

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 active management, research and analysis are primary activities and 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, these posts provide excellent exposure to our thinking.

Also, in addition to managing a mid cap core equity strategy, Arété now also 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

Two wild quarters to start the year have created vastly different impressions of the investment environment. After the severe selloff in the first quarter, risk and avoidance were top of mind. After massive monetary and fiscal policy responses were revealed beginning late in March, however, the mindset of investors quickly reverted to a belief that policymakers would save the day and investors should carry on.

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After several iterations of risk spikes followed by progressively easier monetary policy reassuring investors, it's fair to question how long this pattern can continue?

In the [Market Review for the second quarter](#) I highlighted some recent research by Mike Green from Logica Funds which provides a great deal of perspective. In short, Green believes that passive investing has fundamentally altered the market structure in important ways. This has had the effect of favoring momentum over value, undermining the usefulness of security selection, and creating enormous systemic risk.

This has positive and negative implications for Areté's business. On the negative side, it creates headwinds for security selection, value investing, and active management, all of which are part of Areté's core mid cap service.

On the positive side, the value of investment expertise and independent thinking have never been greater. While there may be less immediate need for security-specific expertise right now, there is an enormous need to be able to put the wild swings of the first two quarters into context, to manage risk, to investigate what is happening above and below the surface, and to report the findings to investors in a clear and cogent way. These are also core parts of Areté's value proposition.

One of the things I have done to respond to the situation is to create a weekly newsletter which I call *Observations* for clients and close friends. From a service standpoint, this is designed to share the research and insights I develop in the course of doing research every day. I originally intended for these to be primarily shared indirectly in the form of stock selection, but the situation has changed and this seems to be a more useful vehicle now. I am also considering the possibility of offering it on a subscription basis to people who are not currently clients of Areté.

I have also been thinking a lot about how to best manage the mid cap strategy in this environment. While I have been reasonably pleased with the defensive positioning and the focus on gold stocks, I am increasingly concerned that this pattern of ups and downs without meaningful resolution could go on for some time. A big assumption I have been making is that at some point, there will be a change in regime in which value starts

working again and security selection becomes more effective.

Based on Green's research and what I observe myself in terms of market action and policy responses, I am concerned that the necessary regime change will take longer than anyone cares to wait around for. I absolutely believe such a change will happen, and it *could* happen relatively soon. However, I do not think it is appropriate to make a singular bet on that one possibility.

So, in addition to everything else, I will also be researching ways to better harness some of the prevailing forces without taking on unnecessary risk. I don't know how possible this is, but I don't want to assume it doesn't exist without doing the work.

If you want to stay apprised of my thinking on this subject (and plenty of others), please send me an email and I will put you on the distribution list for *Areté's Observations*.

Thanks - I appreciate it!

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.

Portfolio Characteristics (6/30/20)

	Arete MCC*	Midcap Index**
<u>Size</u>		
Average Market Cap (\$ mil.)	8,294	10,041
Median Market Cap (\$ mil.)	7,998	7,325
Minimum Market Cap (\$ mil.)	260	241
Maximum Market Cap (\$ mil.)***	35,346	48,013
Number of holdings	15	811
<u>Valuation</u>		
P/E current year	26.9	25.8
P/B	2.3	5.7
P/S	2.6	5.3
Yield (%)****	4.9	3.8
<u>Valuation drivers</u>		
ROE (%)****	5.5	11.9

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

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.

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.

Sector exposure (percent of assets on 6/30/20)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.1	11.1	0.9%
Consumer Staples	0.0	4.4	0.0%
Energy	0.0	3.0	0.0%
Financials	2.5	11.4	21.9%
Health Care	2.6	13.0	20.0%
Industrials	0.0	14.9	0.0%
Information Technology	0.0	19.3	0.0%
Materials	9.4	5.1	185.9%
Real Estate	4.8	7.7	62.2%
Communication	0.0	4.3	0.0%
Utilities	3.5	5.9	59.3%
Equity exposure	22.9	100.0	
Cash and equivalent	77.0	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.

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 slightly lower than the mid cap index and the median is slightly higher. 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 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 high and increased again in the quarter with the two sales transactions.

Active share* (6/30/20)

Period	Percent**
Q220	96.2
Q120	96.1
Q419	96.6
Q319	96.1
Q219	95.6

*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

There were transactions in the quarter and both were sales. First, the position in STX was completely liquidated. The stock has always been volatile owing to the facts that

it is in a cyclical business and has a fair amount of leverage. That said, the company is well managed and produces a lot of cash flow. When the stock rebounded powerfully in April despite no evidence of strong economic underpinnings, it provided an opportunity to reduce exposure to a dubious recovery.

The second transaction involved selling down half the position in DVA. The stock had been the largest holding in AMCC for a long time and just like with STX, the strong rebound in the second quarter provided an opportune time to reduce exposure. Although the company seemed to manage through the Covid-19 lockdowns well, the overall impact on the economy, and by extension on government budgets, creates too much uncertainty for the stock to remain the largest holding.

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* (3/31/20 - 6/30/20)**Best performers**

Company	Return in quarter (%)
Yamana Gold	98.6
Lands End	50.6
Royal Gold	41.7
Kirkland Lake	40.9
Weyerhaeuser	32.5

Worst performers

Company	Return in quarter (%)
Gaming & Leisure Properties	-9.6
Capitol Federal Financial	-5.2
Exelon Corp	-1.4
Davita	4.1
Mylan Inc.	7.9

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

Areté's Mid Cap Core (AMCC) strategy returned 5.03% (net of fees) for the quarter versus 24.61% for the Russell Midcap Index® (RMC) (see pages 7 - 9 for performance and related disclosures). While the second quarter rebound was fairly symmetrical to the first quarter selloff, the performance of AMCC demonstrated the value of avoiding major losses: RMC is down 9% for the first half while AMCC is only down 3½%.

The best performers were dominated by real assets in general and gold in particular. More than ever, the message of performance was one of macro trends and not security-specific developments. It was also one of greater concerns about US dollar weakness than of fundamentals.

The situation was very similar with the worst performing stocks. Most of the bottom performers were there simply by virtue of having performed relatively well in the first quarter. As a result, there really wasn't any meaningful company-specific information revealed by this list.

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 - June 30, 2020

Period	Gross-of-Fees Return (percent)	Net-of-Fees Return (percent)	Russell Midcap®		Internal Dispersion (percent)	Total Composite Assets (\$)	Composite Assets With Bundled Fees (\$)	Percentage of Composite Assets With Bundled Fees	Total Firm Assets (\$)
			Index Return (percent)	Number of Portfolios					
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									
January	0.16	-0.09	-0.80	3	NA	1,045,862	1,045,862	100%	1,255,939
February	-2.92	-2.92	-8.69	3	NA	1,015,294	1,015,294	100%	1,222,241
March	-5.22	-5.22	-19.49	3	NA	962,276	962,276	100%	1,164,373
April	4.14	3.89	14.36	3	NA	999,674	999,674	100%	1,207,109
May	0.84	0.84	7.03	3	NA	1,008,082	1,008,082	100%	1,215,937
June	0.26	0.26	1.80	3	NA	1,010,676	1,010,676	100%	1,219,085
Q1	-7.85	-8.08	-27.07	3	NA	962,276	962,276	100%	1,164,373
Q2	5.29	5.03	24.61	3	NA	1,010,676	1,010,676	100%	1,219,085
YTD	-2.97	-3.45	-9.13	3	NA	1,010,676	1,010,676	100%	1,219,085

*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.