



In Pursuit of Value

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

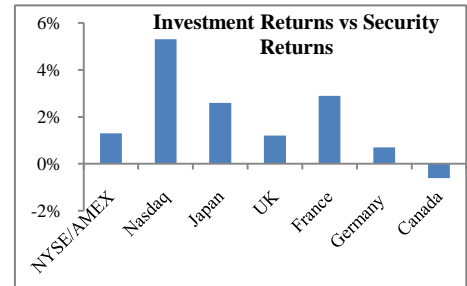


Timing is Everything

Back in the 90s when tennis had some personalities and Andre Agassi was monetizing his hip, “bad boy” image by selling Canon digital cameras, he would assert that “Image isn’t everything; it’s the only thing.” It would be only a modest overstatement to say the same of timing with respect to investing in equities. What you invest in obviously counts for a great deal, but timing matters for investors both individually and in aggregate.

Returns for securities and market indices are conventionally expressed as if \$1 was invested at the beginning of the period and sold for its value at the end of the period, with dividends reinvested over time. Returns on portfolios are typically calculated to reflect timing of inflows and outflows. The difference is important; if you buy 100 shares of Hot New Stock (HNS) at \$10, grin while it rises to \$20 where you buy another 50 shares, and then grimace as it sinks back to \$12, the return on HNS the stock is 20%, but your \$2,000 investment in HNS is only worth \$1,800 and has lost 10%. Unfortunate timing for one individual, but for every buyer there’s a seller and presumably in this example the investor who sold HNS did well. Just as buys and sells net out, gains and losses should too, so that in aggregate HNS investors made 20%. However, if the seller of the stock at \$20 is HNS itself (i.e. it issued new shares) things become less clear. It could be that the investors overall lost out. In the above example, the *security* return on HNS was 20%, whereas the *investment* return for this investor was -10%.

Investment returns often are lower than security returns. In 2004 Ilya Dichev (now at Goizueta Business School, Emory University, Atlanta) wrote a research paper “What are stock investors’ actual historical returns? Evidence from dollar-weighted returns”, and although it’s somewhat dated, his conclusions (based on over 30 years of data) are no doubt still valid. It turns out that companies are better than you might think (and therefore, investors are correspondingly worse) at timing the market. IPOs and secondaries tend to happen at prices that suit the seller (i.e. the company raising the capital), while stock buybacks and acquisitions (by a private buyer such that they result in a delisting) generally take place at good prices for the buyer. The Nasdaq represents an acute case of the problems of market timing. From 1973-2002 returns to investors were 5.3% per annum worse than the Nasdaq index itself, a differential large enough to drive aggregate returns down to the risk free rate. The 1999-2000 market climax saw \$1 trillion of new money invested through hot IPOs and secondaries. Even today that’s a lot of money. To cite another example, research done on Peter Lynch’s record during his time running the Magellan Fund found that from 1981-90 the average investor earned 13.4% annually compared with the S&P’s 16.2% and Magellan’s reported return of 21.8%. The result is that across markets and timeframes, investors do worse than the securities they invest in. The chart illustrates the difference between what investors earned and what indices returned in the six largest markets from 1973-2002 (NYSE/AMEX is 1926-2002). It’s a reliable phenomenon.



A good part of the problem is caused by investors’ efforts to time the market. It’s rarely easy, and can be very harmful to returns. Today, as on most days, the equity markets appear quite risky. There are numerous potential headwinds, currently including (in no particular order): potential gamesmanship in Congress over raising the debt ceiling; China’s efforts to combat inflation; instability in the Middle East;

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

high energy prices; excess debt at just about every level of government in the U.S. and in most other developed countries as well. Few could be surprised if any of these issues depress markets in the weeks ahead. Quite understandably, the “top down” or macro perspective frequently induces caution.

By contrast, it’s still possible to find interesting investments at an individual level, many of which we’ve written about in recent months (one of which is profiled below). Figuring out the near term movements of the stock market is not something we spend much time on. We’re by no means the first people to have concluded it’s too hard. Finding attractively priced investments requires hard work too, but at least the research effort can be cumulative as more time reading and networking result in (hopefully) a better understanding of the opportunity. In addition, the contrasting results illustrated by Mr. Dichev would suggest that, while timing’s important, if you don’t have any timing insight then don’t take any timing risk. Consequently, we choose what we think is the easier road: put serious thought into your asset allocations and stick with them; review them only infrequently, when circumstances change.

What We Own

Gannett (GCI) is an old media company that’s turning into a new media one. Newspapers are by any measure a business in decline. Having read the Times and the Journal every day for decades commuting into New York, I wasn’t one of the first to make the internet my primary source of news. My children are the first generation in three centuries to start their day without a daily newspaper. Shrinking at a low single digit pace is probably the best the industry can hope for. But in addition to owning 82 daily newspapers (including USA Today) in its Publishing division, GCI also owns 23 TV stations that reach 18% of the U.S. population in its Broadcasting division and a wide variety of websites in its Digital division.

Pessimism about the newspaper industry has pressured the stock which currently trades at less than seven times next year’s earnings. Although newspaper advertising will likely shrink 3.5% this year, and Broadcasting’s year-on-year comparisons will appear weak with no Presidential election or Olympics to drive ad spending, growth in their Digital division is accelerating and by next year top line revenues should be increasing once again. They own a dizzying array of narrowly targeted websites, such as CareerBuilder, ShopLocal, PointRoll (digital marketing) and Schedule Star (a high school athletic scheduling platform). They’re also managing the conversion from newspaper to website better than most (the company notes that its USA Today newspaper layout is inspired by today’s web design). Meanwhile, the company is showing good expense discipline and is generating substantial amounts of cash. Last year they generated \$773 million in operating cashflow, and with minimal capex needs they paid down over \$700 million in debt. At that rate they could eliminate their \$2.2 billion long term debt within three years, which might allow them to start buying back shares or even make them an acquisition target. However, with leverage of just 1.9x EBITDA, Gannett is well under the company’s debt covenant of 3.5x and doesn’t need to further reduce debt levels. Management can conservatively start returning cash to shareholders through share repurchases and increased dividends. For example, if management decided to return all free cash flow to investors, they could retire a quarter of shares outstanding each year at current prices. Or if they decided to pay out 100% of free cash flow as dividends, they could raise the dividend from \$0.64 to \$3.50. At a 10% yield, GCI would trade at more than double its current \$15/share while shareholders collect a large dividend. GCI is a holding in our Deep Value Strategy.

SL Advisors runs three separate strategies: Fixed Income, Deep Value and Discount Arbitrage. Contact us for more information, or go to our website: www.sl-advisors.com

Fixed Income Strategy Monthly Returns (%)

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2009							9.6	4.3	6.3	-1.2	1.8	1.4	24.0
<i>Index</i>							7.0	1.5	2.2	1.5	1.6	-1.5	12.7
2010	2.7	1.5	2.7	1.8	-2.1	0.3	0.8	0.8	1.0	0.3	-1.0	0.0	9.0
<i>Index</i>	1.5	0.4	0.3	1.8	-0.6	2.2	2.2	1.9	0.6	0.1	-0.8	-0.8	8.8
2011	0.4	0.2	0.2	1.2									2.0
<i>Index</i>	-0.1	0.7	-0.2	1.8									2.1

Returns do not include cash balances prior to November 2009. YTD returns are unannualized compounded returns. The Index is the Dow Jones Corporate Bond Index, an equally weighted index of 96 investment grade bonds. Returns are net 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	0.1	2.4	1.9	2.4									7.3
<i>Index</i>	2.4	3.4	0.0	3.0									9.1

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.

Discount Arbitrage Strategy Monthly Returns (%)

	Jan	Feb	Mar	April	May	June	July	Aug	Sep	Oct	Nov	Dec	YTD
2009											-0.2	0.9	0.7
2010	0.8	0.0	-0.7	-0.8	-0.6	1.3	0.1	1.6	1.4	-0.1	0.1	0.8	4.0
2011	-0.7	0.0	1.6	-0.7									0.2

YTD returns are unannualized compounded returns. Past performance is not indicative of future returns.

SL Advisors offers separately managed accounts for individuals, family offices and institutions across three different 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 Fixed Income Strategy

A diverse portfolio of U.S. government debt, investment grade corporate credit, bank debt, and sovereign emerging market debt. The objective is preservation of capital combined with income generation. The portfolio's exposure to interest rates and credit spreads changes depending on the manager's outlook and assessment of relative value opportunities in each sector. Income generating investments with appropriate risk are favored when interest rates are stable or rising, while longer duration investments are selected when interest rates are falling. Investments are through ETFs, listed closed end funds and U.S. government securities. This strategy represents the fixed income allocation for balanced accounts, and is most appropriate for individuals, family offices and smaller institutional accounts.

SL Advisors Deep Value Equity Strategy

A portfolio of 10-20 names that are deeply undervalued. Investments are in listed U.S. equities trading significantly below the value of their tangible assets. In addition, they must have a strong balance sheet with relatively low debt and are likely to be underperforming similar securities in the recent past. Industries include energy, mining, shipping, infrastructure and others with hard assets where tangible value can be assessed. Potential investments are identified through a proprietary screen following which detailed research is performed to assess underlying value. The likely holding period is generally at least several months but can extend to one or two years until value realization occurs. The portfolio is reassessed regularly and all holdings are rated for return potential and risk against their peer group, which often results in rebalancings to upgrade into more attractive opportunities. This strategy is part of the equity allocation for balanced accounts for individuals, and is also appropriate as a deep value equity strategy for institutional accounts.

SL Advisors Discount Arbitrage Strategy

This portfolio consists of several sub-strategies that seek to extract value from pricing inefficiencies while minimizing market risk. One sub-strategy holds the same positions as the SL Advisors Deep Value Equity Strategy combined with a market hedge. Another sub-strategy takes long positions in closed end funds that are underpriced and hedges out the market risk. A third sub-strategy invests in special situations where a pricing inefficiency can be identified and isolated from overall market risk. Occasionally other sub-strategies will be employed when opportunities appear. Securities used include equities, listed closed end funds and ETFs. Broad equity market exposure is hedged away so this strategy is managed on a market-neutral basis to generate steady returns that are uncorrelated with other major asset classes, and is appropriate for institutional accounts.



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>.

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