

# 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, 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

With the first full quarter of publication of the *Arete's Observations* letter complete now, I have a better perspective to judge the pros and cons. In sum, I am pleased with the content but have work to do to increase the reach.

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Perhaps the most important thing I have learned with *Observations* is that it has served as a good incremental discipline for my research. I read and dig into interesting stories all the time, but producing the newsletter has forced me to become more organized and more consistent.

I also feel like it provides a good vehicle by which to communicate my work and findings for clients and followers of Arété. It gives me a platform to sort through all of the news items and focus on those I consider most important. It also allows me to put stories into context. Finally, it allows me to provide important foundational content such that investors can manage risk on an ongoing basis rather than after the fact.

All of that said, there are also a couple of areas that I believe need improvement. One is to find the right balance between frequency and utility. When I started the letter in early May, the selloff from March was still fresh, the consequences unclear, and the interest in commentary very high. The letter was partly a response to that situation and the needs it created.

Later in the summer, sentiment had stabilized, "breaking" investment news slowed to a trickle, and interest in commentary subsided as well. I'll keep experimenting to find the best way to be responsive when necessary, but also able to dive in when investment opportunities present themselves. Indeed, this a timely consideration since I am observing an enormous array of underappreciated risks in the market right now that can create enormous opportunities later.

The other area that really needs improvement is marketing reach. When my materials get posted on various investment sites, it always attracts notable readership, but does little else. Substantial interest is not translating into commitment.

From what I can tell, this problem is endemic to the industry. It is easy for investors to get material and a lot of it can be gotten for free. When markets are rising, as they generally have been for the last eleven years, little substance, quality, reliability, access, or accountability are required.

When things turn, however, as they did in March, it raises a lot of questions and highlights a lot of risks. A quote from the latest "[in gold we trust .report](#)" captures the situation well: "A financial crisis is a great time for professional investors and a horrible

time for average ones." While I do believe things are due to change, the existence of only a few fleeting moments of real investment challenges has temporarily diminished demand for professional investment advice.

In an important sense, that challenge is less onerous for Areté than it could be. The main reason is that the value proposition has always been a fairly unique one designed for a targeted audience. As a result, I do not feel compelled to do the types of things associated with appealing to a mass market such as producing large volumes of content and competing aggressively for internet search rankings. That is a different business.

Rather, I am much more interested in finding investors who are long-term oriented and who value a strategic perspective. This includes people who are more interested in being positioned properly than in desperately competing for slightly better returns each quarter. If you know anyone who might be interested, please feel free to share *Areté's Observations* or any other material with them and/or have them contact me at [drobertson@areteam.com](mailto:drobertson@areteam.com).

As for research, I have started allocating more time to the effort lately. While I have spent most of my time on higher level, macro issues through the summer, I plan on increasing the proportion of industry and company-specific research over the next several months. My sense is that the market is getting close to a tipping point that could produce enormous opportunities. That being the case, I like to put in the work up front to prepare.

Finally, while I have been frustrated that the financial crisis in 2008 did not serve as an impetus for meaningful change, that just

means the change is even closer today. It's been a long time coming. When it does, I think Areté's mission of helping investors to get the most out of their investing activities will resonate deeply.

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.

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 (9/30/20)

	Areté MCC*	Midcap Index**
<u>Size</u>		
Average Market Cap (\$ mil.)	8,778	10,685
Median Market Cap (\$ mil.)	7,666	7,727
Minimum Market Cap (\$ mil.)	425	251
Maximum Market Cap (\$ mil.)***	34,866	45,443
Number of holdings	15	821
<u>Valuation</u>		
P/E current year	22.6	25.7
P/B	2.5	6.1
P/S	3.2	5.7
Yield (%) ****	4.7	3.7
<u>Valuation drivers</u>		
ROE (%)****	5.7	11.9

Source: Calcbench

\*Note: Excludes positions which are less than 0.1% weights.

\*\*Note: Areté 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 slightly lower than the mid cap index and the median is very similar. 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 9/30/20)

Economic sector***	Arete MCC*	Midcap Index**	Percentage Comparison
Consumer Discretionary	0.2	11.7	1.7%
Consumer Staples	0.0	4.3	0.0%
Energy	0.0	2.3	0.0%
Financials	2.4	10.7	22.4%
Health Care	2.7	13.4	20.2%
Industrials	0.0	15.5	0.0%
Information Technology	0.0	19.3	0.0%
Materials	10.1	5.3	190.3%
Real Estate	5.5	7.1	77.7%
Communication	0.0	4.6	0.0%
Utilities	3.3	5.8	56.9%
Equity exposure	24.2	100.0	
Cash and equivalent	75.7	0.0	

Source: Calcbench

\*Note: Areté Mid Cap Core is represented by the aggregate of all assets in the composite at the given date.

\*\*Note: Areté 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\*** (9/30/20)

Period	Percent**
Q320	96.3
Q220	96.2
Q120	96.1
Q419	96.6
Q319	96.1

\*Note: Computed for AMCC composite

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

## Transactions review – Areté Mid Cap Core

The only transaction in the quarter was the sale of the exchange traded fund, CLTL. The fund was originally purchased to take advantage of slightly higher Treasury rates with the abundance of cash in accounts. For a couple of years that worked to generate some incremental interest income with still very low risk. With rates falling again nearly to zero, the advantages of the fund have been completely obviated and therefore the position was sold.

## 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.

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#### Stock performance\* (6/30/20 - 9/30/20)

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##### Best performers

Company	Return in quarter (%)
Lands End	62.1
Weyerhaeuser	27.0
Kirkland Lake	18.6
Seritage Growth Properties	18.0
Owens Illinois	17.9

##### Worst performers

Company	Return in quarter (%)
Capitol Federal Financial	-15.9
Mylan Inc.	-7.8
NRG Energy	-5.6
Royal Gold	-3.3
Gaming & Leisure Properties	-2.2

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

Areté's Mid Cap Core (AMCC) strategy returned 1.47% (net of fees) for the quarter versus 7.46% for the Russell Midcap Index® (RMC) (see pages 7 - 9 for performance and related disclosures). The third quarter was similar to the second in that it provided the exact same message. Even though RMC continued to rebound strongly on the back of unprecedented monetary and fiscal stimulus, AMCC is still ahead for the year, albeit slightly. Once again, this shows the importance of avoiding major losses.

There was very little information to be derived from any of the stock performances in the third quarter. For one, there was little exceptional performance. While LE stood out, it has been an exceptionally volatile

stock. The vast majority of notable performance, on both the positive and negative side, was due more to bouncebacks from prior price action than to anything related to company fundamentals.

## 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 - September 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
July	2.83	2.58	5.87	3	NA	1,036,753	1,036,753	100%	1,248,941
August	0.32	0.32	3.52	3	NA	1,040,084	1,040,084	100%	1,252,199
September	-1.40	-1.40	-1.95	3	NA	1,025,517	1,025,517	100%	1,235,656
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
Q3	1.72	1.47	7.46	3	NA	1,025,517	1,025,517	100%	1,235,656
YTD	-1.31	-2.04	-2.35	3	NA	1,025,517	1,025,517	100%	1,235,656

\*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.

Areté Asset Management Mid Cap Core performance composite disclosures continued:

### **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 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.