail investment services is often under-appreciated because performance hasn't mattered much for the last forty-some years. Healthy global growth and declining interest rates ensured all financial assets did exceptionally well. Success was not so much a function of outperforming as simply being there.

I bring all this up because I think this is about to change in a pretty significant way. Now that the seeds of inflation are planted, the Fed has a lot less flexibility to maintain "super-abundant" reserves. Less liquidity – and less tailwind for stocks. Given extremely high valuations, stocks have a long way to fall before looking cheap.

In addition, the vast majority of financial assets are highly correlated with stocks. That means not only is the return on stocks likely to be much lower in future years, but it won't be easy to find truly diversifying return streams either.

So, I think investors are right on the threshold of having a big investment problem to solve: How do you generate decent returns and establish effective diversification in an environment where nearly all the winds are blowing in your face?

The answer isn't that hard in a sense; it involves doing something very different than what got you to this place. More specifically, it involves recognizing all the flaws in the standard 60/40 approach and correcting for them. For one, it involves a more selective approach to stocks that mitigates the valuation risk of major indexes. It also addresses the risk inflation poses to fixed income investments. Finally, it reaches beyond conventional asset classes to incorporate truly diversifying assets. In short, it involves all the things I have done in developing the All-Terrain strategy.

I am increasingly convinced that the main investment problem for most investors is going to be "making money", i.e., generating sufficient returns. Simple access to risk exposure ain't gonna cut it any more. As the problem of lower returns becomes increasingly evident, I expect my proposition to become much more appealing. Or, as Clark puts it, "the investment case is also the business case".

I expect the appeal to be broad-based. It will be appealing to older investors who have done well with their investments but are nervous about losing what they have accumulated. It will be appealing to people who are still working but have only a tenuous hold on funding their retirement. It will also be appealing to younger investors who have been alienated by a financial system and a financial services industry that doesn't work for them. Moreover, this will be especially appealing to do-it-yourselfers who discover investing is a lot harder than they thought.

I expect the transition to a more difficult investment environment to transpire over years and quite possibly decades. As result, there should be some really nice tailwinds for Areté's business.

If you have any questions about what I do or just want to learn more about the All-Terrain strategy, please reach me at drobertson@areteam.com. I look forward to it!

Thanks for your support!

David Robertson, CFA
CEO and founder, Areté Asset Management

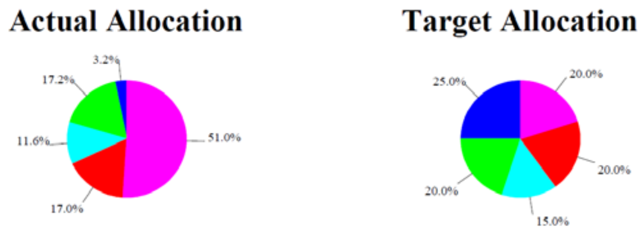
Asset Allocation

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.

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



The main effort continues to be establishing an allocation very different from the conventional 60/40 (stocks/bonds) strategy. The rationale is neither stocks nor bonds are attractive for long-term investors at this point.

That being the case, cash is essentially the benchmark for any new investment. That explains the large allocation. With the prospect of cash yields coming down this year, however, the pipeline is actively being filled with stocks and funds that can benefit from rising prices and/or decent economic growth.

It is also a continuing priority to *avoid* assets that depend on leverage or structured finance as well as assets that seem to be targets for speculation.

The main macro theme remains higher inflation (longer-term) and therefore also higher long rates. This has mainly been right but has not affected major stock indexes meaningfully yet.

Transactions review

The only transaction in the quarter was an addition to the PFIX interest rate hedge position. A relatively large distribution was made at the end of the year which significantly reduced the size of the position. The transaction served to restore and slightly increase the prior weight.

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 fourth quarter, the ATA strategy returned -0.20% (net of fees) while VBIAX returned 9.98%. It was a blowout quarter for VBIAX which was driven by falling inflation expectations and expectations of looser monetary policy by the Fed.

The All-Terrain strategy was essentially flat in the quarter due to its large cash position and avoidance of highly speculative stocks. One of the key features (and benefits!) of the All-Terrain strategy is its lack of correlation with the conventional 60/40 strategy. While this positioning has generally served it well, it does work in reverse when there is a strong risk-on move in markets as there was in the fourth quarter.

Holdings performance was the mirror image of the third quarter. Gold stocks rallied and PFIX, the interest rate hedge ETF, was down over 20%, giving up some of its third quarter gains.

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 - December 31, 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
October	0.58	0.37	-2.18	6	NA	2,452,696	2,452,696	100%	2,452,696
November	-0.17	-0.17	7.40	6	NA	2,448,551	2,448,551	100%	2,448,551
December	-0.41	-0.41	4.69	6	NA	2,438,542	2,438,542	100%	2,438,542
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
Q4	0.00	-0.20	9.98	6	NA	2,438,542	2,438,542	100%	2,438,542
YTD	3.19	2.24	17.56	6	NA	2,438,542	2,438,542	100%	2,438,542

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.

Benchmark

The benchmark is the Vanguard Balanced Index Fund Admiral Shares (VBIAX), and its performance is reported in U.S. dollars.

Areté Asset Management All-Terrain performance composite disclosures continued:

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.

Areté Asset Management All-Terrain performance composite disclosures continued:

Verification
Areté has not been verified by an independent verifier.