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In Pursuit of Value

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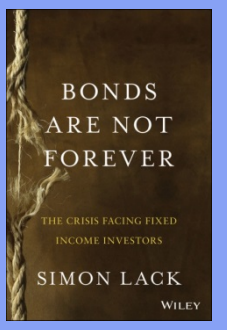

Contact info:

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

How Dovish is Janet Yellen?

One of the biggest surprises of 2014 for investors must be the persistently low yields on bonds. Just over a year ago when former Fed Chairman Ben Bernanke raised the issue of scaling back the Fed's program of Quantitative Easing (thus triggering the "Taper Tantrum" as equity markets swooned in fear) ten year treasury yields briefly touched 3.0%. They exceeded that level earlier this year as the Fed's planned reduction in bond buying got under way. In a few months the Fed's bond buying program will be over in its current form, although they intend to reinvest interest received and principal from maturities, so their $4TN balance sheet will continue to grow. Bond markets are calm, as the reality has been less harmful than feared, and ten year treasury yields languish around 2.5%. Whereas prospective investors in equities are often persuaded to wait for a better opportunity in the form of lower prices, bond investors are rarely so patient. James Carville, lead strategist for Bill Clinton's successful 1992 Presidential campaign, once said he wanted to be reincarnated as the bond market, so he could intimidate everybody. Today's bond investors are a far cry from those of a generation ago as they passively accept the paltry yields on offer and have little fight left in them.

Incoming Fed Chair Janet Yellen is generally expected to continue the policies followed under Ben Bernanke. Her predecessor laid the ground nicely for his successor and so far she has not faced any controversial decisions. Almost assuredly that time will come, at which point we'll see how ably her leadership skills can be used to reflect her economic biases.

The Federal Reserve in Washington DC, where the eagle above the entrance is likely one of the few hawks around.

A thoughtful article in The New Yorker titled *"The Hand on the Lever"* provides interesting material for those seeking to forecast interest rates under a Yellen Fed. The label of "dove" (meaning biased towards easy monetary policy; "hawks" favor tighter policy) has never slipped as long as she's been at the Federal Reserve. A career that includes teaching Economics at Berkley, briefly running the Council of Economic Advisors under Clinton and heading up the San Francisco Fed put her squarely in the liberal camp for most observers. Yellen's public comments including in the abovementioned article reveal a sensitivity to unemployment not articulated by past Fed chairmen.

The Fed has a dual mandate of pursuing maximum employment and price stability. In practice this has come to mean around 2% inflation, whereas the level of *sustainable* unemployment (the point at which it reflects normal labor market turnover as opposed to inflation-triggering shortages) is open to debate. Labor force participation has fallen notably in recent years, and it's not clear if past levels of maximum employment still apply.

While maximizing employment has long been one of the Fed's two economic goals, it rarely received as much attention as inflation until the aftermath of the 2008 financial crisis. Past periods of interest rate hikes under Greenspan and Volcker were regarded as consistent with maximum employment over the long term even while they caused job losses in the short term, since high inflation has been shown to be negative for growth and employment. The notion that the short run/long run trade-off could be reversed (i.e. allow inflation to rise over the short term in the interests of reducing unemployment) has never been seriously considered before, and yet much of Janet Yellen's history and public comments show on which side of the twin mandate her heart lies.

In April, during a speech in New York shortly after assuming her new role, Yellen noted her, "expectation that the achievement of our economic objectives will likely require low real interest rates for some time." She's telling us to expect low real rates (i.e. adjusted for inflation) and cares very much about what monetary policy can do to improve employment. Her vote on the Fed's policy making Federal Open Market Committee (FOMC) could not be plainer. There are hawks to be sure who will balance her dovishness, and nobody yet knows how the interaction between the two camps will play out. Fed chairmen have varied from dominant to collegial, and one imagines she'll rely more heavily on the power of her intellect than a forceful personality to steer monetary policy where she desires.

My view is that she's easily the most dovish Fed chairperson in at least 35 years and one of the most dovish FOMC voting members in recent memory. Since 2008 we've experienced only moderate GDP growth of 2% and unemployment has been slow to fall, although at 6.2% it's reaching the 6% threshold that has been the Fed's initial objective. However, the debate over the drop in participation continues with some arguing it represents temporarily discouraged workers who will return when jobs are more plentiful, thereby adding capacity to the labor force and reducing inflationary wage pressures. Others see a more permanent loss of relevant skills as the long term unemployed become eventually unemployable.

Fixing these problems is unarguably a noble objective. Janet Yellen's husband George Akerlof, a retired Economics professor, has frequently collaborated with his wife on academic papers. He told The New Yorker, "Both of us, separately and together, really, really care about unemployment." We'll soon see how effectively Janet Yellen can lead her FOMC colleagues along a path of extended monetary accommodation aimed at fostering an economic climate in which everyone who wants a job can find one.

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

The most recent statement from the FOMC in late July acknowledged the steady improvement in the economy but also noted that that the current target for Federal Funds (short term interest rates) will remain within its present range of 0-0.25% for, "a considerable time" after the end of their asset purchases (which are likely to finish in October). The prospect of inflation drifting back up to 2% coincident with a labor market containing plenty of spare capacity is increasingly likely. It should provide for lively public comments from some FOMC members as the doves and hawks publicly air their contrasting views.

None of this is intended as a criticism. The Fed's ample monetary stimulus has done far more good than harm. But it does tilt the risks towards higher inflation, because low real rates (as we've been promised) and a deep concern for the unemployed relegate inflation to a secondary priority. Inflation today, at least as conventionally measured by the Bureau of Labor Statistics, remains low and indeed below the Fed's own 2% target although this week they noted it was "somewhat closer" to that level. Inflation may stay low indefinitely, but if it drifts up before the economy has unarguably employed every willing soul, expect a non-preemptive Fed to find at least some reasons why a pick-up in inflation is temporary.

This is what financial repression looks like. Low interest rates, and low or even negative real rates must be especially seductive as a means to alleviate underemployment and perhaps other public policy challenges such as continued income disparity. Or put another way, if one day Janet Yellen announces that interest rates need to rise because of inflation, it'll be in spite of her deep seated concerns for the unemployed. Based on her history, this Fed chair won't be in a hurry to establish her "inflation fighting credentials" as has been required of her predecessors.

As public policy it has been more successful than many observers originally expected. In fact, the Fed may ultimately restore interest rates to a more normal level and begin to de-lever their balance sheet without precipitating another financial crisis. There's never a shortage of critics warning of the severe difficulties we will endure due to current policy. That may be right too, but what does seem pretty clear is that sharply higher interest rates, and especially high *real* rates, are unlikely to be a solution adopted by this central bank in response to any plausible set of economic challenges. Investors shouldn't bother fighting it, but should simply deploy their assets towards businesses that can raise their prices as their input costs go up. Bonds remain the very antithesis of such an approach. So far, *Bonds Are Not Forever* remains accurate.

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			16%	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	2.5	0.1	-0.1	-2.2						0.6
Index	*0.7*	*0.7*	*0.6*	*0.6*	*-1.8*	*0.3*	*0.4*						*1.6*

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			57%	Index		81%
	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	2.9	1.3	0.8	-2.4						3.6
Index	*-3.5*	*4.6*	*0.8*	*0.7*	*2.3*	*2.1*	*-1.4*						*5.7*

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			180%	Index		134%
	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	2.3	1.3	4.7	-2.3						6.4
Index	*-3.5*	*4.6*	*0.8*	*0.7*	*2.3*	*2.1*	*-1.4*						*5.7*

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 (%)							Since Inception			218%	Index		158%
	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	2.5	5.5	9.5	-3.9						23.1
Index	*0.6*	*-0.2*	*1.5*	*4.3*	*3.4*	*5.9*	*-3.5*						*12.2*

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			105%	Index		1%
	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	3.0	-1.0	3.6	-0.7						-0.4
Index	*-0.1*	*1.6*	*-0.2*	*-0.7*	*0.5*	*0.8*	*-0.4*						*1.5*

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 available at Amazon.com.

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

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Contact info:

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