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In Pursuit of Value

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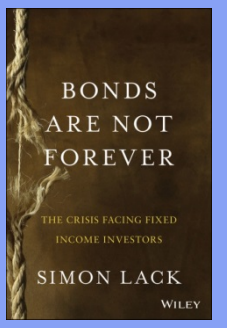

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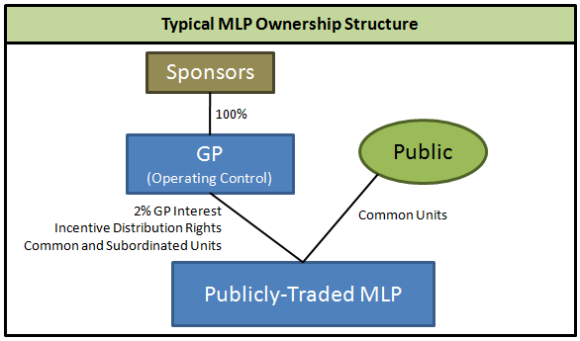
Quarterly Outlook

Regular readers will be aware that several themes exist across our investment strategies. The Low Beta Anomaly, the notion that low volatility stocks outperform the market on a risk-adjusted basis, is an enduring concept. It exists in part because active managers tend to own higher volatility names in the hope of outperforming a rising market. Consequently, low volatility stocks are typically not widely owned by active managers. The bias of so many managers towards higher volatility stocks depresses their returns and similarly increases the returns of lower volatility stocks. For our part, we don't avoid higher volatility stocks ourselves but tend to underweight them; an elegant way to bet against the collective futility of all those active hedge fund managers out there striving to beat the market. Similarly, the ownership of General Partners (GPs) in our MLP strategy reflects the analogy of MLP GPs to hedge fund managers and MLPs to hedge funds; better to own a piece of the operator than be a client. Because of the strategies we run, we tend to be overweight the energy sector, which had a weak quarter.

We evaluate our own results against relevant benchmarks and by examining how these and other themes have performed. Long only strategies are supposed to generate positive returns in a rising market, but we're more interested in how they did against their benchmark. Too often, investment results are presented without a benchmark, especially multi-asset ones. A manager whose mandate includes the ability to vary his mix of equity versus fixed income risk may be talented at such timing, but you'll rarely see that skill presented with reference to a relevant index. The obfuscation of results is a perennial tool for the mediocre financial advisor.

Put in that context, 3Q14 investment results at SL Advisors were mixed. The Low Beta Anomaly worked nicely as shown by the outperformance of both High Dividend Low Beta and Hedged Dividend Capture compared with their benchmarks. Good versus bad regimes for this theme seem to last several quarters although so far we haven't identified a reliable timing signal. Our April newsletter noted the recent underperformance of low volatility stocks, coincident with a much greater urgency to be invested in the market than is present today. Strong equity markets tend to leave low volatility stocks behind, and the calmer while still positive recent months have favored boring stocks with stable businesses that reliably grow their earnings and dividends. We expect that bias to continue.

The ownership of MLP GPs has been our biggest idea, having first been implemented nearly four years ago. Not all GPs are publicly traded, but where they are you're better off to own them rather than the MLP itself. Operating control and Incentive Distribution Rights (as noted in the diagram) can be a powerful combination. It's been a considerable source of outperformance in our MLP Strategy, and MLPs themselves continue to perform very strongly too. The most important driver of further attractive returns remains the backlog of future infrastructure investments for MLPs whose positive net cashflows will fuel continued growth at their respective GPs.



Prospects remain encouraging for many names as predictions of $50 billion in annual capital expenditure to support America's shale revolution steadily become reality year after year. When MLPs are growing their asset base and distributable cashflow, owning GPs is a pretty compelling proposition. However, the theme's

strong contribution to outperformance stalled during 3Q14. Kinder Morgan Inc. (KMI), one of our larger holdings across all strategies, reacted strongly to the announced restructuring in August but proceeded to give up most of those gains in September. Williams Companies (WMB), another significant holding, was also weak. Both companies are scheduled to close on value enhancing restructurings later this year, and remain attractive investments. Strategy returns came from the MLP sector itself, of which roughly half were from distributions.

The energy sector has been weak this year – notably during 3Q14 including 7% underperformance versus the S&P500 in September. Small cap stocks have also lagged the large cap index and both of these developments weighed on relevant holdings. The U.S. Energy Information Agency (EIA) continues to lower its forecast for global oil demand in the face of weaker Chinese and Russian growth as well as greater non-oil power sector use in Japan. Increased U.S. production of oil and gas as well as its return as the number one producer of liquid petroleum ahead of Saudi Arabia (a position last held in 1991) and the perhaps surprising stability of Middle East supplies in spite of the growing conflicts there have all served to depress prices. Although we don't tend to make large investments predicated on future oil prices, sector weakness extended to names such as Chicago Bridge and Iron (CBI), a construction company of large energy infrastructure products. Similarly, although we don't invest much in small cap stocks, weakness in this sector hurt names such as Gencorp (GY), a small defense manufacturer. The weakness in the energy sector combined with a sharp drop in the names mentioned and also Hertz (HTZ) led to a disappointing 3Q for Deep Value. Finally, Low Beta Long/Short, which holds positions in the "Best Ideas" among our low volatility picks, had a decent quarter helped in part by a jump in Family Dollar (FDO) following Dollar General's proposed acquisition.

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

Looking ahead, the Federal Reserve continues its transparent unwinding of "extraordinary monetary accommodation". While rates are undoubtedly headed higher, the pace of tightening is well communicated and likely to be slower than forecast. The ubiquitous "blue dots" which graphically portray each Federal Open Market Committee (FOMC) member's expectation of rates in the future has become one of the most pored over releases that the Fed issues. Chair Janet Yellen now spends part of every press conference downplaying the nuances of minor changes in the location of blue dots. Nonetheless, the overall trend has been one of delayed normalization for short term rates and a lower ultimate equilibrium rate. Both of these are positive for equities and while there's no short term directional insight to be had from such examination, the medium term investment prospects for stocks remain more attractive than for bonds.

Hedge Funds Lose a Big Client

The recently announced decision by the California Public Employees' Retirement System (CalPERS) to redeem its $4 billion in hedge fund investments was quickly followed by numerous journalistic enquiries of yours truly for reaction. It seems there are still few enough hedge fund critics that I am the inevitable go to source at such times, even though I have since moved on in search of other more egregious activity. Non-traded REITs (recently highlighted on our blog) represent an extraordinary separation of clients from their assets through myriad fees levied on those who think every financial advisor is a fiduciary (they're not). It's a story that needs to be told, and it will be next year in *Dodging the Potholes on Wall Street* along with other financial shenanigans in need of a proper public airing.

Returning to CalPERS, I had always understood that their $300 billion investment pool provided them with enough heft to negotiate fees aggressively. So I was surprised to calculate from their recent press release that every $2 of investment return in their last fiscal year (through June 2014) had required an additional $1 in fees. $4 billion in hedge fund investments generating a 7.1% net return with $135 million in fees are all the inputs you need for this calculation. Two for you and one for me scarcely seems the kind of fee arrangement for which CalPERS is known. I cannot answer the most common question, which is whether other public pension funds will re-evaluate their own holdings in this light. They should though. It's not that hedge funds are necessarily bad; some of the most talented managers run them. But if you can't get a fair deal, you won't really experience the investing talent you seek.

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			20%	Index		2%
	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*	*1.7*	*3.3*
2014	-1.7	0.1	1.9	2.5	0.1	-0.1	-2.2	3.1	0.6				4.3
Index	*0.7*	*0.7*	*0.6*	*0.6*	*-1.8*	*0.4*	*0.2*	*0.9*	*0.3*				*2.6*

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			64%	Index		62%
	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2011										5.9	0.1	4.0	10.3
Index										*5.9*	*1.2*	*3.2*	*10.5*
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	*-0.5*	*1.9*	*2.8*	*1.1*	*-1.6*	*4.2*	*2.1*	*-0.9*	*1.7*	*-0.1*	*-0.2*	*-0.5*	*10.3*
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	*5.0*	*2.7*	*4.9*	*3.8*	*-3.4*	*0.6*	*4.2*	*-4.8*	*2.0*	*4.6*	*1.2*	*1.1*	*23.6*
2014	-3.5	2.5	2.0	2.9	1.3	0.8	-2.4	5.1	-0.5				8.2
Index	*-2.5*	*3.7*	*2.1*	*1.9*	*1.0*	*2.2*	*-3.8*	*3.8*	*-0.9*				*7.5*

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

Deep Value Strategy Monthly Returns (%)							Since Inception			181%	Index		140%
	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	6.3	-5.6				6.8
Index	*-3.5*	*4.6*	*0.8*	*0.7*	*2.3*	*2.1*	*-1.4*	*4.0*	*-1.4*				*8.3*

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			236%	Index		175%
	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	7.4	-1.5				30.1
Index	*0.6*	*-0.2*	*1.5*	*4.3*	*3.4*	*5.9*	*-3.5*	*8.2*	*-1.6*				*19.5*

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			115%	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	5.1	-0.6				4.1
Index	*-0.1*	*1.6*	*-0.2*	*-0.7*	*0.5*	*0.9*	*-0.9*	*1.1*	*-0.6*				*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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