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In Pursuit of Value

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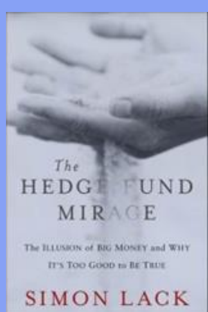


Quarterly Outlook

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

This Mark Twain quote is an apt description of financial market views on the probability of a Brexit vote. Hence, the subsequent pricing adjustment has been violent. Although the opinion polls were close, the betting markets which demand more thoughtful decisions of their participants were clearly signaling that Remain would win. So now we'll endure a live ammunition class of how you leave the EU.

There is a wide range of possible paths and eventual outcomes. If Behavioral Finance teaches that we are often over-confident of our forecasts, now is a time to be mindful of this. It's likely we'll all become more intimately versed in the nuances of the Treaty on European Union, Article 50, which governs how a member state leaves the EU. It's also likely we'll get used to a very long process. Businesses will adapt to years of uncertainty, and we'll accept the rumble of exit negotiations in the background.

It's not as certain as many might think that the UK will leave the EU, although that is the most likely outcome. None of the major political parties campaigned to leave and around 75% of current Members of Parliament were in the Remain camp. Parliament has to vote to trigger Article 50, and they may not. Although the next election is not due until 2020, one could be called earlier with the major issue being to accept the terms of exit, which would by then be better understood. It's likely UK voters will have one further opportunity to vote in some form.

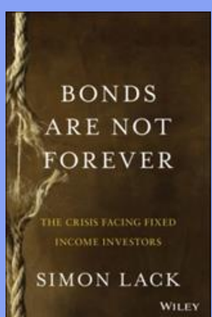
When leading Brexit campaigner Boris Johnson shocked everyone by declining to run for Prime Minister (PM), it simply confirmed the absence of leaders with good judgment in Britain. The people there deserve far better. Johnson presumably assessed that the UK is already slipping into recession and ducked the responsibility of explaining as PM why. The UK will experience some of the negatives of leaving without any of the possible benefits which may provoke demands for another referendum as Leavers regret their vote. Alternatively, if the UK's economy doesn't suffer that much it could embolden EU critics in other member countries, leading to an improved offer to the UK to stay. Or the EU could collapse under the weight of the disastrous Euro, widely divergent intra-EU economic performance, a refugee crisis and weak political legitimacy from electorates whose opinions are rarely sought. Brexit is not just a UK problem.

What does seem likely is that this will be the dominant issue in UK politics for several years, and that uncertainty around the ultimate outcome will prevail perhaps even up until the final, irrevocable decision. As if to punctuate the collapse of the natural order of things, England's humbling exit from Euro 2016 (a quadrennial soccer tournament) in France at the hands of lowly Iceland prompted many to note that only England could exit Europe twice in one week. England's team was distracted by the impact on their multi-million pound salaries of the collapse in Sterling. A pro-EU England supporter could not be more depressed at recent developments.

Those who incorporate international equity exposure for its diversification benefits are finding that they're assured of being involved in just about any global financial crisis, including the current nascent one. Diversification may be the only free lunch in Finance, but that doesn't mean it's always appetizing. Over the two business days following the surprising vote, around $3TN was wiped off the value of global equity markets. The U.S. wasn't immune.

Energy Infrastructure, which includes Master Limited Partnerships (MLPs), is a wonderfully provincial asset class. You're unlikely to see any of their quarterly earnings reports open with an admission that the Brexit vote hurt their business. Their stock prices may well gyrate along with the broader equity markets, but the cashflow generating capabilities of, say, Transco (Williams Companies' (WMB) extensive pipeline network down the eastern U.S.), or REX (Tallgrass's (TEGP) natural gas pipeline from Wyoming to Eastern Ohio) are about as far from a Brexit vote as you can get. How pleasant to be invested in assets that are over here not over there.

SL Advisors, LLC focuses on investment strategies that provide income without relying on fixed income securities.



Low Volatility stocks also allow the luxury of slothful decision making. There's rarely any need to hastily decide on new exposure. We don't know how the Brexit vote will impact the UK economy, the Eurozone or indeed global markets. We delegate such decisions to the many corporate managers at the global companies that populate this strategy. They are collectively better situated to shift exposure and capital to protect themselves and exploit opportunities.

We run three versions of our Low Volatility Strategy (Long Only, Hedged and Best Ideas). Although they are not designed for excitement and periods of outperformance are completely unpredictable, the past twelve months have reflected reasonably well on these strategies. Low Vol Hedged in particular incorporates some useful features. The hedge immunizes it to market moves but sharp falls in equities are often reflected disproportionately in the S&P500 (our short position) compared with the low volatility names we own. This feature manifested itself in the two days following Brexit, during which Low Vol Hedged was +1.0% while the S&P500 was -5.3%.

If you believe market timing is hard (and we do), then you structure your investments in such a way that making such calls isn't a key element of the strategy. Near term market direction is an endlessly fascinating topic of discussion but we are bullish on what we own. We further think the long term outlook for U.S. crude oil production is very positive. As noted in Why Oil Could Be Higher for Longer, U.S. shale production enjoys many advantages over more conventional exploration and production projects, in that numerous wells can be drilled relatively quickly in familiar geology, with high and sharply declining initial production.

Shale drillers can stop drilling when prices are unattractive far more readily than can other producers, which is why the rig count collapsed last year. This represents a much more attractive risk profile than many conventional projects with their enormous capital requirements and pay-off horizons far enough out to preclude any realistic price hedge.

Between depletion of existing oil fields and new demand, the world needs around 6 million barrels a day of new supply annually, roughly 6% of global output. The $1TN of estimated capex reductions through 2020 make it unlikely that the additional supply will be there at current prices. The U.S now produces 3.5Mbbls/day of NGLs. Natural gas is our biggest source of electricity generation. Energy independence is in our future – to us this looks like a safer bet than figuring out what'll follow the Brexit vote.

We are invested in WMB and TEGP

To Our Clients

At SL Advisors it’s important to us that your investments with us are aligned with your financial situation and objectives. If there have been any relevant changes from your perspective or any reasonable restrictions you wish to impose, please let us know and we'll be happy to discuss appropriate modifications. Of course, anytime you have any questions or concerns don’t hesitate to contact us. We value your business, and never forget the faith you have placed in us as stewards of your capital.