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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 make our expertise more accessible to a broader audience. 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

One of the things I have come to realize over the last several years is how much my view of Areté has evolved. I started with the notion of creating a high quality money management effort and while I still absolutely maintain that objective, in hindsight it seems so limiting. An important part of my change in views has resulted from an extended period of extremely difficult conditions for active management.

To people outside of the investment industry and to those who do not have consistent access to in-depth research, talk of "extremely difficult conditions" may sound more like sour grapes than an objective assessment of the investment landscape.

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But Areté is certainly not the only firm that has been affected by such adverse conditions. As I have reported several times, many of the smartest and most talented hedge funds managers have closed shop due to the low return on excellent research.

Further, Rusty Guinn of Epsilon Theory dared to articulate one of the "dirty little secrets" that has emerged in the industry [here]: "Pursuing better returns by uncovering absolute truths about the companies and governments we invest in is not a serious enterprise in the face of markets rife with Narrative abstractions. It is a smiley-faced lie, a right-sounding idea that doesn't work, and which we know doesn't work."

In other words, it's pretty clear to anyone paying attention, that the traditional practice of conducting in-depth research in order to reveal underappreciated stocks and to better manage risk doesn't work in a world awash in liquidity from central banks. This comports well with my

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assessment from last quarter in which I noted, "Such policies [i.e., persistently loose monetary policy] almost completely undermine the value of ongoing analysis and risk management."

This unfortunate reality has weighed heavily on me the last few years. As a conscientious money manager you have to accept that many of the skills you have developed and much of the knowledge you have worked hard to gain and much of the experience you have attained just "doesn't work" in this environment. So you need to figure something else out.

To be sure, I have not given up on the possibility that active management will once again have its day in the sun. For one, there are indications that conditions are improving for active management most conspicuously in the form of significantly increased volatility in the first quarter. In addition, I'm ready to go if that does pan out since I've got the valuation model in very good working shape. There are certainly all kinds of mispricings that can't persist forever.

In the event that some degree of "normalcy" does not return to markets in the not-too-distant future, however, it is only prudent to consider other options. In fact, I started doing that some time ago by conceiving the personal Chief Investment Officer service. Indeed, as investing continues to become more important, it is also becoming more difficult. As such, there are all kinds of ways in which "good research, independent thinking, and putting clients' interests first" can provide valuable services outside of just money management.

Further, as I continue to share my thoughts on the exercise of investing, navigating the investment environment, and navigating the panoply of investment services through the Areté blog, I have been extremely encouraged by the numerous and diverse indications of interest in what Areté does.

For example, with each blog post I almost always gain additional followers on various distribution platforms. I often get comments, thank yous, phone calls and other forms of engagement with my writings. I get notes informing me of typos or minor editorial errors which tells me that readers are not just paying attention, but also trying to help out. In addition, the posts are regularly highlighted on platforms such as *Advisor Perspectives* and several posts now have been included in the morning email from *Financial Advisor IQ* which goes out to 65,000 financial advisors.

While all of these responses are encouraging, they are especially so given how small Areté is and given that I spend virtually nothing on marketing. Of course I'm sure there is an element that a number of people are simply recognizing that they are getting really valuable investment insights for free, but nonetheless, I think it is fair to say that my message is getting out there and that people care about it.

This phenomenon of substantial outside interest dovetails with a related phenomenon. Over the last ten years or so (i.e., since the financial crisis) I have seen a number of what I'll call "alternative" research sources emerge. The common threads running through all of these efforts are affordability, high quality, independence, and above all, a sincere interest in helping investors.

A similar movement has also occurred among service providers such as money managers and financial advisers and other industry participants such as journalists. Participants from every reach of the industry are increasingly recognizing the need to do things differently and are offering suggestions or actually experimenting with new ideas.

While this group still constitutes a small minority of industry participants, it is a significant number and is growing. It coalesces around similar values and philosophical beliefs. The unifying message seems to be, "We recognize the highly conflicted position of Wall Street and did not get into this business simply to enrich ourselves. We want to do something better." In other words, on both the client and provider side, many of us are joined in wanting the investment business to work better.

All of this suggests that there may now be enough critical mass of support for these efforts to take hold in a meaningful way. As a result, I will be focusing more of my efforts on finding ways to connect and collaborate in order to build a new and better investment services industry.

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.

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.

Portfolio Characteristics (3/31/18)

	Arete MCC*	Midcap Index**
Size		
Average Market Cap ($ mil.)	10,786	10,085
Median Market Cap ($ mil.)	6,372	7,784
Minimum Market Cap ($ mil.)	288	348
Maximum Market Cap ($ mil.)***	37,646	56,298
Number of holdings	18	777
Valuation		
P/E current year	23.6	25.3
P/B	2.9	4.8
P/S	1.7	2.5
Yield (%) ****	3.6	2.7
Valuation drivers		
ROE (%)****	9.5	12.1

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

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 a little 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 18 currently.

Sector exposure (percent of assets on 3/31/18)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.6	14.1	4.3%
Consumer Staples	0.0	4.1	0.0%
Energy	0.0	5.5	0.0%
Financials	9.4	15.0	62.8%
Health Care	4.8	9.5	50.7%
Industrials	0.0	14.6	0.0%
Information Technology	2.4	16.9	14.2%
Materials	4.1	5.7	72.5%
Real Estate	6.7	8.8	75.8%
Telecommunications	0.0	0.4	0.0%
Utilities	3.6	5.7	63.7%
Equity exposure	31.6	100.0	
Cash and equivalent	68.4	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* (3/31/18)

Period	Percent**
Q118	94.9
Q417	95.0
Q317	95.2
Q217	94.9
Q117	96.0

**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

Although we did not execute any transactions in the quarter and continue to find most valuations excessive, we are starting to see glimpses of opportunity in the form of securities that appear to be much cheaper than the rest of the market. The numbers are not large, but large enough to step up our research efforts.

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.

Stock performance* (12/31/17 - 3/31/18)

Best performers

Company	Return in quarter (%)
Seagate Technology	39.9
Lands End	19.4
TD Ameritrade	15.8
NRG Energy	7.2
Royal Gold	4.6

Worst performers

Company	Return in quarter (%)
Sears Holdings	-25.4
Annaly Capital Management	-12.2
Seritage Growth Properties	-12.1
Yamana Gold	-11.5
Gaming and Leisure Properties	-9.5

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

Areté's Mid Cap Core (AMCC) strategy returned 0.42% (net of fees) for the quarter versus -0.46% for the Russell Midcap Index® (RMC) (see pages 8 – 10 for performance and related disclosures). AMCC underperformed in January as markets raced ahead but held in admirably as volatility spiked later in the quarter. Such performance provided a clear demonstration of what the portfolio is currently designed to do – which is to muscle through adversity in good stead.

The key theme amongst outperformers was really the link with rising rates and the implications for real assets. AMTD is leveraged to higher rates and both NRG and RGLD are leveraged to higher commodities prices. That said, NRG did help its own case by making significant progress on its transformation plan.

The top two performers stood out on their own merits, however. STX topped the list by continuing its rebound off of lows last summer. It probably didn't hurt that a lot of the higher growth, higher profile tech stocks finally got hit in the first quarter though. Finally, LE popped with its earnings report late in the quarter showing nice revenue growth and improvement in profitability.

Two dominant themes were expressed among the underperforming stocks in the portfolio. The most noticeable was the poor performance across virtually all of the REITs. Although it is common for retail money to flee high yielding stocks such as REITs when rates rise, we are very comfortable with the positioning of SRG and GLPI in particular. SHLD was the worst performer reflecting the ongoing pressure on bricks and mortar retailers in general, and on SHLD in particular. AUY also stood out as most gold-related stocks did well in the quarter, but it got a big boost last quarter and growth prospects remain attractive.

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 - March 31, 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
Q1	0.67	0.42	-0.46	4	NA	988,813	988,813	100%	1,185,130
YTD	0.67	0.42	-0.46	4	NA	988,813	988,813	100%	1,185,130

**Note*: Peformance 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®).

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.

Areté Asset Management Mid Cap Core 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 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.