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# In Pursuit of Value

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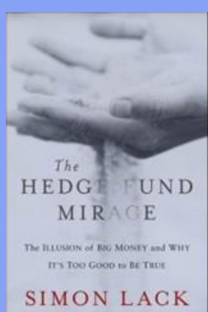
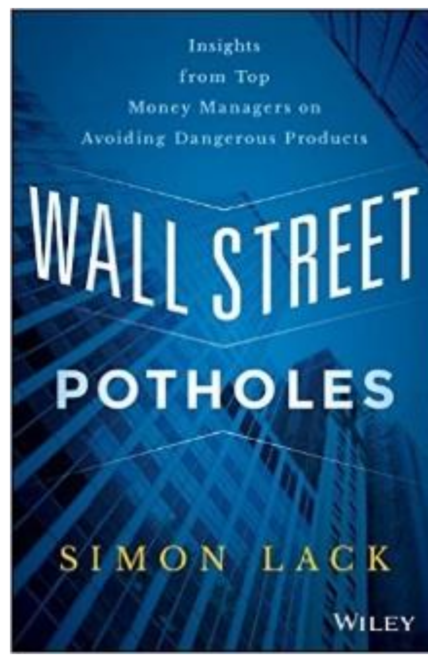
*SL Advisors, LLC is a registered investment advisor offering separately managed accounts to individuals, family offices and institutions.*




## Wall Street Potholes

In the Summer of 2013 a new client called Penelope (not her real name) came to visit us with her husband. As we reviewed the investments she held based on her previous advisory relationship, we came across Inland American Realty, a hitherto unfamiliar type of security called a Non-Traded Real Estate Investment Trust (NTR).

Publicly traded REITs have been around a long time, and while we generally don't invest in them plenty of people achieve quite satisfactory results doing just that. But non-traded REITs are nasty little securities that exist in a regulatory gray area between what's appropriate for the retail investor and what should be limited to high net worth clients. They are registered securities, which qualifies them to be sold to the general public. But since they are not listed, there is no liquidity which would allow a buyer to exit. Their illiquidity ought to restrict their sale to qualified investors and institutions, but their public registration meets the requirements for sale to the general public.



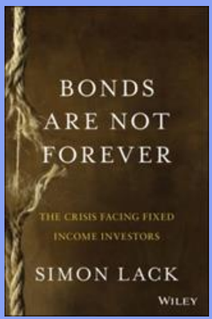

The standard of suitability and disclosure which governs how they are sold (for as you'll see, no fiduciary could recommend such an investment) is a low one. Underwriting fees of 15%, additional fees for buying, managing and selling property (which is, after all, what a REIT does) and incentive compensation are all common features. Prospectuses also list myriad conflicts of interest, since service providers are often affiliates and have contracts "not negotiated at arm's length". Such securities honestly should not exist, but the fact that they do shows that if you disclose to an investor all the ways in which you plan to rip them off, then you've met the legal standard if not a reasonable one. I suspect the reason such securities are not publicly listed is to avoid the dismal research coverage they would draw if traded on the stock exchange. The absence of commissions from secondary trading eliminates the interest of any investment analyst to write about them.

I was so shocked, and indeed affronted, as I read the prospectus following my introduction to these investments through Penelope, that I was moved to write about it in our June 2013 newsletter (titled Hotel California, since without liquidity, investors could check out but never leave). Financial services has done much to draw the public's opprobrium in recent years, and while many bad judgments were exercised not all the criticism and the fines heaped on Wall Street have been fair. But as long as securities like Inland American Realty exist, there will be ammunition for those who argue that investors' interests come second.

In 2010 an essay I wrote for Institutional Investor titled "Hedge Find IRR Has Been Pathetic" eventually led to my first book in 2012, *The Hedge Fund Mirage; The Illusion of Big Money and Why It's Too Good To Be True*. Once again, an essay has led to a book, called *Wall Street Potholes; Insights From Top Money Managers on Avoiding Dangerous Products*. It may be naïve or perhaps unfashionable, but I believe investing other people's money comes with the obligation to do your best work, honestly, and to charge appropriately. None of that should be at conflict with running a commercial business, but people who embrace conflicts of interest, egregious fees and other tools that hurt the overall client return ought to leave the business. We'd be better off for it.

As I lamented to industry friends, the low standards that sometimes apply, I heard of more examples like Penelope with other dubiously selected investment products. In the belief that sunlight is the best disinfectant, I partnered with four like-minded individuals to produce a book that we hope will be helpful to every retail investor out there. Each chapter reveals information that a financial salesperson somewhere would prefer investors didn't know. Some in the industry debate whether Finance is "a profession" such as medicine or law. One requirement is clearly an expectation of uniformly high standards of advice to clients, and in some small way we hope our book will further this cause.

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




CFA Institute, of which I am a charterholder as well as Vice Chair of the New York chapter's Market Integrity Committee, is committed to Putting Investors First as one area of focus in its Future of Finance Initiative. This is the one that interests me most. They have an Integrity List of actions CFA charterholders can take to "build trust and enhance your firm's reputation." The second bullet point (out of 50) is "Name and shame unethical behavior". That's pretty confrontational, in fact more so than CFA Institute is willing to go itself (as I've discovered when offering to write such blog posts for them). And yet, how will we ever raise standards unless we do so.

Sameer Jain, until recently a senior executive at American Realty Capital, advocates NTRs because of "illiquidity that favors the long-term investor", because it impedes "panic selling" or indeed any selling at all. He further argues that they are less risky than publicly traded REITs because their prices don't fluctuate, although this is only possible because there are no tradeable prices at all without liquidity. You can judge for yourself whether such advice meets any reasonable standard, or simply puts the client's interests far behind those of American Realty. One wonders what they think of their regulator, FINRA, finding it necessary to issue an Investor Alert concerning NTRs. Why isn't this warning shared with every potential investor before they commit funds the way tobacco products carry government health warnings? NTRs are by no means the only example of investments designed to extract substantial fees from the client. Our book covers many of them.

**Energy Infrastructure Investments**

Although we run six investment strategies, energy infrastructure accessed through Master Limited Partnerships (MLPs) as well as C-corps represent the most important part of our business. After reading last month's newsletter, one of our energy infrastructure clients expressed the wish that our recent results were as pleasant as my writing. I accept the compliment and heartily wish for the same! 2015 is shaping up to be the worst year for MLPs as measured by the Alerian Index since 2008, and the second worst in its 20-year history since 1996. Although our relative performance versus the index has remained positive, the sector's overall returns will quite understandably command attention. In recent weeks I have personally increased my exposure to the sector since values are so much more compelling than the alternatives on offer. As readers of our weekly blog will know, we have sought ever new ways to articulate a bullish view. Investing without leverage in companies with strong balance sheets lessens the need to get the timing precisely right, because timing the market is one of the hardest things to do. Few are good at it. Distribution yields and growth prospects in our opinion provide a compelling case for an overweight, although recent months have been as unpleasant for us as anyone. This too shall pass.