

# SOUND ADVICE

Volume XX, Number 10

Subscription Rate: \$195 per year

October 12, 2007



About a decade ago, I ran into a respected newsletter writer, and asked him how he thought his career would have turned out had he gotten his start not at the 1982 dawn of the greatest bull market of our lifetimes but during the 1970s bear market. He smiled, "Had I started in the depths of a bear market, I might be pushing a broom today." We laughed, acknowledging his modesty but also recognizing that circumstances abet success.

His words came back to me while reading Alan Greenspan's memoir, in which he confesses that his navigating the U.S economy through everything from the 1987 market crash to the tech bubble's implosion in 2000 was not, as the media described, purely the triumph of his personal genius.

The Maestro concedes he could keep inflation at bay because trends over which he had no control enhanced his own efforts. What were those trends? Technology-inspired productivity increases, globalization, and the emergence of new economies especially in Asia with ultra-low labor costs made his rate cuts and opening the money supply spigot effective. Had he been swimming against those tides, the results would have been less lopsided. Ben Bernanke already is confronted not just by the ebbing of Greenspan's friendly tides but also by the consequences of Greenspan's own policies. Now Bernanke has cut rates and opened the money spigot, just as Greenspan would have, but, we think and Greenspan implies, the Fed does not have the wind at its back. If the price of gold and the drop in the dollar mean anything, the markets see the same.

--Gray Emerson Cardiff

## Don't You Read the Papers?

Bill Miller, among the most respected value-oriented mutual fund managers, is distinguished by his heretic's definition of value, since he made fortunes for his shareholders by buying things like Amazon.com, which most orthodox value investors would never consider. But Miller to his credit saw Amazon as undervalued, and events proved him right. Indeed, Miller until 2006 outperformed the S&P 500 for 15 consecutive years. As that string of successes last year was coming to an end, he explained to shareholders that the absence of energy stocks from his portfolio had contributed to his fund's underperformance during 2006.

In his most recent letter to shareholders, Miller reflects on why his fund again in 2007 is lagging the S&P, and notes what is obvious to anyone glancing at his portfolio: not only does he remain uninvolved with energy, he is also long homebuilders and other companies tied to real estate.

Miller is not apologetic about the real estate exposure. "We actually try to buy low and sell high, and you don't buy low when everything is great and the headlines reflect it. Usually, but not always, when you read about some industry or company having the worst time since some period of years, or even decades ago, you will find that buying that industry or company when it was going through those difficulties proved quite profitable if your time horizon wasn't measured in days or months."

He notes that industry observers say this is the worst stretch for homebuilders since the early 1990s, and points out that had you bought homebuilders during that previous implosion, you today would have spectacular, market-beating profits. Had you sold when the market was euphoric about the residential real estate market back in 2005, your profits would be beyond spectacular. What Miller doesn't note, but would not shrink from, is that depressed housing stocks did not really start realizing their potential until the end of the 1990s, nearly a decade after their implosion. Had you bought, for example, Lennar or Centex after the sector cratered in 1987, you would have had to wait until 1991 to start to see a recovery and 1999 for the real ascension. How many investors are willing to wait even four years to begin to reap the benefits of so lonely an investment decision to say nothing of a decade to pocket the real payoff?

<b>IN THIS ISSUE...</b>	
<b>Ford Convertible Preferred (F.PRS-NYSE)....Pg. 3</b>	
<b>Sound Advice Portfolio Updates.....Pg. 6</b>	
<b>Sound Advice Portfolio.....Pg. 8</b>	
<b>Sound Advice Indicators.....Pg. 9</b>	

# Don't You Read the Papers?

---

We eventually will become buyers of homebuilders, but just not yet. As for energy, well, we continue to hold on to what has been a very, very profitable cluster of investments. And we continue to be uncomfortable with their success. If this strikes you as bizarre, remember we worship at the altar of reversion to the mean, and after five years of rising prices for energy positions, the possibility that these wonderful prices might revert to more normal levels is always on our mind.

Miller says that shareholders, miffed by his overweight position in homebuilders, might ask him “don’t you read the papers?” We do read the papers, and know that energy remains on the buy lists of most investors and market strategists. Just tune in to CNBC and count the number of talking heads that recommend buying energy. Our only comfort against this enthusiasm is that there remains a strong and vocal minority that proclaim energy prices are in a speculative bubble that will collapse soon and take oil down to the mid-\$40s and natural gas to the \$5s. Every time oil surges through some previous upper limit, most recently in mid-September when it broke \$80 and crested above \$84, we heard the skepticism, and when prices retreated below \$80, there was a positive howl of relief from the energy bears. “You see,” they proclaimed, “it’s straight down from here. “Oil bounced back quickly, and as we write, is still over \$80 a barrel. Someday they will be right. Just not yet, we hope.

## NICE RECOVERY

In the wake of the Federal Reserve’s generous September 18<sup>th</sup> rate cut, Miller’s fund, with or without energy stocks, and just about everything else has prospered. Frankly, we think that Bernanke by responding so robustly—50 basis points was an emphatic counter to whatever ailed the credit markets—has exchanged one problem for another. In place of a seized-up credit market and anxiety that it might lead to recession, Bernanke now has accelerated the U.S. dollar’s downward spiral and greased the skids for the U.S. economy

slide to inflation. For confirmation, you need look no further than gold, which went from \$655 an ounce in mid-August as the mortgage morass overran its banks and the market began to speculate about whether the Fed would have to cut rates, to \$710 on the day before rates were slashed. Now gold stands at \$735, a 12.2% change from mid-August. Gold’s appreciation owes much to those chopped interest rates, which naturally undercut the appeal of the dollar as investors look for higher rates elsewhere and speculators conclude that the Fed has decided to turn a blind eye to inflation risk. The Euro in mid-August cost \$1.3402, and \$1.386 on the eve of the FOMC announcement. Today, a Euro costs \$1.4043 a 3.5% move from mid-August. In more tangible terms, **American Global Gold Fund**, our way of playing the weakening dollar by using mining stocks, which move higher or lower faster than does the price of gold, went from \$16.06 at the mid-August low to \$19.85 just before the FOMC met. Today BGEIX stands at \$21.82, a 35.9% move. Over the same period, the S&P 500 has added 10.4%. These assets all moved in anticipation that the Fed would intervene, but it was the dollar and gold that moved with the greatest confidence in anticipation that the U.S. central bank would sacrifice the dollar and its fight against inflation to cope with more immediate problems.

## WHAT TO DO?

We do not think that dollar weakness is over, and we do think that evidence of inflation will emerge. Interest rates, especially the longer-term variety over which the Fed has little control, are also going to move higher as bond buyers insist on getting a higher yield to compensate them against the prospect of further deterioration in the dollar. So, stay with **BGEIX** as well as the natural resource grab bag that is **AAUK**. Look at the updates to see what has appreciated most since the last issue for suggestions as to what the market likes most in a weak-dollar environment. And—please pardon the paradox—as always, be ready to buy what the market hates most. **SA**

Gray Cardiff's Sound Advice is published monthly by S.A. Newsletters, LLC. Editor-in-Chief: Gray Emerson Cardiff. Managing Editor: Steve Horwitz. Executive Editor: Linda Cardiff. Office Manager: Angela Castellano. Subscription rate: \$195 per year. Send subscription requests to: Sound Advice, 939 Hartz Way, Suite 210, Danville, CA 94526. Phone: (925) 838-6710. Fax: (925) 838-0522. Information presented in Sound Advice may be used provided the newsletter—its name and address—is mentioned as the source. The information contained herein has been carefully compiled from sources believed to be reliable, but accuracy cannot be guaranteed. ©2007 S.A. Newsletters, LLC.

When securities are initially recommended herein, the editors, affiliates, and associates of the editors do not have positions in such securities and are required to wait at least seven days from the date Sound Advice is mailed before placing orders for them. Editors and staff members may own stock of companies discussed herein.

# Is There A Ford Convertible in Your Future?

Investors are pain averse, and instinctively steer clear of investments that contain a significant chance of failure. If the B-word (bankruptcy) enters the conversation, few want to hear anything more. But *Sound Advice* frequently wades into situations that are bleak, though our choices usually are insulated by a strong balance sheet, have current valuations that coincide with those reached at historical lows, are either enduring a down moment in that company's business cycle or has encountered problems, which, though daunting, are clearly solvable. In this case, for one of the no-longer so big Big Three automakers, the pluses are slim. The U.S. auto industry is in trouble. Not only are higher gas prices changing what Americans are looking for and foreign manufacturers have a keener sense of what that is, but the economy is slowing and the spending giddiness that the stock market engendered in the 1990s and the booming housing market extended until this year has subsided. With profits in decline, managements are struggling with onerous labor contracts, which their predecessors preferred to lard with benefits for retirees rather than meet more immediate demands. And then there are company specific issues.

Visit online sites where shareholders of auto companies gather, and the mood as well as the language is desperate. Yahoo! tallies the opinions of Wall Street analysts, which are 10-3 pessimistic about the shares of this month's subject. Yet, there are opportunities amid the risks, and given how lopsidedly gloomy expectations are, we are willing to recommend Ford Motor Company, though not through its common shares. Instead, we want to lay out the case for **Ford Motor Company Capital Trust II 6.5% Cumulative Convertible Trust Preferred Securities (F.PRS—NYSE) (FCTCP)**, which generates an 8.5% yield while giving us the right, should Ford common appreciate, to exchange the preferred shares for common shares.

Needless to say, should Ford satisfy the dour expectations of its the many pessimists and goes into bankruptcy, neither the share price nor the yield means anything. This is one investment that we recommend only to subscribers with a high tolerance for risk, and an appreciation of what long-odds wagers mean.

Bankruptcy gossip about Ford as well as General Motors has been a media staple for several years, and will continue to ripple until repudiated. A friend, a very knowledgeable investor whose insights about the auto industry are dour, has been advising his clients that Ford will not be an independent company a decade from now. Either Ford will merge with another company, go private, be bought or cease doing business. We don't presume Ford is done for as an independent entity, though we could live with the first three scenarios, and as for bankruptcy, our experience with such predictions when the horizon is several years in the future, suggests the likelihood of such an outcome declines considerably. There is no doubt that Ford has very serious and very visible problems, more serious than any company we have ever recommended. There is no guarantee that Ford management can solve those problems. However, investing always is a balancing act between risk and reward.

## **FORD**

Long after Americans had decided that foreign cars, first European, then Japanese, and now even Korean vehicles, were superior to what American manufacturers were hawking, Ford remained a powerful company. Just a decade ago, in 1997, Ford had sales of \$127 a share, cash flow of \$12, earnings of \$5.62 and showed a book value of \$24.83. At the time, its market cap was \$54 billion. Total debt stood at \$163.6 billion, of which \$78 billion was long-term. Ford common sported a 4% yield. Slightly more leveraged than General Motors, Ford was rolling, its stock having run up by 50% that year.

Last year, Ford had \$84.61 per share in sales, cash flow was \$7.24, earnings were minus \$1.50, and book value was minus \$1.83. Long-term debt had ballooned to \$134.9 billion and short-term debt was \$35.1 billion. As for yield, Ford last paid a dividend on the common in 2006. Though total debt might be about the same, market cap today has shrunk to \$16.6 billion, about the size of Marriot or Weyerhaeuser, nice companies but hardly corporate cornerstones. Price ratios, our standard starting point for placing a recommended company's stock

# Sound Advice on Ford Capital Trust II Convertible Preferred

price in a meaningful historical context, are irrelevant for Ford.

Ford during the second quarter generated \$821 million in pre-tax income from its automotive business: South America accounted for \$255 million, Europe and PAG (Premier Auto Group, which includes Jaguar, Volvo and Land Rover and is domiciled in the UK but consolidates global sales including the U.S.) \$650 million, Ford Asia Pacific and Africa \$99 million, but at home Ford had a \$76 million loss. Unfortunately North America is where Ford sells 45% of its vehicles. In terms of units sold, there was an 11% decline from the same period last year. While Ford is retaining market share outside the U.S. and with the decidedly upscale PAG, here at home its slice of the car market shrunk from 16.7% to 15.6%.

Ford, like other car makers, is also a finance company for both its dealers and its customers, and Ford Motor Credit had remained solid despite the manufacturing division's turmoil. Last year, for example, Ford Credit accounted for nearly \$2 billion in pre-tax earnings. This year, however, events are conspiring to sap that strength. In the second quarter, for example, income from Ford Credit before taxes tumbled from \$435 million to \$112 million, which reflected higher borrowing costs, higher depreciation costs for leased vehicles, and a lighter benefit from smaller loss reserve deductions, though there was some boost from cost savings in operations. Finally, charge-offs for non-performing loans and leases increased a bit, principally in North America.

To put this in context, look at General Motors, which over the last three years crawled along by growing revenues at an annualized rate of 3.7%, while Ford has seen revenues shrink by 1.2%. Stepping back to consider foreign competitors, Honda expanded at a 10.8% clip, Nissan at 11.4%, and Toyota at 11.5%. For this year and next, Ford expects no earnings, while GM anticipates sales will be stagnant over the next two years.

Finally, if you think the Federal government might rush to rescue Ford, forget it. The conditions that had Congress cosign Chrysler's borrowings in the late 1970s do not today exist. No one will be cosigning Ford's debts except the share and bondholders.

## ***SELLING MORE CARS IS NOT THE ANSWER***

Dwindling sales numbers alone are not the real problem. Ford is built for massive production, but demand for its products in North America is mediocre. Management is in the process of closing plants, trying to trim its workforce, to make the remaining facilities more efficient, and confronting a dysfunctional business model, which includes a very, very out-of-whack labor contract that has saddled the company with huge responsibilities for retired workers, especially promises made to cover healthcare. But even if Ford can solve these profound problems, it must come up with a line of products that Americans want to buy.

The problem for Ford is not how many cars it is selling but at what prices. As the joke goes, the butcher despite selling each pound of hamburger at a loss expected to make his profit on volume. Ford seems to have learned the butcher's lesson. Looking at the diminished unit sales, we wonder if some of the shortfalls cited above can be read not as Ford falling further behind but as evidence that a different approach to how to sell cars is taking hold. For example, in 2006 to clear its bloated inventory Ford rolled out a zero-interest-for-72-months sale that was very effective in fattening unit

**There is no doubt that Ford has very serious and very visible problems, more serious than any company we have ever recommended. There is no guarantee that Ford management can solve those problems. However, investing always is a balancing act between risk and reward.**

sales but did nothing for earnings. Each car sold just dug a bigger hole in the income statement. We have not seen similar desperation this year. Another provocative number concerns fleet sales, that is sales to car rental companies, to government and to large corporate clients, which even in good times constitute the smallest profit margins. In August, fleet sales were down 18% on a year-over-year basis, and in September showed a similar decline. Management apparently is showing less interest in producing cars and trucks to sell at a loss.

If too many cars from too many plants staffed by too many workers have been killing the company, the other side of the sales equation, buyer interest, is just as pressing. Car buyers are not crazy about the Ford product line. Compared to General Motors, which also relied too heavily on big SUVs, heavy trucks and minivans—all gas guzzlers—Ford lags behind in plotting out new products and means of production. This adds to inves-

# Sound Advice on Ford Capital Trust II Convertible Preferred

tors' wariness about Ford's ability to pull itself out of the ditch. Furthermore, GM is far ahead of Ford in partnering in Asia and other emerging markets, and is generating significant revenue, while Ford primarily has a one-third interest in Japan's Mazda brand.

At the moment, Ford's sexiest product is the Mustang. The extremely successful Taurus, which in its time revolutionized domestic passenger cars, had been put out to pasture in 2006 but this year was resurrected by slapping the Taurus brand on two cosmetically redesigned sedans to remind buyers of Ford's last influential and widely successful passenger vehicle. But today's Taurus is just keeping the name alive until a truly new Taurus appears in 2010. Can Ford come up with bread-and-butter products as well as sizzlers like the classic Thunderbird that created its own market segment?

The bottom line, which now is nil, is that if Ford can return to making a profit on its cars in the U.S., and can make an impact globally, its shares, which today are priced like a call option on that future, have considerable upside. We would not be recommending the preferred regardless of the yield were this not a realistic (but not a sure) outcome.

## UNIONS

The contract between GM and the United Auto Workers, which is soon to be voted on, and, we presume, approved by the rank and file, breaks decisively with existing conditions. The key elements are a trust funded by GM with \$30 billion and owned and administered by the UAW will replace the crushing unfunded burden of healthcare costs for retirees, and a two-tiered system of wages will ease unionized workers' wage and benefit costs. Existing workers will continue to receive average pay and benefits that amount to \$51 an hour. New workers, who will start as janitors and maintenance workers, will receive \$28 an hour. If they advance to working on the assembly line or to other more responsible positions, they will get first-tier wages. There are plenty of other details about job security.

The union recognizes that the survival of any U.S. auto jobs depends on returning GM, Ford and Chrysler to profitability, and leadership knows it must collaborate with management for that to happen. The UAW

## Comparison of Ford Common and Preferred

<b>Current Price of Ford Common</b>	<b>\$8.37</b>
<b>Current Yield on Ford Common</b>	<b>0%</b>
<b>Current Price of Ford Convertible Preferred</b>	<b>\$38.10</b>
<b>Current Yield on Ford Convertible Preferred</b>	<b>8.53%</b>
<b>Premium (Spread) Over the Conversion Value</b>	<b>\$14.30</b>
<b>Current Yield on Spread Over Conversion Value</b>	<b>22.72%</b>

can't say that shareholders are taking all the profits and leaving them nothing. It's clear that shareholders are in just as bad a shape as the workers.

The UAW will seek to impose the same contract pattern on Ford and Chrysler, but we expect a struggle since GM, in a far stronger position than either Ford or now privately owned Chrysler, could make concessions neither of the other two can. For example, GM has progressed far enough in its restructuring to know what models it will be producing and where through 2010, and thus could make firm agreements about factories to close and employee headcounts. That is not possible for Ford, which is still fleshing out its future. Further, because Ford is in a weaker position than GM, it must seek more concessions from the UAW. We expect negotiations will include a strike, likely to last longer than the two-day token affair the UAW put on for GM's benefit when talks stalled. However, the union will be under pressure to retain as many jobs as possible, and ultimately must make more concessions for Ford. The only question is how long the process takes. On the plus side, having established how to deal with healthcare costs and the introduction of the two-tiered wage system in the GM talks, the parties have a roadmap for reaching consensus on the most difficult issues.

Is there anything good to be said about Ford? Yes. Let's start with leadership. After being run by members of the Ford family since Henry rolled the first car out the door, an outsider, Alan Mulally, who made his reputation by remaking another troubled manufacturer, Boeing, became CEO in 2006. Mulally succeeded at Boeing where he took a messed-up corporation's commercial aircraft division, which was being outflanked by its European competitor, Airbus and reduced the number of Boeing workers, made those who remained more efficient, improved the balance sheet, and made product decisions that created a huge backlog orders for Boeing planes. Admittedly, he turned around a smaller company with a handful of products, and had only one

# Sound Advice on Ford Capital Trust II Convertible Preferred

---

real competitor. Ford's circumstances are more complex.

Second, Ford is finally slashing away non-core businesses regardless of how much it will have to write off of the billions management paid when the acquisition of prestigious European brands seemed a way to invigorate the product line and enhance Ford's image. Thus, Aston Martin is gone, and we expect Jaguar, Land Rover and Volvo to be next. Ford has to concentrate on its mass-market products domestically and abroad.

Third, Ford along with the other U.S. carmakers have woken up to the fact that SUVs on steroids, which made them so much money during the days of cheaper gasoline, are for now dead. The automakers are setting up to produce cars people need. The reconceived and redesigned Taurus in 2010 will be a defining moment. However, Ford and Chrysler trail GM in getting such products ready for market. While GM already is producing crossovers to capture what had been the SUV market, Ford lags behind.

## **OWNING A FORD CONVERTIBLE**

If you buy our argument that despite Ford's precarious situation, expectations of total failure are unwarranted, the question becomes how to buy into the potential for recovery. The simplest answer is to buy the common, or, if you have a hunch that matters might turnaround within a specific time period, you could buy calls. We recommend neither.

We prefer getting paid while we wait for Ford to recover, and that brings us to the FCTCPs, which carry a 6.5% coupon, meaning they pay on a quarterly basis a total of \$3.25 a year, and can be called (redeemed) by Ford at anytime for \$50. The shares if not called or converted by holders into common, mature on January 15, 2032, at which time Ford extinguishes the securities by paying holders \$50 per share. If you want to review the nitty-gritty of the prospectus, it is available at <http://www.ford.com/about-ford/investor-relations/company-reports/us-sec-edgar-filings>.

These convertible preferred shares are rated along with Ford's other debt as sub-investment grade, that is, they are junk, which approximates Ford's precarious situation. Junk status is no reason to avoid the FCTCPs. But you need to appreciate the risk.

What is a "cumulative convertible trust preferred share?" Preferred shares are senior to common shares

when it comes to the payment of dividends, which in this case offers little insulation, since Ford has ceased paying a dividend to common shareholders. This is where the "cumulative" part comes into play. Should Ford decide to not make the scheduled dividend payment on these preferred shares, the unpaid dividends accumulate and become an obligation on Ford's books. At its discretion, Ford could defer payments for up to 20 quarters before being considered in default.

However, going out of business turns this obligation as well as the \$50 redemption price represented by the cumulative convertible preferred shares into just another junior claim against the company's assets. Senior debt will consume everything.

Finally, shareholders have the right, but not the obligation, to exchange each FCTCP for 2.8249 shares of Ford common stock, which when the shares were issued at \$50 represented a 20% premium to the conversion value of the preferred. Today's prices, \$38.10 for the preferred and \$8.37 for the common, leave an even bigger spread between the conversion value and the price of the preferred. But we have 25 years to close that gap completely. Meanwhile, any change in the common will generate gains for us, and we always have the annual \$3.25 distribution.

Look at the comparison on Page 5 between the two ways of owning a share in Ford's future. The FCTCP, if you strip away the conversion value, costs today \$14.30. For that premium, you receive \$3.25, a 22.7% yield. You can see why owning the preferred is the better way.

If after considering this recommendation, you decide to buy the Ford preferred, we strongly encourage you to use limit orders rather than a market order, since after Ford completed a tender offer for the FCTCPs in late July, the number of shares has shrunk by 43% to 57.5 million. The average daily volume now is around 52,000 shares. Over the same period last year, the daily average was five times that. When volume is so low, prices can jump around when new buyers appear. Limit orders allow you to specify the maximum you are willing to pay, and thus protect you from sellers taking advantage of buyers a recommendations such as this can create. Some place their limits significantly under the current price, and hope the shares' ask price will come to them. Others simply use the last printed trade price as their limit. We recommend buying the Ford Convertible Trust Preferred Series S up to \$41. **SA**

## Portfolio Updates

The Bernanke bounce that followed the Fed's 50 basis point drop in the Fed Funds Rate translates into a 7.2% upmove in the S&P 500, which considering that as of the September issue the S&P for the year, after the reversal that began in mid-July, was up all of 2.5% year-to-date. The *Sound Advice* portfolio kept pace, returning 7.2% as well. The Dow was slightly higher, while the Nasdaq outdid all with an 8.3% move. Our Leading and Lagging Indicators remain bullish.

Last issue, we highlighted three busted acquisitions, and they did not disappoint coming out of the gate. **Symantec**, the computer security company that acquired Veritas, put in the best showing, up 14.1%. **Boston Scientific** added 8%, and **Sprint Nextel** 6.5%. What moved the stocks? Nothing we can see in the case of Symantec, substantial news for Boston Scientific and rumor for Sprint Nextel. BSX had been raked over the coals this year as researchers published results bringing into question the effectiveness of and even raising dangers from drug-coated stents, Boston Scientific's franchise business. Last month, the newest study suggested not only that the value of stents—especially Boston's stents—but also addressed directly earlier negative research. This followed similar reports that corrected worrisome preliminary results in other studies. There remain plenty of problems for BSX, but anything that tempers the pessimism of the earlier studies is welcome news not just to those who might benefit from stents but to us shareholders as well. Sprint Nextel got two doses of rumor. First, we got another version of the buyout story. This time it was Britain's BT Telecom. Then media reports last week suggested Gary Forsee, the CEO, might be out of a job because shareholders, agitated by Ralph Whitworth, whose fund owns 2% of S, were displeased with Forsee's management, especially his large expenditures to roll out WiMax. Who knows? Our take remains that Sprint Nextel despite the tough times integrating the two companies' diverse technologies and client bases is worth more than the current price.

**Whole Foods Markets**, the previous month's recommendation and our best performer this month, roared to life as investors began to see how the newly

acquired Wild Oats' existing stores would be transformed. Some will be closed, others expanded, and all will begin to implement WFMI management and inventory policies. Since the last letter, WFMI is up a whopping 23.4%.

### WANT TO SEE EACH MONTH'S ISSUE ASAP?

Get an E-Subscription, and get your issue on the same day we mail hard copies to other subscribers. Of course, you will continue to receive midmonth and other portfolio updates as well.

Because using the Internet saves us printing and mailing costs, we want to share these savings with you, and will add to your current subscription or renewal a six-month extension. No more postal delays, no more copies mangled in the mail, no more changing your address when you move or are traveling. If you're interested, send us an email at [soundadvice@soundadvice-newsletter.com](mailto:soundadvice@soundadvice-newsletter.com), and provide the email address you want the issue to go, the name under which you subscribe and your postal address.

The other top performers spanned several sectors, though not surprisingly inflation-related issues did well, since we think the Fed's decision, though it might have accomplished its intended goal of getting the credit markets back to work, just adds to inflationary pressures. **Anglo-American**, the mining conglomerate, made another move in honing itself down to being primarily a miner of iron, coal, platinum and diamonds by announcing it would sell off half of its 41% interest in Anglo-Ashanti Gold. Since the last letter, AAUK is up 20.6%. **American Global Gold Fund** posted a 13.5% increase, and **Plum Creek Timber** is up 8.9% despite predicting that profits for the quarter would fall short of expectations due to wildfires in Montana which damaged standing timber and closed down mill operations. Also, land sales scheduled for this quarter are being pushed into the following quarter. **Agrium**, the fertilizer maker and distributor, continued its torrid year, adding 14.6%. Reading analysts' comments, we repeatedly encounter enthusiasm about demand and how this commodity would prosper regardless of the North American economy fares. Where was this enthusiasm when the market was giving shares away at \$10 five years ago? I guess that's what a relentless move since then up to the mid-\$50s will do.

Energy stocks trailed the market with **EnCana** doing best, up 6.1%, **Icon Energy Fund** up 5% and **Transocean** adding 4%. **Royal Dutch** did not budge. We continue to think oil and especially natural gas have

# Sound Advice Portfolio for October 2007

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
HRPT Properties	HRP	NYSE	\$10.30	8.16%	\$11.50	BUY
<b>Diversified Growth</b>						
Agrium	AGU	NYSE/TSE	\$53.54	0.21%	<b>\$59.50</b>	BUY
American International	AIG	NYSE	\$69.39	0.72%	\$75.00	BUY
Boston Scientific	BSX	NYSE	\$14.26	0.00%	\$16.00	BUY
Coca-Cola Enterprises	CCE	NYSE	\$24.23	0.99%	\$26.00	BUY
Disney	DIS	NYSE	\$35.47	0.87%	\$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$50.03	1.14%	N/A	BUY
Excelsior Value & Restructuring	UMBIX	800-446-1012	\$60.27	0.80%	N/A	BUY
Fastenal	FAST	NASDAQ	\$48.90	0.86%	\$50.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$18.21	0.00%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$27.33	0.51%	N/A	BUY
Honeywell	HON	NYSE	\$59.82	1.52%	\$64.00	BUY
Insituform Technologies	INSU	NASDAQ	\$16.09	0.00%	\$20.00	BUY
Johnson & Johnson	JNJ	NYSE	\$66.25	2.26%	\$69.00	BUY
Liberty Capital	LCAPA	NASDAQ	\$126.28	0.00%	\$130.00	BUY
Mattel	MAT	NYSE	\$23.31	2.79%	\$26.00	BUY
Microsoft	MSFT	NASDAQ	\$29.84	1.34%	\$34.00	BUY
<b>Molson Coors Brewing***</b>	TAP	NYSE	\$49.68	1.65%	<b>\$59.00</b>	BUY
Newell Rubbermaid	NWL	NYSE	\$29.24	2.87%	\$32.00	BUY
New York Times Co.	NYT	NYSE	\$20.00	3.50%	\$27.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$10.32	0.00%	\$12.00	BUY
Perrigo	PRGO	NASDAQ	\$21.41	0.84%	\$23.00	BUY
Sara Lee	SLE	NYSE	\$16.61	2.41%	\$20.00	BUY
Schering-Plough	SGP	NYSE	\$29.54	0.74%	\$37.00	BUY
Sony	SNE	NYSE	\$50.68	0.42%	\$59.00	BUY
Sprint Nextel	S	NYSE	\$19.01	0.53%	\$24.00	BUY
Superior Industries	SUP	NYSE	\$22.04	2.90%	\$24.00	BUY
Tetra Tech	TTEK	NASDAQ	\$21.18	0.00%	\$26.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$67.40	4.96%	N/A	BUY
United Parcel	UPS	NYSE	\$76.41	1.99%	\$82.00	BUY
Wal-Mart Stores	WMT	NYSE	\$45.37	1.48%	\$52.00	BUY
Whole Foods Markets	WFMI	NASDAQ	\$53.20	1.28%	<b>\$58.00</b>	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$62.22	3.16%	N/A	BUY
Xerox	XRX	NYSE	\$17.54	0.00%	\$21.00	BUY
<b>Energy/Natural Resources</b>						
American Cent. Gold Fund	BGEIX	800-826-8323	\$21.82	0.23%	N/A	BUY
Anglo-American PLC	AAUK	NASDAQ	\$34.02	2.88%	\$36.00	BUY
EnCana	ECA	NYSE/TSE	\$62.61	0.96%	\$75.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$41.67	8.06%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$44.12	3.63%	\$46.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$80.13	3.06%	\$87.00	BUY
Transocean	RIG	NYSE	\$112.87	0.00%	<b>\$120.00</b>	BUY
<b>Aggressive Growth</b>						
Comcast	CMCSA	NASDAQ	\$24.22	0.00%	\$30.00	BUY
Discovery Holdings	DISCA	Nasdaq	\$29.24	0.00%	<b>\$33.00</b>	BUY
Electronic Data Systems	EDS	NYSE	\$22.67	0.88%	\$30.00	BUY
<b>Ford Motor Convertible Pfrd.</b>	<b>F.PRS</b>	<b>NYSE</b>	<b>\$38.10</b>	<b>8.53%</b>	<b>\$41.00</b>	<b>BUY</b>
Getty Images	GYI	GYI	\$28.49	0.00%	<b>\$34.00</b>	BUY
Liberty Global	LBTYA	NASDAQ	\$42.32	0.00%	\$50.00	BUY
<b>Maxim Integrated****</b>	<b>MXIM.PK</b>	NASDAQ	\$29.45	1.89%	\$38.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$5.76	1.74%	N/A	BUY
Symantec	SYMC	NASDAQ	\$20.39	0.49%	\$22.00	BUY
Time Warner	TWX	NYSE	\$19.06	1.15%	\$24.00	BUY
Western Digital	WDC	NYSE	\$25.40	0.00%	<b>\$28.00</b>	BUY

\*Prices as of the market close on Friday, October 5, 2007

\*\*Yield represents all distributions during current calendar year divided by share price.

\*\*\*Molson Coors split its shares 2:1

\*\*\*\*Maxim Integrated shares are now trading on the Pink Sheets with the Ticker Symbol MXIM.PK

**BUY, HOLD, SELL OR LIMIT IN BOLD SIGNALS CHANGE IN ACTION OR LIMIT**

# Sound Advice Market Indicators for October 2007

more upside. Supply is not increasing, though demand is, and the world becomes edgier every day.

The rate cut helped financial stocks. We had been pushing **American International Group** ever since subprime loans got so hot no one wanted to touch them. Not only did we think AIG had no real exposure but we also said as long as its shares were being dumped in the panic, it was worth taking the other side of that deal. Since the last letter, AIG is up 9.2%, while **HRPT Properties Trust**, our remaining office REIT, added 7.9%. The well-covered yield here remains attractive at 8.3%, though a few weeks ago during the REIT retreat it cracked 9%.

Our technology positions in addition to **Symantec** had a good month. **Western Digital**, a decidedly old-tech name, jumped 13.6% despite rumors that Seagate, its larger competitor, might have to cut prices to reduce inventories, which would pressure everyone's margins. **Microsoft** is up 5% on strong sales of Halo 3, a video game.

Our funds, with one not surprising exception, prospered. **Third Avenue Value Fund**, heavily weighted toward Asian holding companies, which for

most of us seem inscrutable but whose unrecognized value Marty Whitman and his staff grasp, jumped 9.5%. **Fidelity Japan Fund** saw a 7.6% gain, while **Excelsior Value and Restructuring Fund**, an eclectic collection of out-of-favor selections, ran up 8.6%. **Dodge & Cox International Fund** was up another 6.6% benefitting from continued weakness in the dollar. **Gabelli Global Telecommunication Fund** was 6.2% to the good, and **WisdomTree Dividend 100 Fund**, an ETF, increased by 7.4%. Only **The Prudent Bear Fund**, a hedge against a market in decline, which decidedly was not the case this month, lost ground, down 4.2%.

## WHAT TO DO NOW

It's unrealistic to expect stocks to repeat the last month's performance, and we would not be surprised to see some loitering or even a decline. The dollar story, though still intact, might recede for a while, but on any weakness in natural resource and international stocks, we suggest adding to your positions. **SA**

---

## The Sound Advice Market Indicators

**The Diffusion Index of Lagging Indicators** gives "Sell" signals when all of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. Currently 13 percent of the indicators are above their levels of six months earlier.

**The Diffusion Index of Leading Indicators** gives "Buy" signals when its individual leading economic indicators drop below their respective levels of six months earlier, providing a zero percent reading. This reveals a softening economy and a ripe atmosphere for a lasting decline in interest rates. The latest reading came in December 2005 as a "Buy".

Currently 67 percent of the indicators are above their level of six months earlier.

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well

indeed. The results are shown above. Between each "Buy" signal and each "Sell" signal, the S&P 500 rose substantially without exception. The average gain was 33 percent, not counting dividends. On an annualized bases the gain was 17.4 percent per year. Confining

stock investing to these times would have produced substantially more profits than a single buy-and-hold strategy.

During the intervening periods between "Sell" signals and "Buy" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased 6.8 percent during these

times. On an annualized basis, not counting dividends, the gain was a paltry 0.6 percent per year, a return that could have easily been beaten many times over with safe investments such as

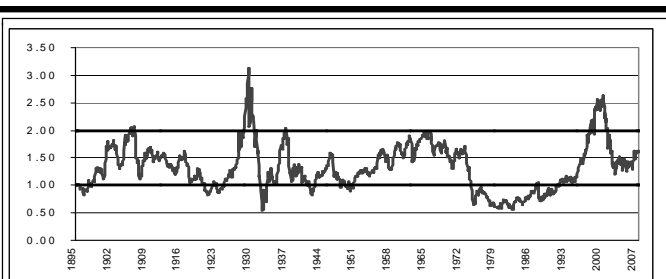
Buy Signals		Sell Signals	
Date	S&P 500	Date	S&P 500
Sep-69	94.51	Feb-69	101.50
Nov-74	71.74	May-73	107.20
Jan-81	132.97	Aug-77	97.75
Sep-85	184.06	Dec-83	164.36
Mar-89	280.00	Oct-87	280.16
Oct-92	415.10	Sep-89	347.33
Feb-97	798.38	Jan-95	464.72
Feb-03	841.15	Sep-99	1,383.60
<b>Dec-05</b>	<b>1,248.29</b>	Jul-05	1,234.18

# Sound Advice Market Indicators for October 2007

Treasuries, short-term bonds or other low-risk investments.

To assess whether a market crash is likely after a "Sell" signal, we turn to the Risk Indicator. If the Risk Indicator is close to or above 2.0, we know the market is relatively high and contains a high degree of risk. This was indeed the case in September 1999 when the Diffusion Index of Lagging Indicators flashed a "Sell" signal and the Risk Indicator was (substantially) above 2.0. The peak came in six months, marking the end of the bull market as well as the peak of Supercycle Five. The market subsequently crashed. The S&P 500 dropped 39 percent until the next "Buy" Signal was given by the Diffusion Index of Leading Indicators in February 2003 (which was the exact month that bear market low point was reached). During that decline, most stocks suffered greater losses. The NASDAQ dropped nearly 80 percent.

Conversely, the market does not suffer lasting declines after "Sell" signals when the risk level is low. For example, the "Buy Signal" in November 1974 was one month from the bottom of that bear market, and came at a time when the Risk Indicator was below 1.0. Consequently, this "Buy" signal also marked the beginning of Supercycle Five. As the upward phase of Supercycle Five ensued and the Risk Indicator remained relatively low, the market did not experience lasting downturns after "Sell" signals. Instead, the bull run was merely interrupted with short declines, sideways movements, and sometimes even advances. Even the three-day decline in October of 1987, which became known as the "Crash of 87", was followed by a stampede of buyers snapping up bargains. I remember seeing individual investors lined up to invest outside discount brokerage offices because the phones were log-jammed with buyers.



**The Risk Indicator** tracks supercycles in stocks by comparing prices of stocks to real estate (house prices). A reading above 2.0 indicates times when stocks are extremely high relative to real estate. These are times when the risk is high and a supercycle is approaching a zenith. Conversely, a reading below 1.0 indicates stock prices are extremely low relative to real estate. At these times, the upward phase of a new supercycle is beginning. The current reading stands at 1.60.

However, as previously noted, when Supercycle Five reached its peak and the Risk Indicator climbed above 2.0, the decline was severe after the September 1999 "Sell" signal due to the excessive heights to which prices had previously been propelled.

We recommend remaining fully invested in the *Sound Advice* model portfolio at all times. We use the *Sound Advice* Market Indicators to influence our approach and nature of our recommendations. When "sell" signals are in force, our recommendations are more defensive in nature. We will be looking for special situations and are likely to recommend taking profits more readily. Conversely, during "buy" signals, our recommendations will be more aggressive. We believe that these proprietary indicators have been important factors in our ability to consistently outperform the market averages (97% more profits than the S&P 500 since 1/1/2000). The chart below shows how *Sound Advice* recommendations have performed over time versus the S&P 500. **SA**

Since 1-1-2000

## Sound Advice versus the S&P 500

An Investment of \$25,000 becomes:

Start Date	S&P 500		Sound Advice*		
	Annual Return		Final Value	Annual Return	Advantage Over S&P
From 1/1/2000	2.4%	\$30,162	<b>\$59,590</b>	<b>11.8%</b>	<b>\$29,427</b>
From 1/1/2003	14.9%	\$48,334	<b>\$56,794</b>	<b>19.0%</b>	<b>\$8,460</b>
From 1/1/2006	15.6%	\$32,238	<b>\$33,797</b>	<b>19.3%</b>	<b>\$1,529</b>

\* These returns assume an equal amount is invested in all *Sound Advice* Model portfolio positions at the time of the initial recommendation.

## YOUR CHOICE: A GREAT DEAL OR THE BEST DEAL

### A GREAT DEAL: With Your One Year Renewal, I Will Send

**Panic-  
Proof  
Investing**  
in the  
Stock Market  
By Gray Emerson  
Cardiff

The **2007 edition of *A Millionaire's Guide to Panic Proof Investing***. This is the book that explains all of the *Sound Advice* indicators, including the Diffusion Indexes and the famous Risk Indicator, and exactly how they work so that you can update them yourself.

***The China Backlash*** A \$29.95 Value... **YOURS FREE**. The rapid expansion of the Chinese economy has created a ticking bomb. This report explains the key factors of the Chinese expansion and how they are connected to an unavoidable backlash that will impact all of our investments.

SOUND ADVICE

**THE  
CHINA  
Backlash**

**This is a great deal. Even forgetting about the Special Reports, *Sound Advice* will cost you less than 25 cents a day — less than a cup of coffee. But wait, it can get even better if you take me up on my...**

### BEST DEAL: With your Two Year Renewal, I will send you both of the items mentioned above, PLUS...



***A Gift (or Extension) of Sound Advice***. Here is a 6-month gift subscription of *Sound Advice*. And it includes all of the introductory special reports that you received initially when you subscribed, including the **2007 edition of *A Millionaire's Guide to Panic Proof Investing***. **You can also give this gift to yourself.** It will extend your renewal by 6 months, absolutely FREE. See the Coupon on the back on how to give yourself this gift.

***The Sound Advice Special Situations*** A \$29.95 Value... **YOURS FREE**. Here is a complete update of each stock and mutual fund in the *Sound Advice* model portfolio. We review the fundamentals of each recommendation, why they are special situations, and what we expect for the future. This will give you a chance to review your investments along side our recommendations, and make sure your money is working the hardest it can for your future.

SOUND ADVICE

**THE  
SOUND  
ADVICE  
SPECIAL  
SITUATIONS**

If you take the **BEST DEAL**, you will receive *Sound Advice* for only 16.3 cents a day. You can't buy anything for that. But whether you take the Great Deal or the Best Deal, you will receive wealth-building advice that you can take advantage of on your own through no-load funds or discount brokers. The commission savings alone will pay for your subscription many times over, not to mention the astonishing and reliable profits I am confident you will reap, along with inflation-proofed high income. Join me in helping you dramatically increase your wealth safely in the new bull markets starting right now.

***Make your choice on the coupon on the back page, and send it in today to receive the special discounted renewal rate. (See the coupon on the reverse side)***

# FREE Gift Subscription Certificate--Good Until October 31,2007

Sound Advice / 939 Hartz Way/ Suite 210 / Danville, CA 94526 / 925-838-6710 / Fax 925-838-0522

**YES!** I want to continue to protect my investments and build a fortune the *Sound Advice* way. Please renew my current subscription as indicated below:

**See Page 5 For A Free Six-Month Extension for All First-Time E-Subscribers**

**BEST DEAL!** 24 more issues of *Sound Advice* for only \$165--more than half-off the cover price. Plus both of the Special Reports listed on the reverse side as well as the 6 Month Gift Subscription package. My Best Deal is worth \$522.35

12 more issues of *Sound Advice* for only \$99--a savings of 49% off the regular rate. Plus, both of the Special Reports. **This deal is worth a total of \$254.90**

**WITH MY TWO YEAR SUBSCRIPTION SEND MY FREE 6 MONTH GIFT SUBSCRIPTION TO:**

*(Write "To Me" to extend your own subscription.)*

Name \_\_\_\_\_

Address \_\_\_\_\_

City \_\_\_\_\_ State \_\_\_\_\_ Zip \_\_\_\_\_

Phone ( \_\_\_\_\_ ) \_\_\_\_\_ - \_\_\_\_\_

Enclosed please find my check payable to:  
**Sound Advice**

Please charge my:  Visa  MasterCard

Credit Card #: \_\_\_\_\_

Expiration Date: \_\_\_\_\_

Security Code\* \_\_\_\_\_  
3-4 Digit Number on the back of your credit card

Signature: \_\_\_\_\_

Daytime Phone # (in case there is a question about your order):  
\_\_\_\_\_ - \_\_\_\_\_ - \_\_\_\_\_



For fastest service,  
call **1-800-825-7007**  
7 days per week, 24  
hours per day

*(tear along perforated dotted line)*

**Enclosed: the October Issue of Sound Advice for...**

**NEXT ISSUE MAILED ON NOVEMBER 16TH**

Address Service Requested

First Class Presort  
US Postage  
PAID  
Permit #185  
Sacramento CA

**Sound Advice**  
939 Hartz Way  
Suite 210  
Danville, CA 94526