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In Pursuit of Value

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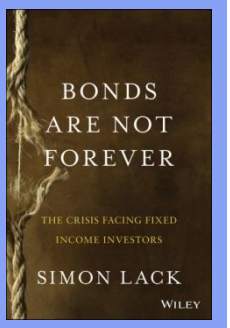
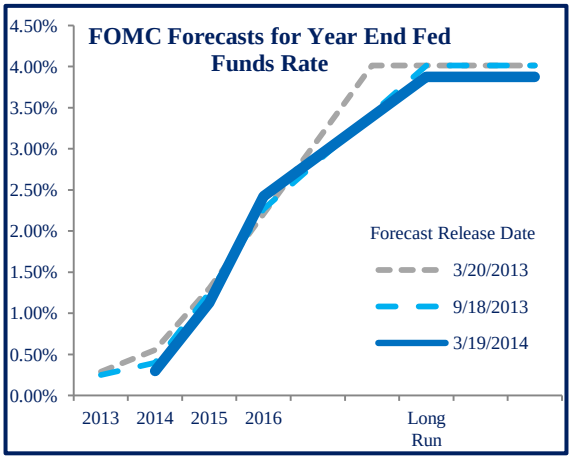


Quarterly Outlook

The evaluation of any investment relies on an interest rate with which to discount the future expected cashflows. Janet Yellen is now the primary source for this most basic building block of finance. Consequently, her recent press conference was of greater than typical interest. Her prior speeches as well as her six years (2004-10) heading up the Federal Reserve Bank of San Francisco (presumed to be as liberal as its neighborhood) have cast her as ever so slightly more willing than her predecessor to tolerate higher inflation in search of higher employment; such differences as may exist are probably far too subtle to be measured, and in any case the Fed routinely notes that there is no long term trade-off between their twin mandates (maximum employment with stable inflation).

It's been amusing to see talking heads (too forgettable to quote) on cable TV solemnly note that changes in leadership at the Fed "usually" cause an economic slowdown. My own career in Finance had until last month encompassed only two such changes and three Fed chairman (Paul Volcker, Alan Greenspan and Ben Bernanke). We've had more frequent changes at the White House, so opining on TV about any type of pattern simply confirms that TV producers occasionally need warm bodies to fill the gaps between commercials (a suspicion sometimes reinforced when I'm invited on TV myself).

A careful reading of the transcript from Janet Yellen's recent press conference and a review of the FOMC projections released suggests that very little has changed about the interest rate outlook notwithstanding the market's initial conclusion that rates will rise faster than anticipated. The chart of "blue dots" which reflect individual FOMC-member expectations for short term rates barely changed. The median forecast for the Fed Funds overnight rate at the end of next year is 0.75%, the same as it was in December. The average forecast rose from 1.06% to 1.13%, hardly substantial and in any case caused largely by the two highest forecasts moving even higher. Low rates for a long time remains the most likely outcome. The probable interval between the end of the Fed's bond buying and the beginning of higher rates (estimated at six months by Chair Yellen) seems dictated by the rhythm of eight FOMC meetings per year and their strong preference to announce policy changes ($10 BN less bond buying; 0.25% increases in Fed Funds) following each meeting. It's also highly doubtful that her objective in her first press conference leading the Fed was to cause a shift in interest rate expectations. The forecast path for short term rates defined by the FOMC remains the most likely way forward. It signals a Fed Funds rate of 1.13% by the end of next year and 2.42% by the end of 2016, as has been approximately the case for quite a while. The Fed's inflation forecast doesn't exceed 2% for almost three more years (through 2016) so they evidently see plenty of excess capacity in the economy. Surprises will assuredly occur, but for now it looks like a very long time until interest rates will rise to levels that make bonds once again an attractive proposition.



An important thematic element in our investment approach is the selection of stable companies with a high likelihood of growing their earnings year after year without the use of excessive leverage. The stock prices of such companies tend to have low betas (meaning they're less volatile than the overall market). Investing

styles move in and out of fashion just like colors; although the low beta tortoise usually beats the momentum-driven hare, the short run race is unpredictable. By our measure the hare has been winning for the past three quarters, although there are recent signs that the pendulum is swinging back. While there are regrettably no reliable signposts to indicate when the "in" style is about to shift, qualitatively there seems to be less media attention on the urgency to get in to stocks. To paraphrase Ben Graham, perhaps the in-vogue investing style is switching from that of a voting machine in which fund flows drive popular stocks higher to that of a weighing machine in which earnings drive returns.

MLPs

MLPs had a great 2013 even by the standards of the asset class. So far this year the index returns have been unexciting (like equities) although we've managed to outperform the index by a decent margin. Kevin Kaiser of Hedgeye, a Connecticut-based research firm, may be the most notorious analyst following the sector. There's little doubt that Hedgeye punches above its weight in terms of press exposure, as one might expect given their contrary view. In recent months they've moved from recommending selective sales of certain MLPs to being broadly negative on the entire sector. This view was provided with a wider platform a few weeks ago when Barron's based an article largely on an interview with Kevin Kaiser.

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

An important differentiator within MLPs, one we think has been long overlooked, is whether there is a GP taking a share of the distributable cash flow (DCF) or not. As we've noted before, we have positioned our MLP strategy to be virtually free of the drag from GP Incentive Distribution Rights (IDRs). The GP is to an MLP as is the hedge fund manager to his hedge fund. GPs and hedge fund managers can both only win when the pool of assets they manage grows. This is the mantra we repeat whenever we discuss our MLP strategy. The ability for the GP to cause its MLP to issue equity allows the GP to benefit from increased cashflows without the need to put up additional capital, while the LP unitholders in the MLP always face the risk of possible dilution.

What this means in practice is that, while an MLP's unit price usually drops when it announces a secondary equity offering, the GP should increase in price for the same reason. There are indications more recently that the market is beginning to differentiate along these lines. For example, on the day in late March that Kinder Morgan announced it plans to invest $2BN in its CO2 business, Kinder Morgan Partners (KMP) was weak as investors anticipated the need for an additional equity raise by KMP to provide the funds. By contrast, Kinder Morgan Inc (KMI), which owns the GP of KMP, was firm because of the prospect of increased distributable cashflow as a result of the higher earning assets at KMP. Around the same time Regency Energy Partners (RGP) announced plans for a $400MM equity issuance which weakened its price while Energy Transfer Equity (ETE), which shares in the DCF of RGP through its GP ownership, was up. For these reasons, we are invested in KMI and ETE, but not in KMP or RGP.

Some investors have asked whether we think MLPs are due for a correction given the sector's recent strong performance. At such times, asserting up front that we don't try and time the market turns out to be a wonderful cop-out from having to answer a virtually impossible question. While we're definitely sellers of securities that we believe are expensive, such a view of an entire asset class (whether it is MLPs, low volatility dividend yielding equities or some other sector) could be arrived at only through an inability to identify attractively priced investments (i.e. bottom up) rather than a top-down assessment. The additional factor for MLP investors to consider is the tax consequence of selling. Creating realized taxable gains in addition to the recapture of previously deferred distribution income can create a substantial tax liability which requires the accurate forecast of a substantial fall in MLP prices to generate sufficient profit to offset the taxes. This has come about in part through strong performance and is to some degree a high class problem, but is nonetheless an important consideration for any MLP investor with a couple of years or more of history in the asset class.

Bonds Are Not Forever

If you have the time and inclination, you might want to read the generous review of my latest book by Laurence B. Siegel, Director of Research at the CFA Institute's Research Foundation.

SL Advisors runs a variety of strategies focused on generating attractive risk-adjusted returns using public equities in long-only and long-short format. Contact us for more information, or go to our website: www.sl-advisors.com

Returns for each strategy shown at right are from a single continuously managed account. The Hedged Dividend Capture, Deep Value and MLP Strategies have all been independently verified and attested to by Marcum, LLP. Documentation available on request.

Hedged Dividend Capture Strategy Monthly Returns (%)							Since Inception			15%	Index		1%
	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2011										0.4	0.2	3.5	4.2
Index										*0.6*	*-0.2*	*0.2*	*0.6*
2012	-3.5	-2.1	1.1	1.6	1.2	2.1	1.1	-1.3	0.4	0.8	0.5	-0.7	1.0
Index	*0.4*	*-0.8*	*-1.2*	*-1.5*	*-0.4*	*-1.5*	*-0.1*	*-0.1*	*-0.3*	*0.2*	*0.5*	*0.1*	*-4.7*
2013	2.8	3.4	4.1	0.9	-2.8	1.1	1.4	-3.2	-0.5	3.2	-0.8	-0.4	9.3
Index	*0.4*	*0.2*	*0.0*	*0.5*	*0.2*	*-0.6*	*0.6*	*-1.6*	*-0.1*	*1.4*	*0.6*	*0.3*	*1.8*
2014	-1.7	0.1	1.9										0.3
Index	*0.7*	*0.7*	*0.3*										*1.7*

The Index is the HFRX Equity Market Neutral Index. Returns are net of fees. Past performance is not indicative of future returns.

High Dividend Low Beta Strategy (%)							Since Inception			53%	Index		75%
	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2011										5.9	0.1	4.0	10.3
Index										*10.9*	*-0.2*	*1.0*	*11.8*
2012	-1.3	0.1	2.8	1.3	-1.8	4.2	1.8	-0.2	1.7	-0.1	0.8	-0.2	9.1
Index	*4.5*	*4.3*	*3.3*	*-0.6*	*-6.0*	*4.1*	*1.4*	*2.3*	*2.6*	*-1.8*	*0.6*	*0.9*	*16.0*
2013	5.4	4.1	6.0	1.9	-1.6	-0.4	4.0	-4.6	1.1	5.5	0.7	0.8	25.7
Index	*5.2*	*1.4*	*3.8*	*1.9*	*2.3*	*-1.3*	*5.1*	*-2.9*	*3.1*	*4.6*	*3.0*	*2.5*	*32.3*
2014	-3.5	2.5	2.0										0.9
Index	*-3.5*	*4.6*	*0.8*										*1.8*

The Index is the S&P 500 including dividends. Returns are net of fees. Past performance is not indicative of future returns

Deep Value Strategy Monthly Returns (%)							Since Inception			164%	Index		125%
	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2009							8.5	1.0	11.3	0.4	3.5	9.8	39.3
Index							*7.6*	*3.6*	*3.7*	*-1.9*	*6.0*	*1.9*	*22.6*
2010	-1.1	3.8	6.6	3.5	-5.6	-4.5	5.2	7.0	7.8	1.2	1.0	2.7	30.2
Index	*-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	2.2	1.9	2.5	-2.3	-2.9	0.6	-5.2	-9.2	12.3	-0.5	-0.6	-2.3
Index	*2.4*	*3.4*	*0.0*	*3.0*	*-1.1*	*-1.7*	*-2.0*	*-5.4*	*-7.0*	*10.9*	*-0.2*	*1.0*	*2.1*
2012	4.4	5.2	0.9	2.0	-8.8	3.8	0.7	3.6	3.3	-0.9	-2.6	1.0	12.4
Index	*4.5*	*4.3*	*3.3*	*-0.6*	*-6.0*	*4.1*	*1.4*	*2.3*	*2.6*	*-1.8*	*0.6*	*0.9*	*16.0*
2013	6.4	0.6	4.3	1.6	2.1	-1.6	4.3	-1.2	1.7	3.1	2.0	5.1	31.9
Index	*5.2*	*1.4*	*3.8*	*1.9*	*2.3*	*-1.3*	*5.1*	*-2.9*	*3.1*	*4.6*	*3.0*	*2.5*	*32.3*
2014	-4.7	5.2	0.3										0.4
Index	*-3.5*	*4.6*	*0.8*										*1.8*

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 (%)							Since Inception			179%	Index		134%
	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2008	-0.7	3.0	-0.8	1.9	4.2	-10.7	-2.0	0.6	-14.9	-1.1	-25.4	7.4	-36.1
Index	*-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	15.4	-2.1	5.0	5.8	9.9	-1.1	10.1	0.1	1.0	2.3	6.2	5.0	73.3
Index	*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	-0.5	5.1	5.8	-1.6	5.0	2.0	3.2	2.7	37.2
Index	*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	-3.0	-0.3	-3.4	9.1	0.2	6.8	15.8
Index	*3.0*	*3.5*	*-0.6*	*3.3*	*-5.0*	*1.1*	*-1.9*	*-1.1*	*-4.1*	*10.3*	*-0.2*	*5.8*	*13.9*
2012	1.7	5.2	-3.7	0.9	-7.1	3.1	5.9	3.2	2.3	-0.7	0.4	-3.2	7.4
Index	*1.9*	*4.2*	*-4.0*	*2.2*	*-7.5*	*3.3*	*5.1*	*1.6*	*2.0*	*0.5*	*-0.8*	*-3.1*	*4.8*
2013	12.9	1.7	5.8	-0.5	-1.2	2.6	0.3	-0.4	1.2	2.4	4.0	3.4	36.6
Index	*12.6*	*0.9*	*5.4*	*0.9*	*-2.0*	*3.1*	*-0.5*	*-2.5*	*2.3*	*2.7*	*0.9*	*1.6*	*27.6*
2014	1.5	2.6	3.8										8.2
Index	*0.6*	*-0.2*	*1.5*										*1.9*

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.

Low Beta Long-Short Monthly Returns (%)							Since Inception			96%	Index		0%
	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2011			-3.5	19.4	6.5	4.5	0.0	9.1	-1.1	6.7	1.9	1.5	52.6
Index			*-0.9*	*0.5*	*-1.4*	*-1.6*	*-0.1*	*-3.5*	*-3.0*	*0.8*	*-0.9*	*-0.4*	*-10.0*
2012	-5.1	-1.6	5.7	3.3	1.1	2.4	3.2	-2.2	2.1	0.7	0.2	-1.3	8.6
Index	*1.7*	*1.4*	*0.0*	*0.1*	*-1.7*	*-0.3*	*0.5*	*0.5*	*0.4*	*-0.5*	*0.4*	*0.9*	*3.5*
2013	7.9	6.2	6.5	3.2	-2.1	-0.7	4.0	-2.1	0.3	0.4	-2.8	2.0	24.5
Index	*2.0*	*0.4*	*0.7*	*0.6*	*0.7*	*-1.3*	*1.0*	*-0.9*	*1.0*	*1.2*	*0.6*	*0.4*	*6.5*
2014	-5.6	-0.6	1.2										-5.0
Index	*-0.1*	*1.6*	*-0.5*										*1.0*

The Index is the HFRX Global Hedge Fund Index. 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 client assets of $1.89 trillion (as of September 30, 2012). 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 High Dividend Low Beta Strategy
This is the long-only version of our Hedged Dividend Capture Strategy (Long/Short), which has been actively managed and deployed since October 2011. Academic research has shown the Capital Asset Pricing Model (CAPM) fails to explain risk-adjusted returns. Over long periods of time, high beta stocks tend to under-perform and low beta stocks tend to out-perform, on a risk-adjusted basis, which is inconsistent with predicted performance by the CAPM. This strategy allows investors to take advantage of this persistent anomaly.

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 Low Beta Long-Short Strategy
Low Beta Long-Short is more concentrated than Hedged Dividend Capture ("DivCap") with added leverage and is not restricted to dividend paying stocks. It includes our best ideas from DivCap weighted according to conviction rather than diversified, equal weight allocations. It is managed to be beta neutral and returns are driven very largely by individual stock selection. Interactive Brokers is custodian for assets in this strategy only.

Bonds Are Not Forever; The Crisis Facing Fixed Income Investors
is now available at Amazon.com.

Our blog, ***In Pursuit of Value***, is at: http://www.sl-advisors.com/blog/

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