



In Pursuit of Value

July, 2010

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



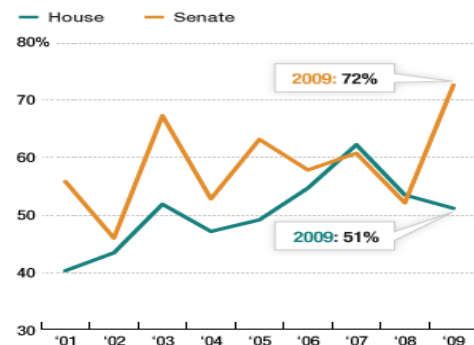
SL Advisors, LLC is a registered investment advisor offering separately managed accounts to individuals, family offices and institutions.

Proposition 14

“It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.” So wrote Justice Louis D. Brandeis in his dissenting opinion in *New State Ice Co. v Liebmann* (1932). That the U.S. states can serve as laboratories of government, allowing good ideas to bubble to the surface and bad ones to die without causing widespread harm is often traced back to Justice Brandeis. While the issue of that day was, quaintly, a state’s ability to regulate ice production at the dawn of the refrigerator, experimentation in state government retains its ability to rejuvenate.

On June 8, voters in California approved Proposition 14, and the rest of us will observe and hopefully benefit from this electoral overhaul. California’s dysfunctional government has been well documented, and commentators generally agree that partisan gridlock increasingly pervades Washington, D.C. as well. Every year the Congressional Quarterly releases the chart below illustrating how often House and Senate members vote on party lines. Without doubt there is little agreement and less compromise, with by far the biggest victim of this discord being America’s fiscal future. Since there is no middle ground to be found, the U.S. spends too much and/or taxes too little (depending on your view), a state of affairs that is as bleak as it is unsustainable.

Our elected representatives generally hold more extreme views than the rest of us, and are becoming less representative of the country as a whole. A New York Times article in 2008 found that in twelve states registered independents were growing faster than either major party (not all states require such registration). Gerrymandered congressional districts by design are less likely to switch parties and so the primary is often the meaningful election, where winning requires the votes of the party faithful and a correspondingly more partisan platform.



And so to California, where voters have opted for open primaries followed by a two-way run-off regardless of party affiliation. The elegance of this primary system, in which all voters can participate, is that of two strong candidates the less extreme will be more reflective of popular opinion and therefore more likely to win. Indeed, proponents expect this to result in the election of less partisan, more centrist candidates, better able to reach the compromises necessary to solve California’s biggest problems. No doubt anticipating their resulting loss of control both major political parties campaigned actively against Proposition 14; no more powerful argument in support is needed. Implementation is in 2012, and it will take some years to assess, but California has been first to market with many good ideas including bans on school segregation and plastic grocery bags (2011) and, less seriously, the frisbee, the jacuzzi and seedless watermelon. If deemed successful, this new primary system could take hold across the country as the constant reinvention that is the U.S.A. is once again triggered by state level innovation. At a time when partisanship, Washington gridlock and fiscal irresponsibility have never made the fiscal future appear so dark, there is a reason to feel hope, albeit some years in the future, for that shining city on a hill.

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

Closed End Fund Activism

This is an interesting time of the year to follow activists. Many funds hold their annual board meetings, and while they are usually perfunctory affairs with sparse attendance, sparks occasionally fly when an investor decides to oppose a fund manager. Deutsche Bank has attracted the unwelcome attention of more than one activist. In one famous case last year, following a period of exceptionally poor performance Deutsche was removed as advisor to one of their closed end municipal bond funds and replaced by Bulldog Investors, a vocal critic, who now manages the renamed fund. This must have represented an embarrassing if not economically significant loss for Deutsche. Another investor, Art Lipson of Western Investment (on which more below) has so low an opinion of Deutsche's asset management skills that he announced through an SEC filing that Deutsche should exit the management of closed end funds entirely. Such investors are frequently criticized by their targets as simply seeking short term profits, but their success typically benefits all shareholders and following them is often worthwhile.

What We Own

DWS RREEF World Real Estate & Tactical Strategies Fund (DRP) is a closed end equity fund that invests globally in REITs and other real estate securities. With a market cap of \$84MM it may not be a major focus of DWS Investments (\$133BN in AUM), Deutsche Bank's retail arm. If not, it should be, since even allowing for the difficult markets since launch in 2007, performance has been breathtakingly poor. Within two years it had lost more than 70% of its initial value, and even after 2009's recovery it's still down over 50%. Perhaps reflecting buyers lack of enthusiasm its stock trades at a 15% discount to NAV. DRP's beleaguered investors may have found a friend in Western Investment, a well-known activist investor. In an unusually colorful SEC filing, they accuse Deutsche of "maximizing its own benefits at stockholders' expense", "dismal operating performance" and ask stockholders to "help us dump them" by electing Western's slate of independent directors. Western is the largest holder of DRP, and naturally their proposed changes are intended to make a profit for them and other DRP stockholders, although not for Deutsche who would cede management of the fund. Deutsche haven't said much publicly, although helpfully they say they've dropped the "DIMA global tactical asset allocation overlay strategy" from their investment process, plan to add leverage and will modestly reduce their fee. New directors require a voting majority of all outstanding shares (rather than simply of votes cast) to be elected, making change difficult since many investors don't bother to vote. Unsurprisingly, Deutsche's IR representative struggled to explain why this was system was good for shareholders. Nonetheless, the nuisance value of a determined activist is not to be under-estimated, and recently Deutsche eliminated the discount on GCS, another undervalued closed end fund targeted by Western, by merging it with a mutual fund. DRP is a holding in our Discount Arbitrage strategy.

Devon Energy Corporation (DVN) is another company we like within our natural gas theme. As we've said before, we think natural gas E&P names have some interesting upside. The U.S. possesses enormous domestic reserves and can be self-sufficient for decades; natural gas burns cleaner, emitting half as much carbon as coal and 30% less than oil; and on an energy-equivalent basis is historically cheap, at around one third the price of oil. We still own Petrohawk (HK) and Southwestern (SWN) which were described in an earlier letter. We expect one of the consequences of the Gulf of Mexico oil spill to be increased regulation and higher required returns on capital for those firms drilling there. As a result we recently added DVN which has slightly less than half of its reserves in crude oil, although none of them are offshore. DVN had most fortunate timing in recently selling their offshore Gulf of Mexico assets to BP of all people. DVN has low debt relative to its peers at 20% of its market cap, and its stock currently trades at around an 18% discount to its estimated NAV. DVN is a holding in our Deep Value strategy.