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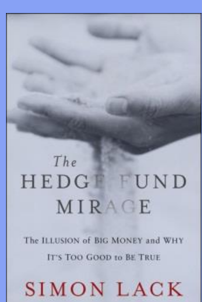

An Attractive Alternative to Alternatives

The Hedge Fund Mirage has been out for just over a month, and it has provoked a far wider reaction in the mainstream financial press than I had any reason to expect. Links to many book reviews can be found on the book's website (www.hedgefundmirage.com) but The Economist, Financial Times and Wall Street Journal have all written very complimentary assessments. Industry publications have provided more in-depth coverage; there's been TV, radio, upcoming speaking engagements and many instances where hedge fund insiders and investors have contacted me to initiate a dialogue or simply comment on the book.

As gratifying as the attention is, my hope is that we will make a difference. Although hedge funds in aggregate have failed to deliver, there are many talented managers and no doubt always will be. A shift in the balance from managers to investors on fees, information rights and access to capital can only be in the long run interests of an industry that used to deliver absolute, uncorrelated returns for a far smaller client base. Many conversations lead to the natural question, "If not hedge funds, then where should I invest?"

We think we have some answers to that. At SL Advisors we don't run a hedge fund or invest in them, but there are risk management techniques common to hedge funds that can have great applicability. Our Philosophy is presented below, and is available on our website. We think that our approach reflects a more client-centric approach that is transparent, accessible and fairly priced. There are no lock-ups or gates, no restrictions on transparency and if investment results are poor it won't be because fees were 98% of the profits (as for the industry as whole). When investment returns are good, clients reap the benefit.

This is how we run our business. We don't have to be the only one. Hedge fund investors might ask their managers why some of the principles described below don't feature more prominently at their firms too.

Why Hedge Fund Investors Need An Alternative Approach:

My book, ***The Hedge Fund Mirage***, challenges hedge fund investors to analyze their allocations to this industry more critically. Virtually all the available literature promotes hedge funds as a sound addition to institutional and high net worth portfolios. And yet, the actual results are strikingly at odds with this conventional wisdom. While there will always be highly talented portfolio managers running hedge funds, accessing a diversified portfolio of such talent has been surprisingly difficult for investors in aggregate. This paper summarizes the challenges for hedge fund investors and anticipates the obvious question: if hedge funds are not the answer, what is?

What Went Wrong for Hedge Fund Investors?

My book reveals that all the money ever invested in hedge funds would have been better off in treasury bills. Although hedge funds have performed well in the past, as the industry grew following the collapse of the internet bubble in 2001-02 the results steadily deteriorated. The high returns of the 90s were enjoyed by a much smaller set of investors than those who fuelled the growth in AUM after 2002. Just as smaller hedge funds outperform the indices, and almost every hedge fund did better when it was small, so did the hedge fund industry as a whole. Amazingly, the enormous sums allocated to hedge funds in recent years didn't focus on the growing difference between the average annual return over time and the asset weighted return (or Internal Rate of Return, IRR). But size has been its own worst enemy, and continues to be so today. The brutal Math is that for today's $2 TN hedge fund industry to generate a 7% annual return, the median expectation of institutional investors, requires $140BN of "alpha" or excess profit every year, a result that's never been delivered. Today's investors are betting on a record year for hedge funds every year.

But even for those investors who are good at selecting managers (and since the average investor fared better in treasury bills, above-average manager selection is critical) the strong mean-reversion qualities of hedge funds make this especially difficult. My book reveals how rarely high-performing managers stay that way – of funds in the top 40% of performers in any one year, only 7% are able to stay in that category every year. The other 93% spend some time in the bottom 60%. This absence of return persistence makes it especially hard for insightful manager selection to remain that way.

Fees have taken up a breathtaking amount of investor capital. I estimate that fees charged by managers and funds of hedge funds from 1998-2010 reached $440BN. Hedge funds have been highly profitable, but the profits have unfortunately not reached the clients. As I say in my book, "Never in the history of Finance was so much paid by so many for so little."

Clients have also willingly accepted far weaker rights and protections than in any area of investing. Traditional assets (such as Equities and Fixed Income) are largely handled through separately managed accounts. Clients retain complete ownership of their capital as well as the ability to access it and observe precisely how it's invested. The co-mingled open-ended fund structure so common in hedge funds affords many benefits to the manager but is disadvantageous to clients. It limits transparency, creates unequal sharing of costs, provides less liquidity than thought (as shown in 2008) and gives the manager far more control over client assets than necessary. My book provides real life examples of how all these weaknesses have manifested themselves.

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

What Should Investors Do?

If $2TN is largely invested in the wrong place, where does that capital belong?

The first reaction may be to reallocate under performing Hedge Fund assets to Equities and Fixed Income (both of these asset classes are transparent, liquid and can be effectively managed with fees that are significantly lower then the fees charged by Hedge Fund managers). That said, in today's economic environment both of these investment choices can appear unattractive.

Equities offer reasonable value for a long term investor but the past decade of flat performance combined with events such as the Dot.com Bubble, the Sub-Prime Credit Crisis (which can also viewed as the Over-Leveraged Debt Crisis) and today's uncertainty surrounding the viability of the Euro Zone leave Equity investors exposed to historically high levels of volatility and fat-tail events (i.e., possible significant draw-downs on this portfolio).

On the Fixed Income side low-risk assets such as U.S. government bonds and high grade corporate debt offer yields insufficient to preserve purchasing power. The equity risk premium (the difference between the earnings yield on the S&P 500 and ten year treasury notes) hasn't been this wide since 1974, a year that closed with the Dow Jones Industrial Average having dropped 45% from its peak only eighteen months earlier, and inflation at 12.3%.

Government policy is to help debt-burdened consumers rebuild their balance sheets by keeping interest rates artificially low. In effect, a slow but steady transfer of real wealth is taking place, from savers to borrowers. As a result, the after-tax return on $100 invested in ten year treasury notes can be replicated with only $20 invested in the S&P 500, assuming that dividends (currently 2.1%) grow at 4% per year (compared with a 50 year average of 5%). While hedge funds have been an appallingly bad investment, the prospects for conventional fixed income are mediocre at best.

At SL Advisors we research alternatives to alternatives; income generating strategies that exploit relatively attractive equity valuations and have more appealing prospects than bonds with acceptable risks.

Our Approach - 100% Pro-Investor:

We understand that Investors originally sought out Hedge Funds to generate absolute returns, un-correlated with traditional asset classes and with active risk management. In hindsight, it is now clear the Hedge Fund Industry has failed to deliver on many of those return objectives while the Managers have enriched themselves tremendously at the expense of their Investors.

While we do not run a hedge fund, we do utilize many of the value-added portfolio management techniques sought by Hedge Fund investors such as in-depth analysis (e.g., Macro/Micro economic and fundamental research) and sophisticated trading tools (e.g., long/short positions).

At SL Advisors we are 100% pro-Investor. By design, the Firm has been set up to address the major structural problems inherent with Hedge Funds

- We provide 100% position transparency through the use of Separately Managed Accounts. It's your money, you should know exactly how it is being deployed.

- We provide daily liquidity. No minimum investment periods, lock-ups or gates. It's your money, if you want to redeploy it you should do so when you want to.

- We charge a management fee of 1%, whereas the standard fee for most Hedge Funds is 2%.

- We don't charge incentive fees unlike Hedge Funds that routinely keep between 10% and 30% of client profits as incentive fees. Let's be clear here: when Alpha is generated -- which is what an active manager is tasked to do -- it should belong to the Investor, not the Manager.

Separately Managed Accounts - Ring Fencing Investor's Assets:

Unlike Hedge Funds, all our clients are in separately managed accounts (SMAs). This allows: complete transparency for the client to see how their money is invested; independent custody and valuation; access to capital. SL Advisors can trade within the account following strategy guidelines but cannot make any withdrawals or transfers ensuring that Investor money is effectively ring-fenced for ultimate protection.

It is how the traditional asset management business operates, and how many hedge fund strategies could be run if investors so demanded. Trades are allocated to all clients in the same strategy pari passu and SMAs are managed alongside my own money which is invested in all our strategies.

What We Are Focused On:

Excessive debt has led to many of the problems facing investors today. Developed country governments, state and local governments and consumers have all borrowed with reckless abandon; today's investment choices are a direct consequence of that. Believing that debt has been abused, we:

- avoid highly leveraged companies, including banks
- don't use leverage
- don't invest in debt

Companies with manageable debt can survive adversity without the bondholders eventually taking ownership of the company. It means that through times of crisis when markets are reeling and everything is uncertain, moderately leveraged companies may suffer declining business prospects but are unlikely to go bankrupt, which allows us to hold onto positions until calmer times prevail. We especially avoid banks, since while there are many well run banks and good times to be invested, the very high leverage and inequitable split of profits that favors employee compensation over returns to investors makes banks better places to work (if you can hang on to your seat and sanity) than invest.

Leverage magnifies returns as well as risk, providing tomorrow's returns as well as today's. It can also force an investor to sell just at the wrong time. We don't like excessive leverage ourselves any more than we like it in the companies in which we invest.

Since the Federal Reserve is distorting credit markets so as to ensure negative real returns to savers, we think fixed income is generally a poor long run choice. In fact, we think every investor with an allocation to fixed income should carefully consider their return prospects and reduce that allocation below what it might normally be. Since a barbell portfolio of 20% equities/80% cash has a good chance of equaling the return on ten year treasury notes, there seems little point in being anything other than underweight fixed income.