First quarter 2009
Volume 2, Issue 1

THE ARETE QUARTERLY

Welcome

As we continue to grow, we continue to solicit and receive feedback from our various constituents. Based on a number of comments about the newsletter, and our desire to communicate as effectively as possible, we are introducing a new format with this edition.

Henceforth, the content originally included in *Arete Insights* will be separated into two different publications. Our commentary and insights regarding the investment management business will now be published in the middle of the quarter under the *Arete Insights* title. The more quantitative information regarding performance and characteristics of the Arete Mid Cap Core strategy will now be published shortly after quarter-end under *The Arete Quarterly* title.

We hope these changes will make each publication more accessible to interested parties. From our perspective, the new format and schedule allows us to more accurately target communication to appropriate constituents and also gives us the opportunity to reach out to you four more times a year.

As always, we appreciate your comments and suggestions regarding the newsletter or any other aspect of the business which might make our services more useful to you. We hope you find our proposition compelling and always look forward to talking with you if you have questions!

Business Update

Despite the continued difficulties in the market, we did welcome a new client in the first quarter. We say in our mission statement (at www.areteam.com), "We treat the trust endowed us to manage your money as a great honor and responsibility. You deserve the effort and attention that level of trust entails" — and we mean it. Thank you!

Inside This Issue

As we constantly evaluate and re-evaluate our marketing proposition in these difficult times, we simply keep coming back to about the same place. The best and most sustainable way for us to grow is to exert the deliberate effort to find prospects and partners which fit extremely well with our philosophy and products. This allows better and deeper client relationships, and hopefully longer lasting ones too.

Indeed we are finding repeatedly in conversations with clients and prospects that people are fundamentally re-appraising the investment management business. One of the "dirty little secrets" of the business has been that money managers have not put the interest of their clients first. Instead, seeing a business model with high fixed costs, they have launched strategic imperatives to grow revenues any way possible. Once costs are covered, enormously high profits accrue. Nice for the manager, not so great for the client. In this context, our messages of fiduciary duty, stewardship, and minimization of conflicts of interest are really resonating.

Another part of the business that is not new, but deserves mention is that of custodial services. In too many shops, custodial details are considered mundane back office activities that do not deserve serious attention. Recent history and scandals suggest custodial services are extremely important.

We provide our services to individuals through a retail platform with Shareholders Service Group. SSG is employee-owned and its business model is focused solely on providing services to registered advisers. It has no debt, no illiquid investments, no position trading accounts, and no proprietary inventory. In addition to being a member of SIPC, SSG carries insurance through Lloyd's of London to protect client assets up to an overall aggregate level of $1 billion for assets in custody for each adviser. If this level of protection seems unusual in the industry, that's because it is. But it is also evidence of what can be done when fiduciary duty is taken seriously.

We always enjoy talking about the business, the market, and stocks so if you are going to be in Baltimore, please stop in and see us. We'd love to get together and talk about what we can do for you.

Thanks and take care!

David Robertson, CFA
CEO, Portfolio Manager

Portfolio Characteristics – Arete Mid Cap Core

A key proposition for Arete'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.

Portfolio Characteristics (3/31/09)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	3,284	2,914
Median Market Cap ($ mil.)	2,732	2,199
Minimum Market Cap ($ mil.)	253	43
Maximum Market Cap ($ mil.)	10,402	15,395
Number of holdings	52	788
Valuation		
P/E current year	12.7	12.7
P/E forecast Y1	15.2	13.5
P/B	2.6	2.2
P/S	1.4	1.2
Yield (%)	1.7	3.1
Valuation drivers		
ROE (%)	20.8	15.5
LT eps growth forecast (%)	13.3	13.5

Source: The Applied Finance Group™
**Note:* Excludes ASCMA allocation resulting from DISCA corporate action.
***Note* : Arete currently does not subscribe to the Russell Indexes and therefore the statistics presented here represent approximations of the Russell Midcap® Index.

We believe maintaining a truly representative mid cap portfolio is important for two reasons. First, it allows for accurate assessment of performance. The "games" that so many fund managers play such as market timing through changing cash allocations or style drift by buying larger or smaller stocks if they seem to be in favor may appeal to some. To us, such activities more often than not just serve to obfuscate the underlying value creation of the manager (or lack thereof). Second, a truly mid cap portfolio allows an asset allocator to appropriately fit the strategy in to a larger allocation scheme and faithfully plays its role in the scheme.

Portfolio characteristics for the quarter confirm our claim that AMCC is a very representative mid cap portfolio. Market caps are a little bit higher for AMCC than for the mid cap index and valuations are slightly higher. The only very noticeable difference is that average ROE for AMCC at 20.8% is much higher than the 15.5% for the index.

Sector exposure (percent of assets on 3/31/09)

Economic sector	Arete MCC*	Midcap Index**	Difference
Autos & Transportation	5.1	2.7	2.4
Consumer Discretionary	17.3	17.4	-0.1
Consumer Staples	2.3	5.6	-3.3
Financial Services	16.9	17.4	-0.5
Health Care	13.1	9.7	3.4
Energy	9.0	6.5	2.5
Materials & Processing	11.2	8.7	2.5
Producer Durables	8.1	9.1	-1.0
Technology	7.1	11.4	-4.3
Utilities	6.4	11.0	-4.6
Other	1.8	0.5	1.3
Equity exposure	98.3	100.0	
Cash and equivalent	1.7	0.0	

Source: The Applied Finance Group™
**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.

Sector exposures for the strategy in the first quarter did not change much and were again for the most part well within our general guidelines of 50% - 150% of benchmark sector weights. One exception to the guideline weights was autos and transportation which started the quarter at 150% due to especially attractive stocks we found in that sector. During the quarter these stocks out-performed.

The weight in consumer staples also remained under our guideline minimum of 50% due to a dearth of attractive valuations in that group. We are actively seeking attractive new candidates to add to the staples group, but are at least somewhat restrained by the prolific opportunities we find in other sectors.

Transactions review – Arete Mid Cap Core

Given the continuation of rapid and violent swings in market prices in the first quarter, we have been "cautiously opportunistic" with transactions. What we mean is that high correlations in the market are belying significant differentials in fundamental performance and competitive advantage. As a result, we have been selectively increasing exposure to stocks that present extremely high appreciation potential with funds coming from sales of stocks that have less potential.

Consistent with our long-term investment horizon (of three to five years) and low turnover philosophy, we had only two transactions in the quarter. Both involved purchasing additional shares of ENER as its price became significantly more attractive. Both transactions were also part of a general plan to opportunistically increase the sector weight in energy as well as part of a tactical plan to reduce some of our larger stock positions.

The first transaction was funded from reducing the position in NRG. While we still like NRG, the position had become relatively large and the prospects for upside have been tarnished to some degree by the exceptionally low takeover offer from EXC. The second transaction reallocated funds from AGP. AGP became a relatively large position partly through good absolute performance, but also by performing so much better than the market as a whole since last summer.

Market Overview

The performance story evolved from complete mayhem in the fourth quarter last year to short cycle waves of euphoria and fear/depression in the most recent quarter. High correlations, macro bets, and short-term trading remained as the dominant characteristics of activity. What changed was the emergence of glimpses of improvement, or at least the possibility of improvement.

Many of the negative pressures on the market have not receded or changed much. The economy is still weak, the banking and finance industry still needs to be repaired, and firms and individuals are continuing to deleverage which continues to place a premium on liquidity.

With such clear and numerous pressures, there are obvious incentives for many to bet against the market on the basis of news flow alone. Steep price declines also cause many investors to challenge conviction in their own research, much of which was sadly bereft of rigorous analysis. Further, a high degree of doubt and uncertainty creates an incentive for certain participants to “fan the flames” with misinformation.

Finally, we can also add the somber mood at many money management firms to the list of negative pressures. Nobody is happy with small or nonexistent bonuses for last year. Further, it is clear that many jobs will be at risk. It is also clear that the investment business is not likely to be anywhere near as lucrative as it once was. I’m not entirely confident many of these people are placing stock selection and fiduciary duty at the top of their priority lists right now.

Through the eyes of a stockpicker, however, such extreme negativity creates excellent conditions for stock selection. First, stocks are cheap. They may not be as cheap as they were at the lows of the Great Depression, but things aren’t nearly as bad as they were in the Depression either. While it is *possible* that stocks could hit new lows based on further financial and economic erosion, it takes quite an extreme view to bet *everything* on the on the prospect of continued and sustained deflation.

Another condition conducive to stock selection is the market’s lack of differentiation. Extreme negativity has triggered a uni-directional response: Sell. It has not mattered to the market that some companies are gaining share, improving on strong competitive advantages, or run by strong, adaptive management teams. The fundamental difference between winners and losers is increasing while the difference in market valuation is decreasing. This may very well be the best environment for long-term stockpickers we have ever seen.

The opportunities, however, are also offset by risks. Our greatest concern right now is regarding public opinion and public policy. We believe more will need to be done in terms of fiscal stimulus and aid to the banking industry to completely correct the problems. Given the high level of public outrage expressed, we have significant concerns our government will not be able to complete the difficult task of righting the economy. If the effort falls short, we believe the economy is likely to under-perform relative to its potential for many years.

In addition, we believe there is also a risk specific to mid cap stocks. Given the demands on government policy to manage systemic risk with limited resources, the government is (necessarily) making decisions that help some firms and not others. Since mid cap firms do not pose systemic risks, they are not priority targets for assistance. In the short-term, the opportunity for a government backstop and low cost capital creates a relative advantage for larger firms.

Longer term, however, we believe such assistance (which, by the way, is frought with its own risks) will serve primarily to weaken the larger companies. Mid cap companies, in comparison, will have to adapt and become even stronger, which is likely to serve them well in the long run.

Performance review – Arete Mid Cap Core

The Arete 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 estimation of intrinsic value. In other words, we try to find situations in which our expectations for a company are substantially more positive than the expectations discounted by the market and our expectations are borne out over time.

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, net of fees, over the course of a market cycle.

Arete's Mid Cap Core (AMCC) strategy under-performed the Russell Midcap Index® (RMC) by 169 basis points in the first quarter. There was decent balance among the best and worst performing stocks, however the three worst performing stocks were all in the financial services sector. Other than that, there were no individual stocks that clearly led to the performance deficit.

Stock performance (12/31/08 - 3/31/09)

Best performers

Company	Return in quarter (%)
Carmax	57.9
Seagate Technology	35.7
Mylan	35.6
Shaw Group	33.9
Health Net	33.0

Worst performers

Company	Return in quarter (%)
Capitalsource	-73.6
Synovus Financial	-60.8
United Rentals	-53.8
Energy Conversion Devices	-47.4
Owens Illinois	-47.2

What did become clear during the quarter was that the bias of the portfolio's holdings towards companies that benefit from global economic growth continued to hurt performance. Interestingly, a notable trend that developed in the first quarter was an increase in volatility of *relative* performance. Relative performance fluctuated as traders' moods vacillated from concerns about the inadequacy of the Treasury's plan to restore bank health and credit flows to optimism that housing and and economic growth were improving.

Despite the under-performance in the quarter, we continue to like the stocks in the portfolio and in most cases have seen underlying fundamentals improving relative to competitors. So how do we reconcile a portfolio we like to short-term under-performance?

For perspective, our philosophy of buying stocks at prices well below intrinsic value requires conditions for those intrinsic values to eventually be realized. Value can be realized in a number of ways, not least of which is gradually, over time. Sometimes the market just needs to see a track record to become more comfortable gauging the economic potential of a company. Similarly, in situations of ambiguity or uncertainty, the market often needs to attain greater visibility and "proof" of either improved performance or absence of a serious problem. Finally, on occasion another company or investor individually recognizes the value and offers to take over the stock at a premium.

Unfortunately none of these conditions are prevalent in today's market on any kind of significant scale. While we continue to monitor the situation, we very much believe that it will just take some patience for conditions to become more conducive to the performance of our stocks (and stocks in general). We view this as essentially a test of analytical rigor and patience. If we continue doing the analytical work and refuse to get lured into over-active trading, we believe we will see the strategy show its performance potential, we just don't know when.

The main risk to this view is the possibility of takeouts that do not allow us to fully realize intrinsic value. Indeed, this may be the case with EXC's lowball offer for NRG. Fortunately, we vastly mitigate any risk such a situation poses by simply keeping our eyes open for attractive new ideas which we do on a regular basis anyway.

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.

Arete Mid Cap Core composite

Arete Asset Management, LLC
Mid Cap Core Composite*
July 31, 2008 - March 31, 2009

Month	Gross-of-Fees Return (percent)	Net-of-Fees Return (percent)	Russell MidcapØ 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 ($)
August	3.75	3.75	1.85	1	NA	117,163	117,163	100%	318,582
September	-12.58	-12.58	-12.26	1	NA	102,420	102,420	100%	286,761
October	-23.75	-23.98	-22.35	1	NA	77,858	77,858	100%	230,830
November	-15.02	-15.02	-10.18	3	NA	196,168	196,168	100%	196,168
December	5.54	5.54	4.27	3	NA	207,031	207,031	100%	207,031
January	-7.54	-7.62	-7.4	3	NA	191,258	191,258	100%	191,258
February	-11.02	-11.02	-9.95	4	NA	318,767	318,767	100%	318,767
March	8.67	8.67	9.15	4	NA	346,401	346,401	100%	346,401
**2008	-37.97	-38.16	-35.01	3	NA	207,031	207,031	100%	207,031
Q1 2009	-10.60	-10.67	-8.98	4	NA	346,401	346,401	100%	346,401
YTD 2009	-10.60	-10.67	-8.98						

**Note*: Composite returns for September have been corrected for an error that occurred in the calculation of accrued income. The new, corrected performance is higher by 10 basis points, which equals our threshhold for materiality. The error occurred due to an ex-post adjustment made by our reporting software. We have identified the source of the problem and have created procedures designed to avoid recurrence.
***Note*: Peformance through 12/31/08 from inception of composite on 7/31/08.

Arete Asset Management Mid Cap Core performance composite disclosures:

Compliance statement

Arete Asset Management has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

Definition of the firm

Arete Asset Management, LLC (Arete) was established in 2008 and is registered as an investment adviser in the state of Maryland. Arete is defined as an independent investment management firm and is not affiliated with any parent organization. Arete 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

Arete Asset Management Mid Cap Core performance composite disclosures continued:

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. Arete 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. For purposes of composite construction, “fully invested” is defined as having greater than 90% of portfolio assets invested in equity securities. Every new portfolio is added to the composite in the first complete calendar month that it is “fully invested”. 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.

Verification
Arete has not been verified by an independent verifier for its compliance with GIPS. Please note that the initial minimum period for which verification can be performed is one year and Arete does not currently have sufficient history to meet this requirement.

To receive a copy of the firm’s Form ADV Part II, please contact David Robertson at 410/649-0086 x710, by email at droberston@areteam.com, or by mail at the address listed below.

Arete Asset Management, LLC, Business address: 729 E. Pratt St., Suite 700, Baltimore, MD 21202
Mailing address: 621 S. Hanover Street, Baltimore, MD 21230
http://www.areteam.com drobertson@areteam.com 866/526-6008