

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

forecast that doesn't leave much room for error in either direction.

Virtually all investors have an allocation to fixed income in one form or another. While bonds have not looked cheap for a long time it does seem that today's low yields, distorted as they are by government intervention, demand a robust response from investors. Since public policy is to make the goal impossibly narrow, maybe it's time to take your ball and go home. If an investor shifted \$100 out of fixed income and allocated \$80 to 0% yielding cash, the remaining \$20 invested in risky assets (such as equities) need only grow at 6% p.a. pre-tax to generate the same \$113 of ultimate value as in the ten year treasury example above (assuming a 15% tax rate on dividends and capital gains).

To illustrate with some brief Math: since dividend yields are 2%, this only requires 4% of annual growth. 2% dividend yields imply companies are paying out only 2/9ths of profits (as earnings yields are 9%). The remaining 7/9ths that's retained would need to earn a return on equity (ROE) of only 5% to generate the 4% dividend growth noted above (dividend growth = % of earnings retained X ROE; 7/9ths of 5% is approximately 4%). A 5% ROE is around half the current cost of equity implied by the S&P500's 9% earnings yield. To summarize without the Math – being more pessimistic than this probably isn't the winning side of the trade over the long run. In the short run, anything can happen.

The 80/20 Cash/Stock substitute for fixed income doesn't need to jump very high to clear the performance hurdle that's been set. It incorporates some attractive upside, in that dividends may grow faster than 4%. And one day in the far distant future, maybe cash will even sport a yield again as it once did. This strategy also provides the flexibility to invest some of the cash at a later date, perhaps when the economic outlook is clearer and when bonds would presumably have to be sold at a loss.

We don't yet have the requisite Newsweek cover announcing "Why You Should Only Invest in Bonds", but the Math is starting to look compelling. Alternatives to bonds include MLPs (currently offering around 6% tax deferred yields with a solid history of distribution growth); stocks with long histories of reliable dividends; bank debt, and the cash/equities barbell described above.

Hedged Dividend Capture Strategy

Regular readers of this newsletter will be familiar with our antipathy towards U.S. interest rate policy. A stealth transfer of real wealth from the thrifty to the profligate has been under way since 2008 with no sign of ending anytime soon. As the Federal Reserve buys more bonds, our thinking is that investors should hold less. The Math is particularly unappealing as discussed above.

To that end, SL Advisors is launching **The Hedged Dividend Capture Strategy** which seeks to generate income from a portfolio of dividend paying stocks hedged with a short position in the S&P500. By selecting a diversified portfolio of stable companies with a history of earnings growth and reliable dividends, the strategy exploits the fact that many companies sport dividend yields that are comparable with bond yields (and dividends grow, whereas bond coupons don't). Such stocks generally move less than the market, and so it's possible to hedge them to be "beta" neutral and so reduce the day-to-day risk while still maintaining an overall long position. The net result is a portfolio that has similar volatility to corporate bonds but we believe has a much more attractive return potential through earnings growth.

As pointed out in the article above, replacing some fixed income exposure with a combination of as little as 20% in equities and the rest in cash provides a more attractive risk/return profile than is currently available in bonds. **The Hedged Dividend Capture Strategy** offers a similar opportunity to seek better overall returns using a diverse portfolio of regularly profitable companies while maintaining levels of risk commensurate with high grade corporate bonds.

We would be happy to discuss the strategy in more detail with anyone interested in an alternative to today's ruinously low interest rates which virtually guarantee a loss in purchasing power after taxes and inflation.

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				11.5
<i>Index</i>	-0.1	0.7	-0.2	1.8	1.6	-0.9	2.6	0.2	0.4				6.1

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	0.1	2.4	1.9	2.4	-2.2	-2.8	0.4	-5.1	-9.1				-11.8
<i>Index</i>	2.4	3.4	0.0	3.0	-1.1	-1.7	-2.0	-5.4	-7.0				-8.7

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	-0.3	-3.0				0.2
<i>Index</i>	3.0	3.5	-0.6	3.3	-5.0	1.1	-1.9	-1.1	-4.1				-2.1

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 unlevered diverse portfolio of U.S. equities that possess a history of steady earnings growth, attractive dividend yields and are less volatile than the overall market. The long equities are hedged with a short S&P500 position with the objective of making the portfolio beta neutral while still maintaining a net long equity position. 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 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 MLP Strategy

This portfolio consists of 10-15 investments in Master Limited Partnerships (MLPs). 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 later this year. Go to:

<http://as.wiley.com/WileyCDA/WileyTitle/productCd-1118164318.html>

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