

# 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 (or different) investment insights, please take a look at our blog [[here](#)]. Content for the posts is selected and created on the basis of being important, relevant, and useful.

In addition, *Arete's Observations* provides a weekly assessment of important investment news and insights and these posts provide excellent exposure to our thinking. You can find the letters on the substack platform at: <https://abetterwaytoinvest.substack.com>

Also, Areté provides insights and expertise on a personal basis through the Personal CIO Service. If you would like to learn more, please take a look on the website [[here](#)]. Finally, please always feel free to contact us with questions or comments.

## Business Update

As I mentioned in the last quarterly report, I am reformulating Arete's investment strategy and have continued making progress on the that front. Indeed, the continued runup in stocks in the first quarter despite obvious signs of euphoria and disconnects from underlying fundamentals has made it clearer than ever that investing in stocks alone is a venture fraught with risk.

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At the same time, the distinct possibility of both deflation and inflation occurring in the next few years makes clear that the risk of just sitting in cash and waiting for something to happen is also high. What is needed is a more diversified approach that can make progress regardless of the environment - and that is what I am working on.

Diversification is a key element of the approach, but I am going to apply it in a different way than many advisors do. Specifically, while the notion of diversification has become mantra to the investment community, the way it is normally practiced is by allocating funds variously between stocks and bonds and US

and foreign markets. The problem is while the names of these “asset classes” are different, their return streams are usually highly correlated.

Instead, I am going to focus on uncorrelated streams of returns. Gold is one of those and commodities is another. I don't plan on investing in either of those directly but there are funds that do and can create appropriate exposure.

In many ways this effort is simply a more expansive way to accomplish the same things I have been doing with the stocks-only portfolio. The limited universe of investment options, however, significantly constrained my ability to adapt to the environment as monetary interventions increased and macro themes overwhelmed idiosyncratic stock activity.

As I continue formalizing these plans, a few things will change. For example, since portfolio characteristics will no longer be very relevant, I will stop reporting those. Asset allocation will be more relevant so I will report that instead.

Performance reporting will also be different. Since the structure of the strategy and its benchmarks will be different, GIPS standards will require separate reporting. Each client will continue to have access to inception-to-date performance, however. Related to these changes, I will also stop reporting performance to various consultant databases.

I'm sure there will be other changes to be made along the way and I will keep you posted as they arise. If you have comments, questions, or concerns along the way, please let me know I will get right back to you.

In sum, I am both excited and anxious about these changes. Rest assured, I do not take them lightly. While there is a part of me that hates to “quit” the midcap strategy, there is another part of me that feels relieved to have more freedom to roam where opportunity exists in the markets.

As always, thanks for your support!

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 (3/31/21)

	Arete MCC*	Midcap Index**
<u>Size</u>		
Average Market Cap (\$ mil.)	10,504	13,553
Median Market Cap (\$ mil.)	9,054	10,196
Minimum Market Cap (\$ mil.)	714	474
Maximum Market Cap (\$ mil.)***	42,690	55,901
Number of holdings	15	829
<u>Valuation</u>		
P/E current year	31.2	28.9
P/B	2.9	6.7
P/S	3.5	6.5
Yield (%)****	2.7	2.6
<u>Valuation drivers</u>		
ROE (%)****	NA	8.4

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 more cheaply in the future.

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 lower than the mid cap index and the median is as well, but less so. 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 15 currently.

#### Sector exposure (percent of assets on 3/31/21)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.4	12.1	3.3%
Consumer Staples	0.0	3.7	0.0%
Energy	0.0	2.9	0.0%
Financials	3.7	11.8	31.3%
Health Care	3.1	12.1	25.5%
Industrials	0.0	15.8	0.0%
Information Technology	0.0	18.8	0.0%
Materials	9.0	5.8	154.2%
Real Estate	6.4	7.1	89.9%
Communication	0.0	4.9	0.0%
Utilities	3.9	4.8	81.2%
Equity exposure	26.5	100.0	
Cash and equivalent	73.2	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 remain quite different from benchmark weights, in part due to the high cash position but also due to different exposures. Cash has remained high as excessive valuations have precluded the addition of new holdings.

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\* (3/31/21)

Period	Percent**
Q121	96.7
Q420	96.3
Q320	96.3
Q220	96.2
Q120	96.1

\*Note: Computed for AMCC composite

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

## Transactions review – Areté Mid Cap Core

There were no transactions in the quarter, but that result belies the considerable amount of research conducted and high level of interest in adding to positions. As the strategy gets expanded there will be more room to address gold, commodities, and other desired exposures.

## 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.

#### Stock performance\* (12/31/20 - 3/31/21)

##### Best performers

Company	Return in quarter (%)
Seritage Growth Properties	25.0
Owens Illinois	23.9
Lands End	15.0
Weyerhaeuser	6.2
Capitol Federal Financial	6.0

##### Worst performers

Company	Return in quarter (%)
Viatis	-25.5
Yamana Gold	-24.0
Kirkland Lake Gold	-18.2
Davita	-8.2
Gaming & Leisure Properties	0.1

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

Areté's Mid Cap Core (AMCC) strategy returned -.27% (net of fees) for the quarter versus 8.14% for the Russell Midcap Index® (RMC) (see pages 7 - 9 for performance and related disclosures). With markets continuing to be on fire through the first quarter, AMCC's large cash position was no match.

The performance of individual stocks in the quarter mainly reflected the broad theme of deflation. Retail and industrial firms did well and gold stocks did not.

## 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

Areté Asset Management, LLC  
Mid Cap Core Composite  
July 31, 2008 - March 31, 2021

Period	Russell Midcap®			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)	Index 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	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	-2.06	-3.03	-9.06	4	NA	954,785	954,785	100%	1,152,786
2019	10.73	9.65	30.54	3	NA	1,046,822	1,046,822	100%	1,257,036
2020	2.36	1.34	17.10	3	NA	1,060,915	1,060,915	100%	1,271,549
2021									
January	-0.36	-0.61	-0.26	2	NA	589,353	589,353	100%	1,163,973
February	-0.68	-0.68	5.57	2	NA	585,340	585,340	100%	1,155,976
March	1.03	1.03	2.71	2	NA	591,373	591,373	100%	1,167,661
Q1	-0.02	-0.27	8.14	2	NA	591,373	591,373	100%	1,167,661
YTD	-0.02	-0.27	8.14	2	NA	591,373	591,373	100%	1,167,661

\*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®).

### 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.