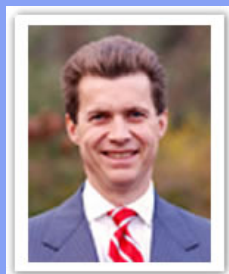




In Pursuit of Value

December, 2011

SL Advisors, LLC is a registered investment advisor offering separately managed accounts to individuals, family offices and institutions.



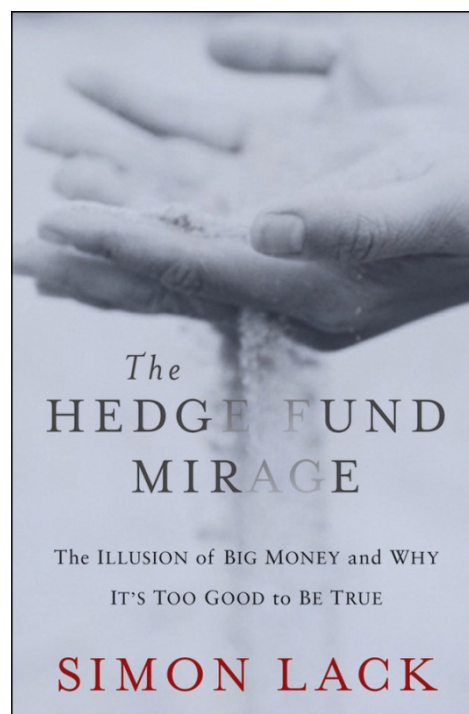
The Hedge Fund Mirage

Ernest Hemingway once said, “There’s nothing to writing. All you do is sit down at a typewriter and bleed.” Writing *The Hedge Fund Mirage* wasn’t as intense and the writer’s tools have evolved. But it still represents an act of faith that people will care what you have to say. Perhaps the most distressing reader response is indifference.

Until last year I never thought I’d write a book. Contemplating such a project and the daunting volume of output seemed absurd (how does one produce 60 *thousand* worthwhile words?), and the notion that I possessed an insight so far not articulated elsewhere somehow arrogant. However, I managed to overcome both obstacles with indecently little trouble and the result is a volume that I hope will be interesting, provocative and at times entertaining.

I learned that to write, you need to care passionately about your subject and be qualified to discuss it. Helping hedge fund investors achieve better outcomes turns out to be one of the few ideas, or perhaps the only one, for which I can check both boxes. While there is a great deal to admire in the investing insight possessed by some of today’s most successful hedge fund managers, I never liked the role of supplicant required of those who would be their clients. The enduring supply/demand imbalance around talent has led investors to endure steadily worsening terms as their numbers have swollen. Recurring equity market shocks, miniscule interest rates and aging populations of future retirees are all adding urgency to the preservation of long term purchasing power. Hedge funds may be part of the solution but if so substantially more of their profits will have to wind up with clients than has been the case so far. The issue is far more than simply one of helping sophisticated, wealthy people stay wealthy. Public pension funds are increasingly relying on hedge funds to meet their retirees’ needs, and as we discovered in 2008 private obligations can all too easily become public ones if assumed returns don’t materialize. Done poorly, this will become a public policy issue and another drain on tomorrow’s taxpayers.

Ask Amazon “How to Write a Book” and the website suggests 146 different titles. It turns out that the way to get a non-fiction book published is to write a book proposal, not a book. The most important part of the proposal is, of course, the Marketing Plan. While I naively assumed that the book is the point, for the publisher making money is really the point. How could a creature of financial markets overlook the profit motive in others? Having gratefully found my way to John Wiley and the undoubtedly better book their partnership has helped create, I also understand why so many writers have two jobs. Many professionals (literary agent, lawyer, and publicist) offer their services along the



*SL Advisors, LLC
focuses on identifying
securities that are
trading at a discount to
intrinsic value.*

way, but the meager pool of net income retained by the writer can be quickly exhausted by such help. The “negotiations” I pursued with John Wiley had much in common with an investor seeking access to a highly desirable hedge fund although Wiley’s charming Acquisition Editor made it an enjoyable process. However, I’m not a complete pushover and so I did manage to retain the movie rights. Since I’m holding out for Brad Pitt to play the starring role the screenplay is not yet far advanced.

At some point you have to put down your pencil and stop writing. Working on weekends during the snowy winter of 2011, at times the words flowed in abundance. I surprised myself at how much I had to say. But the revising and editing is really never over. Every re-reading reveals opportunities for improvement, and while I fervently hope there are no factual errors in the final product the prose, however imperfect, is truly the result of my best efforts. It has already been an enjoyable journey, and the book’s release in January will lead to a much more public phase. I hope you enjoy reading it and, as I’ve told many friends already, stop by my office in Westfield, NJ anytime and I’ll be happy to sign your copy. You can even pick one up from the Town Book Store at 270 Broad Street in Westfield, and then walk two blocks to visit the author.

For those readers that are impulse buyers, here’s the [link](#):

Bond Math

You don’t need a degree in Psychology to know that investors are nervous. Pick up any newspaper, or just take your own pulse. Macro issues dominate almost every investing decision, and it’s therefore not surprising that the safety of bonds remains attractive.

No doubt fixed income has had a great run. The Dow Jones Corporate Bond Index, a benchmark of long duration investment grade debt, has returned 7.9% p.a. since the beginning of the millennium. The S&P500 has managed 0.5% p.a. over the same period. Investing by looking backwards can be reassuring – generally if something has happened before, it can happen again. Bonds look better than stocks in the rear-view mirror and they can appear pretty compelling looking forward too. If the Euro collapses then for stocks, so goes the conventional wisdom, down is a long way. And so it might be.

But here’s the Math. High grade bonds (as defined by the relevant iShares ETF, LQD) yield 4.4%. That is what the hold-to-maturity investor in long term corporate debt can hope for. Factor in a 40% tax rate on interest payments with 2.5% inflation and it will be hard to maintain purchasing power. Stocks were roughly 2.5 times as volatile as bonds over the last decade – selling those bonds and putting 40% of the proceeds in large cap, dividend paying stocks that yield 3.5% (with the rest, for now, in cash) maintains the same overall portfolio volatility and only requires 3.8% dividend growth to beat bonds (compared with a fifty year growth rate of 5%). The 60% in cash provides a useful option to invest at a later date when prospects are clearer – and who knows, maybe one day interest rates with an integer could return to the money markets.

Ben Bernanke is steadily raising the stakes for those bond investors who wish to invest alongside him. The Fed’s QE2 program has created a large and non-commercial buyer for debt that is not motivated by profit. Indeed, the Fed’s objective is to create an environment in which bond investors wish they owned something else. Real returns on investment grade and government debt are likely to remain negative for an extended period of time. The Fed has the ability to ensure this state of affairs persists indefinitely should they so desire. “I promise you negative real returns for many years” may not be a catchy soundbite, but if Chairman Bernanke said those words they would not require any change in monetary policy. While it’s usually good to follow the smart money, in this case it may be academic smarts rather than street smarts that are on display. The most significant long term challenge facing investors must surely be identifying alternatives to traditional fixed income.

Merry Christmas, Happy Holidays and All the Best for 2012!

SL Advisors runs a variety of separate strategies in Fixed Income, Equities and Absolute Return. Contact us for more information, or go to our website: www.sl-advisors.com

Hedged Dividend Capture Strategy (%)

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2006	0.7	0.7	-1.3	1.4	1.7	1.2	3.6	2.0	0.9	2.3	0.9	1.2	16.2
<i>Index</i>	-0.1	0.7	-1.7	-0.5	-0.4	-0.4	1.6	2.1	1.2	1.1	1.4	-1.1	3.8
2007	0.4	1.3	2.7	1.8	-0.5	-2.2	-2.4	1.9	1.9	2.9	1.9	-0.3	9.9
<i>Index</i>	0.2	2.2	-0.7	0.9	-1.2	-0.4	0.2	1.1	0.6	1.2	0.7	0.4	5.2
2008	-4.0	-0.1	1.7	0.8	1.8	-1.8	1.7	1.6	2.0	-0.1	3.2	-0.2	6.5
<i>Index</i>	1.7	-0.1	-0.7	0.8	-1.0	-0.5	-0.5	0.8	-5.9	-5.1	4.9	8.3	1.8
2009	2.4	-4.3	-1.1	-4.5	1.6	4.4	1.7	-0.2	-0.1	0.5	2.5	2.4	5.0
<i>Index</i>	0.8	-2.1	-0.6	3.1	4.1	2.8	4.6	1.4	1.7	0.7	1.6	-1.5	17.6
2010	-0.7	-1.1	0.6	-0.2	-1.3	3.2	2.1	3.9	-0.1	0.4	-2.4	-0.3	3.9
<i>Index</i>	1.5	0.4	0.2	1.8	-0.6	2.2	2.2	1.9	0.6	0.1	-0.8	-0.8	8.8
2011	-1.8	0.8	1.4	3.1	2.6	0.0	-0.7	4.0	1.7	-0.8	0.0		10.7
<i>Index</i>	-0.1	0.7	-0.2	1.8	1.6	-0.9	2.6	0.2	0.4	2.2	-2.1		6.0

Returns are from a long portfolio of 58 equally weighted equities from which actual positions are selected, hedged to be beta neutral. This is not a return from an actual portfolio. The Index is the Dow Jones Corporate Bond Index, an equally weighted index of 96 investment grade bonds. Returns are gross of fees. Past performance is not indicative of future returns.

Deep Value Strategy Monthly Returns (%)

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2009							8.9	0.6	9.3	1.6	1.4	9.7	35.4
<i>Index</i>							7.6	3.6	3.7	-1.9	6.0	1.9	22.6
2010	-1.3	4.3	3.9	3.1	-3.9	-4.6	4.9	7.2	7.8	1.2	1.0	2.7	28.8
<i>Index</i>	-3.6	3.1	6.0	1.6	-8.0	-5.2	7.0	-4.5	8.9	3.8	0.0	6.7	15.1
2011	0.2	2.6	1.9	2.4	-2.2	-2.8	0.4	-5.1	-9.1	12.2	-0.4		-1.2
<i>Index</i>	2.4	3.4	0.0	3.0	-1.1	-1.7	-2.0	-5.4	-7.0	10.9	-0.2		1.1

Returns do not include cash balances prior to November 2009. YTD returns are unannualized compounded returns. The Index is the S&P 500 including dividends. Returns are net of fees. Past performance is not indicative of future returns.

MLP Strategy Monthly Returns (%)

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2008	4.5	3.0	-0.8	1.9	4.2	-6.4	-2.0	0.6	-14.9	-1.1	-25.4	7.4	-29.5
<i>Index</i>	-0.6	-0.5	-6.3	7.3	1.0	-4.9	-1.7	1.7	17.2	-0.1	17.1	-3.7	-36.9
2009	15.2	-2.1	5.0	5.2	9.0	-1.1	10.1	0.1	1.0	2.3	6.2	5.0	70.7
<i>Index</i>	15.3	-4.2	0.7	11.0	9.3	-1.7	12.4	-3.2	4.8	2.9	6.4	6.6	76.4
2010	0.7	5.4	2.0	2.4	-4.5	5.1	5.8	-1.6	5.0	2.0	3.2	2.7	31.7
<i>Index</i>	0.6	4.6	2.9	3.4	-5.4	5.6	7.5	-2.5	6.1	5.4	1.9	1.7	35.9
2011	1.2	5.1	0.0	2.6	-4.3	1.8	-2.4	-0.4	-3.3	9.1	0.1		9.0
<i>Index</i>	3.0	3.5	-0.6	3.3	-5.0	1.1	-1.9	-1.1	-4.1	10.3	-0.2		7.7

Returns do not include cash balances prior to May 2010. The Index is the Alerian MLP Index, AMZX. Returns are net of fees. Past performance is not indicative of future returns.

SL Advisors offers separately managed accounts for individuals, family offices and institutions across various investment strategies. Client assets are held with Charles Schwab, the largest provider of custody services in the U.S. with assets of \$1.36 trillion and 7.9 million individual accounts (as of June 30, 2010). Client portfolios are completely transparent via Schwab's extensive website which provides real-time access to accounts and all supporting information. Detailed monthly statements are mailed directly to clients from Schwab.

SL Advisors Hedged Dividend Capture Strategy

An alternative to bonds, this strategy utilizes stocks of stable companies with high dividend yields to generate income with capital appreciation by investing in a diverse, unleveraged, hedged portfolio of U.S. equities. Companies are selected that possess a history of steady earnings growth, attractive dividend yields and are less volatile than the overall market. The long positions are hedged with a short S&P500 position with the objective of making the portfolio beta neutral while still maintaining a net long equity exposure. Historically this strategy has exhibited monthly swings comparable to corporate bonds, and given the relative attractiveness of equities compared with investment grade bonds it has a more attractive return outlook. This strategy may be considered as a substitute for a portion of an investor's fixed income allocation.

SL Advisors Deep Value Equity Strategy

A portfolio of undervalued stocks of high quality businesses that aims to outperform the S&P500. Investments are in listed U.S. equities trading significantly below the intrinsic value of the underlying enterprise. Potential investments are identified both qualitatively and quantitatively following which detailed research is performed to assess fundamental value. Desired characteristics of businesses include pricing power, low leverage, low costs of production, and attractive valuation. Valuation is defined to us foremost as the net present value of cash one can extract from proportional ownership of the business, then relatively using peer multiples and finally liquidation value. The portfolio is reassessed constantly and all holdings are rated for return potential and risk against their peer group to rebalance into the most attractive opportunities. This strategy is part of the equity allocation for balanced accounts for individuals, and is also appropriate as an alpha seeking equity strategy for institutional accounts.

SL Advisors MLP Strategy

This portfolio consists of 10-15 investments in Master Limited Partnerships (MLPs) to receive a healthy and growing tax deferred income stream. MLPs are publicly traded interests in energy infrastructure and related assets. They represent direct proportional ownership stakes in the underlying assets rather than securities in a corporation. Historically they have paid regular distributions which have grown with the U.S. economy, and as such they can be suitable for investors seeking income generating investments with a tolerance for equity market exposure. The strategy engages in low turnover so as to minimize transaction costs and benefit from the income tax deferral features of the asset class. MLPs are appropriate for high net worth investors comfortable with receiving a K-1 for each investment rather than a 1099. SL Advisors does not provide tax advice.



SL Advisors regularly publishes investment research on Seeking Alpha's website. Click on the image to read more, or go to <http://seekingalpha.com/author/sl-advisors>.

The Hedge Fund Mirage, my new book, will be out in January. Go to:

<http://www.hedgefundmirage.com>

DISCLOSURES: This document is not an offer to sell (or solicitation of an offer to buy) securities in the United States or in any other jurisdiction. Any reproduction or distribution of this document, as a whole or in part, or the disclosure of the contents hereof, without the prior written consent of SL Advisors, LLC, is prohibited. Notwithstanding the general objectives and goals described in this document, readers should understand that SL Advisors, LLC is not limited with respect to the types of investment strategies it may employ or the markets or instruments in which it may invest (subject to any contractual arrangements and/or applicable law). Over time, markets change and SL Advisors, LLC will seek to capitalize on attractive opportunities wherever they might be. Depending on conditions and trends in securities markets and the economy generally, SL Advisors, LLC may pursue other objectives or employ other techniques it considers appropriate and in the best interest of its clients (subject to any contractual arrangements and/or applicable law).

Contact info:

*SL Advisors, LLC
210 Elmer Street
Westfield, NJ 07090-2128
908-232-0830
sl@sl-advisors.com
www.sl-advisors.com*