

# 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, *Observations by David Robertson* provides a weekly collection of insights and analysis that are intended to be especially relevant for long-term investors. You can find the letters on the substack platform at: <https://abetterwaytoinvest.substack.com>

Finally, please always feel free to contact us with questions or comments.

## Business Update

Well things are starting to get interesting now! With the performance of the All-

Terrain composite being down just 0.68% year-to-date compared to the Vanguard 60/40 benchmark being down over 17% (see performance on page 5), it is becoming clearer every day that a purely passive approach is not “safe” and that something constructive can be done about it.

### Inside This Issue

|                             |   |
|-----------------------------|---|
| Welcome                     | 1 |
| Business Update             | 1 |
| Asset Allocation            | 2 |
| Transactions Review         | 3 |
| Performance Review          | 3 |
| Investment Philosophy       | 4 |
| Areté All-Terrain Composite | 5 |

I have been talking about dynamics like this for a long time but it finally feels as if the landscape is meaningfully shifting. That means it takes more work to manage risk by avoiding over-priced and speculative assets and by identifying truly diversifying assets. Fortunately, these are, and always have been strengths of Areté.

The key here is that inflation flips market dynamics upside down. No longer can central banks pump out money to “solve” any little market glitch. Now, investors are forced to figure out what investments are worth - or hold on to the hope things will change and they can go back to the coddled existence of ever-increasing liquidity and ever-increasing prices.

Partly due to the unpleasant implications, many investors are resisting the opportunity to adapt to the new environment by

modifying their strategic focus. From an investment standpoint, this suggests there is plenty more downside for stocks, and probably for bonds too.

From a business standpoint this means there aren't a lot of investors looking to do something different with their portfolios, at least not yet. Unfortunately, it takes time for investors to become so disappointed and frustrated with performance, and then with their service providers, that they consider switching.

In the meantime, I will continue doing what I do - sharing my thoughts about markets and portfolio strategy with clients and other interested parties through the "[Observations](#)" newsletter every week. Look through the archives and it is easy to trace how my thinking has evolved from the start of the pandemic all the way through to today. I also put out [The Areté Quarterly](#) to provide a more detailed analysis of the investment strategy.

So, for those who have been around for a while, thank you for your trust and support! I am feeling like these investment conditions fall right into the wheelhouse of what Areté is really good at - fundamental research, risk management, and independent thinking all wrapped up in a very affordable service.

For those who may be new to Areté, thanks for your interest! Check out "[Observations](#)", check out "[The Areté Quarterly](#)" and if you still have questions, let me know. One thing I can do more easily now than ever before is to talk to investors one-on-one to help solve investment problems.

David Robertson, CFA  
CEO and founder, Areté Asset Management

## Asset Allocation

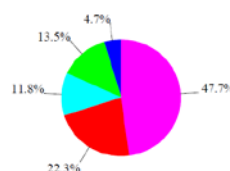
In the current allocation, cash is still the largest position. Uncorrelated has overtaken gold for the #2 position.

The cash position declined as a result of significantly increased holdings in the uncorrelated class. The inverse correlation weight also grew relatively due to outperformance. Both the uncorrelated and inverse correlation assets have served their function of diversifying against stocks and bonds.

Finally, the gold position declined due to weak performance again. Given the continued increase in real rates, this is not too surprising. The longer-term case, however, is still solid and cheaper prices say more about incremental attractiveness than about something going wrong.

The chart below reflects a representative account from the All-Terrain composite.

**Actual Allocation**



**Target Allocation**



As a reminder, the easiest way to think about the strategic priorities of the All-Terrain strategy is as an effort to get the most out of the valid market opportunities that exist. In other words, it is more about finding attractive assets and creating thoughtful diversification than about speculating which hot stock might do well.

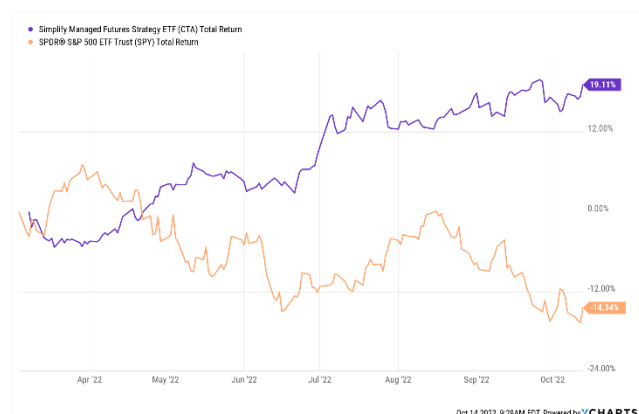
Over the last quarter, the Fed's Quantitative Tightening (QT) program ratcheted up and began to clearly impact markets. As a result,

the primary goal remains to stay mostly clear of stocks and bonds. This explains the high cash levels.

From a high level, while prices are moving in the right direction (in terms of becoming more attractive), prices of stocks and bonds in general are still not cheap. The main efforts right now are to stay clear of assets that depend on leverage or structured finance, to continue building research on possible future additions, and to actively map scenarios of various monetary policy trajectories.

## Transactions review

There was only one transaction in the quarter and that was a significant addition to the managed futures fund, CTA. While CTA is classified as noncorrelated, it has actually been inversely correlated to the S&P 500 this year. As such, it has provided enormous diversification benefits to the All-Terrain strategy. For the time being at least, it seems many of the factors hurting stocks are being captured by the trend-following strategies of CTA.



## Performance review

With the All-Terrain strategy now being the sole focus, here are some of the general principles that guide its management.

The search for undervalued assets remains the same, although the scope of that search expands now encompasses a broad universe of publicly traded securities and funds.

The overarching goal of providing attractive returns to investors on an absolute basis also remains the same. As many markets became significantly overvalued, this is especially important to keep in mind.

Finally, the major change features a greater emphasis on diversification. This new focus will elevate the importance of uncorrelated return streams and reduce the importance of individual security performance.

Since the Areté All-Terrain Allocation (ATA) strategy started at the end of August, performance is reported from that date.

For the third quarter, the ATA strategy returned -0.91% (net of fees) while VBIAX returned -4.50%. The significant outperformance again highlighted many of the major dimensions of the strategy.

Primarily, the large cash position proved useful in the context of both stocks and bonds going down for the quarter. Other diversifying investments again proved effective in offsetting losses in some securities.

The large allocation to gold proved disappointing in the quarter as rate hikes

provided for positive yields on cash and gold provides no yield. Insofar as gold serves as a hedge on the confidence in central banks, however, the longer-term prospects are still very much intact.

## 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.

### **Asset allocation is a key function of wealth management**

One of the most important functions for long-term wealth accumulation is to have access to certain asset classes when they are attractive and to be able to minimize exposure to other asset classes when they are extremely unattractive. In short, diversification moderates the long-term swings in portfolio performance and therefore significantly increases the chances of wealth accumulation over a reasonably long investment horizon.

### **Mispriced assets are an important source of performance**

One of the keys to investment performance is finding and exploiting market inefficiencies. While such inefficiencies can arise in the form of mispriced securities, they can also arise in the form of over- or under-valued industries or asset classes.

Identifying such opportunities begins with the assessment of underlying intrinsic value. When disparities with market prices exist and clear rationale for such mispricing can be identified, there are opportunities to take advantage of the differential.

### **Information management is a core skill of investment management**

Analyzing investment opportunities and developing portfolio construction is a dynamic exercise that involves a constant and ongoing process of gathering information, processing it, analyzing it, developing knowledge, and applying it for the benefit of clients.

### **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. This approach is notably distinct from the common practice of simply gathering assets.

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.

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 All-Terrain Composite

**Areté Asset Management, LLC**  
**All Terrain Composite**  
**August 31, 2021 - September 30, 2022**

| Period    | Gross-of-Fees<br>Return<br>(percent) | Net-of-Fees<br>Return<br>(percent) | Vanguard balanced          |                            | Internal<br>Dispersion<br>(percent) | Total<br>Composite<br>Assets<br>(\$) | Composite<br>Assets<br>With Bundled<br>Fees (\$) | Percentage<br>of Composite<br>Assets With<br>Bundled Fees | Total<br>Firm<br>Assets<br>(\$) |
|-----------|--------------------------------------|------------------------------------|----------------------------|----------------------------|-------------------------------------|--------------------------------------|--|---|---------------------------------|
|           |                                      |                                    | Index<br>Fund<br>(percent) | Number<br>of<br>Portfolios |                                     |                                      |  |   |                                 |
| 2021      | 0.06                                 | -0.20                              | 2.22                       | 3                          | NA                                  | 841,887                              | 841,887  | 100%  | 1,460,255                       |
| 2022      |                                      |                                    |                            |                            |                                     |                                      |  |   |                                 |
| January   | -1.04                                | -1.27                              | -4.52                      | 3                          | NA                                  | 831,184                              | 831,184  | 100%  | 1,444,243                       |
| February  | 2.02                                 | 2.02                               | -1.96                      | 3                          | NA                                  | 847,963                              | 847,963  | 100%  | 1,470,743                       |
| March     | 3.65                                 | 3.65                               | 0.84                       | 3                          | NA                                  | 878,895                              | 878,895  | 100%  | 1,520,113                       |
| April     | -0.58                                | -0.83                              | -7.00                      | 3                          | NA                                  | 871,564                              | 871,564  | 100%  | 1,796,422                       |
| May       | -0.88                                | -0.88                              | 0.14                       | 3                          | NA                                  | 863,873                              | 863,873  | 100%  | 1,776,888                       |
| June      | -3.22                                | -3.22                              | -5.66                      | 3                          | NA                                  | 836,027                              | 836,027  | 100%  | 1,726,023                       |
| July      | -0.63                                | -0.88                              | 6.50                       | 3                          | NA                                  | 828,626                              | 828,626  | 100%  | 1,708,959                       |
| August    | -0.61                                | -0.61                              | -3.29                      | 3                          | NA                                  | 823,581                              | 823,581  | 100%  | 1,698,941                       |
| September | 0.58                                 | 0.58                               | -7.27                      | 3                          | NA                                  | 828,357                              | 828,357  | 100%  | 1,714,003                       |
| Q1        | 4.64                                 | 4.40                               | -5.60                      | 3                          | NA                                  | 878,895                              | 878,895  | 100%  | 1,520,113                       |
| Q2        | -4.64                                | -4.87                              | -12.13                     | 3                          | NA                                  | 836,027                              | 836,027  | 100%  | 1,726,023                       |
| Q3        | -0.66                                | -0.91                              | -4.50                      | 3                          | NA                                  | 828,357                              | 828,357  | 100%  | 1,714,003                       |
| YTD       | -0.87                                | -1.59                              | -20.79                     | 3                          | NA                                  | 828,357                              | 828,357  | 100%  | 1,714,003                       |

Areté Asset Management All-Terrain performance composite disclosures follow:

### 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 All-Terrain performance composite disclosures continued:

### **Benchmark**

The benchmark is the Vanguard Balanced Index Fund Admiral Shares (VBIAX), 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 All-Terrain allocation strategy composite was created in August 2021 and includes all fee-paying, taxable and non-taxable, discretionary, long only, fully invested portfolios benchmarked to the Vanguard Balanced Index Fund. 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” when it breaches the threshold of 90% similarity with core composite portfolios. Each portfolio will remain in the composite until its similarity with core composite portfolios falls under 90%. 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.

Areté Asset Management All-Terrain 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.