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In Pursuit of Value

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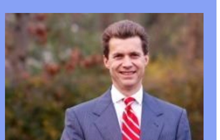
SL Advisors, LLC specializes in publicly listed closed end funds.



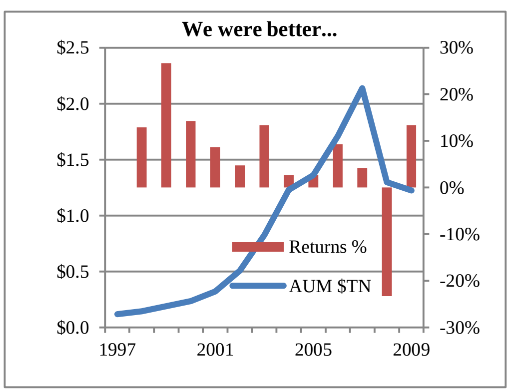
SL Advisors, LLC is a registered investment advisor offering separately managed accounts to individuals, family offices and institutions.

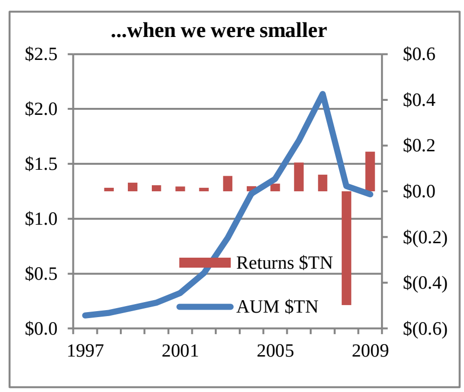
Improving Hedge Funds

Let me start by saying that I have many friends in the hedge fund industry. I've been investing in hedge funds since 1994. So my friends and other readers should regard what follows on hedge funds as friendly, constructive advice that will serve clients well. We all deserve better than we have received.

Hedge funds have many unique features; none is less justified than the poor transparency afforded investors about their investments. Managers of traditional strategies such as long-only public equities and fixed income and most alternatives such as private equity and real estate provide clients with timely detail on the investments made on their behalf. But the hedge fund industry has largely succeeded in convincing its clients that they don't need the same type of transparency provided by all their other investment managers. None of the reasons are pro-client, but they include protecting the manager's investment process, avoiding competition for securities, strategy complexity, and simply "No". Conveniently, this benefits managers in that it makes evaluation of strategy and returns quite difficult, because investors don't have the detailed information necessary to calculate how much of what risks were taken. As a result the analytical rigor with which most other investment strategies are evaluated isn't possible with hedge funds.

While this has been good for hedge fund managers, it's been bad for their clients. The only period in recent memory when the industry did deliver was following the collapse in the internet bubble during 2000-02. Institutional capital followed, seeking to emulate the success of some Ivy League endowments, and hedge funds' low correlation with equity returns was the reason. However, this low correlation is a two-edged sword, because while it makes hedge funds appear complimentary to a traditional portfolio it also makes comparing their returns with equities less relevant. Hedge funds take risks, just not the same risks as a portfolio of long equities, and since investors don't receive transparency they were (and are) unable to evaluate those risks (other than qualitatively through discussions with managers).





Sources: HFRI, BarclayHedge, SL Advisors

The industry's rapid growth led it to $2 trillion in AUM by 2008 when its lost around $500BN, more than all the profits earned since 1997 and probably in its history. Unlike mutual fund managers hedge fund managers retain complete discretion over whether to accept new investments from clients. If they feel the opportunity set doesn't justify client capital they can "close" to new money. Many of the best managers have done this in the past, but the industry was bullish and asset growth compounded at 24% from 1997-

2008. Evaluating hedge funds based on their money-weighted performance (IRR) results in an annual return of 1.3% compared with the more commonly used average annual return of 7.5% (which doesn't adjust for industry size). Some may dispute this method of evaluation, but hedge funds can choose to stay small if investment opportunities are limited. Since relatively few investors enjoyed the strong returns of ten years ago, the result today is that if all the money that's been invested in hedge funds since 1997 had instead been put into treasury bills, the aggregate results for those investors would have been twice as good while also incurring far less expense and risk. Position level transparency should be on every hedge fund investor's non-negotiable list, so they can properly evaluate the risks being taken with their money.

Closed End ETFs

Somebody suggested to me recently that before long all investing would take place through private equity funds or ETFs. While that day hasn't arrived just yet, ETFs recently reached $1 trillion in market cap. The PowerShares Exchange-Traded Fund Trust II (PCEF) was recently launched, offering a rules-based portfolio of closed end funds through an ETF. It's a welcome development that should add liquidity and trading opportunities to the sector.

What We Own

SL Advisors runs three separate strategies: Fixed income, Deep Value and Discount Arbitrage. Contact us for more information, or go to our website: www.sl-advisors.com

General American Investors (NYSE:GAM) celebrates the 80th anniversary of its NYSE listing this year. The current PM Spencer Davidson is only the sixth in their history, so evidently impulsive management changes are not part of the culture at GAM. This stability has no doubt helped them generate NAV outperformance versus the S&P 500 of 2.4% p.a. over the past 50 years with relatively low portfolio turnover of around 25% p.a. Spencer Davidson describes their investment style as long-term capital appreciation with lesser emphasis on current income, focused on equities with growth potential at reasonable valuations. In our Discount Arbitrage strategy we trade more actively than our other strategies, but this is a current holding.

Pacific Alliance Opportunity Fund (LSE:PAX.L) is a listed hedge fund. The UK has a thriving closed end fund market, with a wide variety of underlying strategies since local regulations are less onerous than the 1940 Investment Company Act in the U.S. There are several listed hedge funds and at least two dozen private equity funds worth following. Many of them invest outside the UK, so while they are subject to UK regulation the investment risks can be almost anywhere. A listed hedge fund gives investors an opportunity to exit their investment through the public markets without being subject to any liquidity restrictions imposed by the manager, and investors would benefit from more hedge funds listings.

Pacific Alliance is a Hong Kong-based hedge fund run by Chris Gradel. They have a solid reputation for well-constructed trades that isolate an identified price inefficiency while hedging away related risks. They invest throughout Asia-Pacific although their focus has been on China and neighboring emerging economies. The trades are often complex and not that liquid. Following a restructuring last year, their listed vehicle now invests directly in their hedge fund, and its current 16% discount to NAV allows an attractive entry price to the hedge fund. This is a holding in our Deep Value strategy.