

Avoiding the Potholes

January 2012

The 2011 financial markets reminded us of the condition of Chicago's winter roads; it was important to steer clear of the potholes so as not to cause significant damage. At the end of 2010, many pundits and advisors were adamant the US dollar would continue to weaken, thus an investor needed exposure to emerging market equities and international developed market equities as a way to hedge against a lower dollar. Yet in 2011, the dollar strengthened, the MSCI Emerging Market Index was down 18% and foreign developed equities were off 11%. Even international developed market bonds which were touted in 2011 as better value than their US counterparts lagged US bonds by 5%. Trying to time the market was also a common mistake last year. Many retail investors bailed out of equities, high yield and other risk assets in August and September soon after the S&P 500 dropped 20% peak-to-trough. Value investors were consistently disappointed as financials ended the year down 17%, despite Europe, not the US, being the area with the largest unresolved issues. Even with the turmoil in the markets, the S&P 500 was virtually unchanged on a price basis and up 2.1% when dividends were included. If you weren't paying attention or made the wrong moves, the damage to your portfolio in 2011 could have been significant. RVP managed to avoid many of the potholes and we are pleased to post positive returns in each of our core strategies. RVP has now posted positive returns in 6 of the last 7 years in each of its largest strategies: Absolute Return, Balanced, and Fixed Income.

RVP Returns Net of Fees

Product	YTD (12/31/10 – 12/31/11)	3 Year (12/30/08 – 12/31/11)**
RVP Balanced	2.31%	51.27%
60/40 Benchmark*	4.67%	38.97%
RVP Absolute Return	1.47%	36.08%
3-Month T-Bill	0.09%	0.37%

* 60/40 Benchmark is 60% S&P 500 and 40% Barclays Aggregate Bond Index re-weighted monthly.

**3 Year Returns are Cumulative

For 2011, our Absolute Return Strategy returned 1.47 %, net of fees, compared to the 3-month T-bill of 0.09%, bringing our cumulative 3 year return to 36.08%. Our more expensive, less transparent brethren, the Global Hedge Fund Index posted returns of -5% for the year which makes our muted 2011 return seem more palatable. Our Balanced Strategy returned 2.31% for the year, compared to the average

Lipper Balanced Mutual fund return of 0.70%, while the S&P returned 2.1% and the Barclays Agg returned 7.84%. We are disappointed that we underperformed the 60/40 index but we are confident our long term returns will continue to outperform and we believe this period of underperformance is short-lived. For the Balanced Strategy, our 3 year cumulative performance is 51.27% vs. the 60/40 benchmark of 38.97%, which places us in the top 10% versus our peers.

RVP started 2011 with a short duration bias, a decision that hurt our performance in almost all of our strategies. Our choice to maintain a low relative duration was based on experience and a belief that the Fed would have less influence on the bond market in 2011 vs. 2010. This was the wrong call. A low duration and underweight in treasuries was the single biggest contributor to our underperformance in both our Fixed Income and Balanced Strategies and this overwhelmed the winning trades we did have in fixed income. Entering 2012, our fixed income views remain in line with our 2011 outlook. We believe rates will remain nominally low, although probably higher from current levels and the government will print money until the bond market revolts. We do not believe it is prudent to buy a sub-2% 10-year Treasury note when we do not believe the world will end. Therefore, we continue to favor shorter duration credit instruments versus our Treasury focused benchmark.

In equities this year we made a couple of changes to our sector allocation. In late September, we bought master limited partnerships via the Alerian MLP Fund. We like this sector due to the low volatility, stable cash flow and tax deferred treatment, in addition to the fundamental investment case. On a total return basis, the position essentially matched the S&P 500, yet with less volatility. During market weakness in October, we added a position in high yield bonds in lieu of adding equity exposure. At the time, high yield bonds spreads were at historically wide levels. We viewed this risk reward scenario as favorable, especially given the lower volatility profile of purchasing high yield bonds at such cheap levels. As we start 2012, we believe domestic equities are the most reasonably priced asset class and we will continue to look for sectors which we believe offer superior risk reward.

While we were happy to eke out a positive return in our Absolute Return Strategy this year, we were disappointed it wasn't a higher nominal number. Our tepid returns were caused by discount widening, specifically in the covered-call sector. At the end of 2010, we established our initial covered call position and throughout 2011 we increased the size of the position as the sector got cheaper. We maintain our conviction that these closed-end funds are cheap, especially given their less volatile nature and high, tax-advantaged yield. Many of our holdings ended the year at discounts in excess of 15% and with yields over 10%. While our positions in covered call closed-end funds hurt our 2011 performance, we think it will contribute positively in 2012.

The bright spots for our strategies this year mostly centered around activism. In this month alone, we will see three of our long term holdings complete their open-ending process. The two Sun America funds (FGF & FGI) and the TS&W/Claymore Tax Advantaged Balanced Fund (TYW), all three of which have been featured in previous newsletters, will convert to open-end funds, allowing us to sell these securities at or near NAV. Another fund that has been mentioned before is the LMP Capital and Income fund (SCD). We continue to tender a significant portion of our SCD holdings at levels near NAV. On the most recent tender that occurred at the end of the year, we successfully tendered 17% of our holdings near NAV. We have now successfully tendered 68% of our initial position with an additional tender offer remaining.

As we mentioned in our last newsletter, we were expecting the 4th quarter to be a volatile one, specifically for closed-end fund discounts, as retail investors looked to harvest losses. Our prediction was definitely accurate and we spent much of November and December establishing new closed-end fund positions and increasing our holdings in our old favorites. An example of one new purchase is the Blackrock Resources and Commodities Strategy Trust (BCX). This is a natural resource and energy fund with a covered call strategy. BCX was issued in March 2011 at \$20 (+5% premium) and closed the year at \$13.28 (-15% discount). The pullback in resource stocks and the widening discount typical of a new issue fund created a large loss in the security, which new issue purchasers were eager to harvest. This gave us the opportunity to purchase the fund at deeply discounted levels. We had anticipated that discounts would begin to tighten at the end of December (which would have helped our 2011 performance), and on this prediction we were a little early. Closed-end funds ended the year at what we believe are cheap levels, but we are fortunately seeing the expected discount closing thus far in January. Hopefully this will lead to a solid January performance.

Clearly, issues surrounding the European debt crisis and global economic growth will be front and center in the news again in 2012. Hopefully we can use the volatility to our advantage by reducing risk when optimism rules and being opportunistic when prices are low. Based on valuations as we begin 2012, we are excited for the challenge that awaits us. As always, thanks for your continued confidence in RVP.



Maury Fertig



Bob Huffman

Relative Value Partners, LLC Absolute Return Composite Net Returns

	1 Year (ending 12/31/11)	3 Years Annualized (ending 12/31/11)	5 Years Annualized (ending 12/31/11)
RVP Absolute Return	1.47%	10.82%	7.40%
3 Month T-Bill	0.09%	0.12%	1.36%

Relative Value Partners, LLC Balanced Composite Net Returns

	1 Year (ending 12/31/11)	3 Years Annualized (ending 12/31/11)	5 Years Annualized (ending 12/31/11)
RVP Balanced	2.31%	14.79%	3.19%
60/40 Benchmark*	4.67%	11.59%	2.84%

*60% S&P 500/40% Barclays Aggregate Bond Index

Relative Value Partners, LLC Equity Composite Net Returns

	1 Year (ending 12/31/11)	3 Years Annualized (ending 12/31/11)	5 Years Annualized (ending 12/31/11)
RVP Equity	-0.32%	15.35%	1.01%
S&P 500	2.11%	14.11%	-0.25%

Relative Value Partners, LLC Fixed Income Composite Net Returns

	1 Year (ending 12/31/11)	3 Years Annualized (ending 12/31/11)	5 Years Annualized (ending 12/31/11)
RVP Fixed Income	5.95%	12.89%	6.10%
Barclays Aggregate	7.84%	6.77%	6.50%

Relative Value Partners, LLC Global Equity Composite Net Returns

	1 Year (ending 12/31/11)	3 Years Annualized (ending 12/31/11)	Inception (4/30/07) to 12/31/11 Annualized
RVP Global Equity	-4.59%	15.36%	1.03%
MSCI EAFE Index	-11.68%	8.23%	-6.20%

Relative Value Partners, LLC (RVP) is an independent registered investment advisor. The Balanced Account composite contains fully discretionary balanced accounts and for comparison purposes is measured against the 60/40 Benchmark. The 60/40 Benchmark is comprised of 60% S&P 500 and 40% Barclays Aggregate Bond Index, reweighted monthly. The Absolute Return Composite contains fully discretionary absolute return accounts and for comparison purposes is measured against the 3 Month Treasury bill. The Equity Account Composite contains fully discretionary equity accounts and for comparison purposes is measured against the S&P 500. The Fixed Income composite contains fully discretionary fixed income accounts and for comparison purposes is measured against the Barclays Aggregate Bond Index.

All returns are shown in US dollars and are net of actual fees. The returns shown include the reinvestment of dividends and other earnings. Accounts may own levered closed-end funds or ETFs and may short ETFs. Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk and there can be no assurances that any specific investment will be profitable. Investors may experience a loss.

RVP claims compliance with the Global Investment Performance Standards (GIPS®).

To receive a complete list and description of RVP's composites and/or a presentation that adheres to the GIPS standards, contact Catherine Goel at (847) 513-6300, or write RVP, 1033 Skokie Blvd, Ste 470 Northbrook, IL 60062, or cgoel@rvpllc.com.