

SOUND ADVICE

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We are living through another one of those unnerving episodes in financial history when everything short of being short loses money.

We say "another one," since just as bulls during bubbles banish fears that the party could end by chanting "It's different this time," during periods of deep losses pessimists are just as certain that there will be no recovery, because, well because "It's different this time."

Historically speaking, it's never been different. When will the market turn? You've got me. But it will be before investors realize that it's happening, perhaps even after much of this year's losses are recovered. One clue that perhaps we are close enough to a bottom is Warren Buffett's recent series of large-scale investments.

First he plunked \$4.7 billion of Berkshire Hathaway's cash into Constellation Energy at \$26.50 a share, a quarter of its price in January. He then gave Goldman Sachs \$5 billion for preferred shares with a 10% yield and warrants to purchase another \$5 billion in Goldman common at \$115, \$10 below where it closed that day and less than half where Goldman traded last fall. Then he put \$3 billion into preferreds from GE and anticipates putting at least that much again into the common. A year ago, GE was a \$42 stock. Buffett paid about half of that. In each case, the target companies were under siege because investors worried about their liquidity, and needed Buffett's money and needed even more his prestige. As he observed "The prices make a lot more sense now." Let's hope he has that right.

--Gray Emerson Cardiff

Funds, Part II

The August issue covered six of the then 11 funds in the *Sound Advice* portfolio. We added a 12th fund last month, **PowerShares Water Resources ETF (PHO—NYSE)**, but PHO is fresh in your minds and requires no comment here (See the Updates section on page 7). Three of the five focus on or have a significant admixture of natural resources: **Icon Energy Fund (ICENX)**, **USAA Precious Metals and Minerals Fund (USAGX)** and **The Prudent Bear Fund (BEARX)**. The **GAMCO Global Telecommunications Fund (GABTX)** and the **Fidelity Japan Fund (FJPNX)** fill out the quintet. As the market has gone south, these funds have performed as expected, that is, they broadly speaking have done better than their peers, and in the case of the Prudent Bear Fund has turned in a double-digit return.

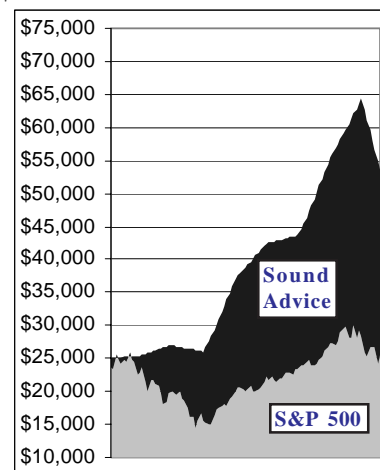
When considering a fund the questions are fairly obvious: what are the costs, how has the fund performed, and how has the manager accomplished that? Has the fund incorporated extraordinarily risky positions and trading strategies, which might have worked but could also have backfired, to achieve those results? Finally, how is the manager thinking right now about his portfolio? What is he adding or subtracting from the portfolio to position it for the future. Too many investors view funds as black boxes bought based on performance but have no clue as to what is inside that box. Thanks to SEC filings we can unpack the portfolio.

Our funds reflect *Sound Advice's* orientation toward value and tend toward a conservative but

Sound Advice Annual Returns

-26.9% Since 1-1-08
5.7% Since 1-1-06
12.4% Since 1-1-03
8.4% Since 1-1-00

Versus the S&P 500



Since 1-1-2000, an Investment of \$25,000 becomes:
\$21,270 with the S&P 500,
for a loss of \$3,280
\$50,834 with *Sound Advice*,
for a gain of \$25,834
= \$29,114 more profits

Sound Advice on Funds, II

contrarian approach, preferring cold sectors and companies that the market has lost interest in. In the current market, it's not hard to find cold sectors.

Icon Energy Fund (ICENX) like the Icon Financial Fund belongs to a stable that depends on an investing model derived from the work of Benjamin Graham, the patron saint of value investing. The manager has no discretion to stray from that model. Over the past five years, in an extraordinary bull market for energy stocks, ICENX has an annualized return of 23.1%, about 4% higher than other energy funds, though year to date ICENX has lost 19.6%, which is still 2.6% better than the average energy fund's decline. The expense ratio stands at 1.17%, which puts it on the lower end of energy funds for costs.

Unlike most value investors in search of companies whose shares are declining or are stagnant for an extended period, Icon looks for sectors or industries that not only are undervalued according to its proprietary model but also are showing relative strength over the previous six months. Icon believes that when sectors assert themselves, they can remain relatively strong for up to two years.

When we look inside the sectors, we see Icon's model acts like a traditional value investor and favors strong balance sheets with low debt and high cash positions. Other less quantitative measures such as management experience, corporate governance, and strategic planning also figure in selection.

Because Icon funds shape their portfolios by following a quantitative model, they can have a higher turnover rate than the typical value fund. ICENX, according to *Morningstar*, has a turnover ratio of 55%. For example, if we compare Icon Funds' SEC filings for the most recent period (June 30, 2008) with the same filing from 12 months earlier, there are several significant portfolio changes. The easiest difference is size: the number of positions has been concentrated

from 52 to 30, and the biggest sector by far is now Integrated Oil & Gas companies (36.8% of the portfolio). Five of the largest holdings are Integrated Energy companies: Exxon Mobil (11%), ConocoPhillips (8.6%), Chevron (8.3%), Murphy (4.7%) and Occidental (4.1%). Also worth noting is a move away from foreign Integrations like China's CNOOC and Royal Dutch, both of which were removed.

Though ICENX claims that only quantitative signals trigger changes in its portfolio and thus have no thematic intention, that doesn't mean there is no message contained in what it emphasizes and deemphasizes. In this case, the message is that investors are moving toward energy companies that do best when demand is strong but prices are not necessarily rocketing higher. If you chart the share prices for the major Integrations against a basket of exploration and development companies, you can see how much higher E&D companies soared as energy caught investors' attention earlier in the decade. However, since May the E&D companies' shares have slowed along with the entire sector, and then, as energy prices dropped, declined more rapidly than other sectors. Integrations have performed better, or to be more candid, less worse. Icon Energy Fund benefited from the move into the energy behemoths, and year to date has lost the least among the energy funds tracked by *Morningstar*, something that doesn't translate into money in the bank but validates its sector-shifting strategy.

The obvious question is whether current prices reflect underpricing or are just a return to rational levels from the distorted prices of mid-July? We believe that energy shares now are priced very attractively due to recessionary fears and market momentum. If you were reluctant to own energy during its blast upwards earlier this year, now is probably a good time to mend that hole in your portfolio with ICENX, or, if you have seen your profits erode, adding to your position now

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Sound Advice on Funds, II

makes sense.

GAMCO Global Telecommunications Fund (GABTX) runs a sprawling portfolio that approaches 200 positions. However, the portfolio's core is in 20 stocks that make up more than half of the fund's assets. Year to date, the fund is down 28%, but over the last three years has averaged an annualized return of 7.4%, and over five years 12.3% that puts it among the best performers in an industry that embodies technologies' impact on society and the economy. The fund's expense ratio is 1.5%, about average for a managed telecom fund.

Mario Gabelli, who started and still oversees the fund, is a traditional value investor, that is, he looks for companies trading below what his shop estimates their intrinsic values are. How "intrinsic value" is gauged changes from value investor to value investor. In Gabelli's case the yardstick starts with analysis of cash flow. Consequently the portfolio trades at a significant discount to the standard valuation ratios for telecommunication stocks. For instance, the average stock in GABTX trades at a third of Price/Sales for the industry and two thirds of Price/Cash Flow. Gabelli is serious about the "Global" part of his holdings. As of June 30th, the most recent SEC filing for the fund, six of the ten largest positions tap into Canada, Mexico, Spain, Germany, Russia and China.

It's a truism that value investors turn in their best results in the wake of poor market conditions, since that is when they harvest positions purchased during a down market. In market's like today, we discover whether we just talk the talk about investing when stocks go on sale. In good times, we tell ourselves these are the moments we wait for.. If that holds true once again, GABTX should be very well.

As Gabelli notes in the latest report to shareholders: "The second quarter and the first half of 2008 have marked the weakest period for telecommunications sector investors in seven years. This has come despite the fact that industry fundamentals remain fundamentally sound and earnings expectations have seen precious few downward revisions." Gabelli walks the talk. Over the last year as share prices in telecom and in general have fallen, GABTX has reduced its cash position from 8.3% to 1.1%, and increased its exposure to

diversified telecom companies (+12%) and wireless (+5.1%)

How did GABTX do the last time telecom stocks went south seven years ago? During the first two years of the decline, GABTX dropped by 45%, and then climbed for the following five. The fund outperformed the S&P 500 from the start of the downturn through the zenith of the recovery. Even though it's down, the fund continues to outperform other telecom funds.

The fund shows remarkable stability, holding positions for long periods, which explains the ultra-modest 11% turnover rate for last year. Compare this to the average telecom fund, which commonly turns its portfolio over at least once a year. The last time the fund showed markedly higher turnover was when it hit 60% in 1999 and 49% in 2000. The fund was struggling to avoid soaring valuations as investors pumped the bubble toward bursting. Portfolio turnover accelerated further in 2000 when the pumping switched to dumping and bargains started to emerge, which set the stage for the fat returns starting in 2003.

The Prudent Bear Fund (BEARX) has been profitable this year (14.8%) and since the market started its decline in October 2007 is up 29% while the S&P is off 30%, which comes as no surprise, since David Tice, the founder and continuing lead manager, has been bearish about equities in general and financial stocks in particular as well as the dollar ever since the fund debuted in 1995. Indeed, Tice made his reputation on Wall Street advising large investors about companies he gauged overpriced.

BEARX among bear funds leads the pack over five-year and longer periods for annualized returns, though in recent years as leveraged inverse funds have come to market, Tice simply leads the smaller cohort of traditional bear funds. The expense ratio is not cheap, running at 1.73%.

Despite Tice's assertion that the fund is not perpetually bearish and would go long were market conditions to change, we have no evidence he will ever acknowledge that the sky is not falling. That is fine with us, since our custom has been to sell the fund out of our own portfolio when we become strongly bullish.

Does the recent SEC rule blocking shorting of almost 900 financial corporations hamstring the fund? The SEC

Sound Advice on Funds, II

rule has some impact on BEARX's portfolio as it stood on June 30th, the last time it filed its holdings with the SEC. Pure financial stocks accounted for 13.9% of the \$470,667,809 of specific company shorts. For instance, Fannie Mae, Freddie Mac and Lehman Brothers have either fallen close to zero or are now in bankruptcy. BEARX was not compelled to cover its shorts. It just could not begin new positions. Tice says this has created no problems: he can "find lots of stocks that will decline."

Other prominent short positions center on technology with both individual companies and ETFs employed. Indeed, the single largest short position (4.2% of shorted stocks) is the Technology Select SPDR. Effectively Tice is making a broad bet that not only the dollar and financial services stocks will continue to fall but also that the overall economy is in a persistent recession. We should also mention that among the latest short positions are several that we are long: **Whole Foods**, **Maxim Integrated** and **Sara Lee**.

The corollary to Tice's shorts is to be long in commodities, especially junior mining companies, which are more leveraged to the price of gold, silver and uranium. BEARX hedges these positions by shorting more established miners like Barrick and AngloAshanti Gold. However, between the last two years' June 30th filings, we see that BEARX has reduced its exposure to all longs and that includes metals by more than half (common stocks went to 9% from 19.2% in 2007, and basic materials went to 4.8% from 9.5%).

The bulk of BEARX's shorts are puts or other shorting techniques on the broad indexes such as the S&P 500. There are changes, of course, in specific shorts, but the thrust remains the same, and is defined by pessimism about the dollar, corporate profits and financial excesses. If you ever get optimistic about the global economy extricating itself from its current perils, you can quash any hope by dipping into www.prudentbear.com/index.php/bearcase, which maintains a library of gloomy articles and reports about

the handbasket Tice believes we are traveling to hell in.

The Prudent Bear Fund is a useful hedge at times like these, though in a bull market it's a position that we usually close out as we did at the start of 2003. Lately it's been a highly profitable position.

USAA Precious Metals & Minerals Fund (USAGX) has tracked precious metals this year, soaring until March, recovering by June, and then in July collapsing to levels not seen in the last two years. Amid the chaos engulfing the financial markets and the

prospect that the U.S. government will have to borrow what will total more than a trillion dollars to try to avoid even worse systemic problems, precious metals, energy and most assets denominated in dollars should be relatively strong, since it seems the Federal Reserve and other financial regulators

apparently have decided to turbocharge the economy with credit.

We introduced USAGX earlier this year to replace the American Century Gold Fund when it closed as a no-load fund to new investors. The USAA fund, which has worked to restrict access to non-USAA members but not succeeded entirely (you can still buy shares in USAA funds through large dealers such as Fidelity), appeals to us not only because its manager has been in place for 15 years and its performance numbers have been strong, but also because the fund covers more than precious metals. At present, gold, silver and platinum dominate the holdings, but the charter permits exposure to non-precious metals, which during an economic expansion can be more dynamic than their precious cousins. The fund's expense ratio at 1.19% is very reasonable for a managed fund.

Because USAGX follows a fiscal year that begins in August, the last filing we have shows positions as of May 2008 when precious metals were riding high. We expect USAA will file its August data toward the end of this month. As with energy shares, the unsustainable bullishness for gold and metals in general that peaked in July was followed by a sharp retreat in prices. As of October 3rd, when we closed this issue, USAGX

These funds have performed as expected, that is, they broadly speaking have done better than their peers, and in the case of the Prudent Bear Fund has turned in a double-digit return.

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had tumbled from a March high of \$40.52 to \$22.48, a 44% decline, and year to date is down 31%, though compared to similar funds it continues to outperform.

Gold and precious metals' purpose in any diversified portfolio is to hedge against weak equity prices and the economic and social conditions which undercut them. The trigger event that brought gold low apparently was the retreat in oil prices from \$147 a barrel in July to \$93.88 now. The dollar had strengthened as investors took to heart chatter that the next move for the Fed would be higher rates, that we had seen the high-water mark for inflation and that the stock market had bottomed now that Bear Stearns had been "saved."

Then as Fannie and Freddie got nationalized, as Lehman went into bankruptcy and AIG effectively became a subsidiary of the Treasury, it all fell apart, and suddenly gold, which had dropped as low as \$731 an ounce, rocketed over \$900. It's not surprising that precious metals are volatile during these truly confusing times, but it is strange that it again has fallen back into the \$830s. We believe that the long-term trend, even after some stability returns to the credit and stock markets, will be a weaker dollar, higher interest rates and a feeble economy. In that environment gold and metals should do very well.

USAGX has tracked all of this. Despite holding 55 positions, the fund concentrates 75% of its value in its top 15, most of which are large, low cost producers such as Goldcorp, Agnico Eagle and Impala Platinum. Speaking broadly, such miners produce more consistent profits and through efficiencies can increase their margins. However, higher cost producers during bull markets usually outperform lower cost competitors through explosive earnings and share price increases.

Let me explain. Think back to when gold was selling for \$400 an ounce, and project the impact on low and high cost producers as the price surged to \$500. For a producer whose total cost per ounce was \$175, profits went from \$225 an ounce to \$325, a 44% jump. For a producer whose total cost per ounce had been \$350, double his more efficient competitor, profits went from \$50 to \$150, a 300% leap. The advantage high cost producers enjoy, so-called operating leverage, can be seductive, but USAGX has opted

for more predictable returns, a highly successful strategy that for 10-year performance ranks the fund at #1 (26% annualized return), #2 over the last five years and #1 over the past three years. More recently it has been rockier with USAGX in fourth place over the past 12 months and 19th over the past three months.

The portfolio over the last year has changed in small ways while its net asset value almost doubled as fresh cash flowed into the overheating precious metals sector. The three largest positions expanded on average by 22.1%, while several positions were closed out due to mergers. The fund did liquidate its position in Abner Diamonds (2.6% of portfolio), and added a 3.1% in African gold miners, which tend to be high cost producers with significant political issues, something that has affected the fund as South Africa undergoes a shift in political leadership. Johnson did slash his platinum miners by nearly half to 8.6% of the portfolio and reduced base metals by 30% to 4.9%. For a managed fund turnover is a modest 28%.

Fidelity Japan Fund (FJPNX) is a diversified large cap portfolio in a weak economy and market that almost 20 years after it boomed to inexplicable highs fueled by its own real estate bubble remains 70% below its 1989 year-end peak, though since bottoming along with the S&P in the spring of 2003, it has outperformed the U.S. big cap benchmark.

Investing in Japan so far in this decade has been a rollercoaster, marked by three-year runs both up (2003-2005) and down (2006-2008). Currently Japan's economy, which is solidly yoked to exports, is creeping to a crawl as China slows, and western Europe and the U.S. seem to be in recession. The Nikkei this year is down 28%, and FJPNX is off 17%. Looked at broadly, national funds rise and fall in tandem, there's little reason for one managed fund to grossly out or underperform its peers over time. FJPNX has a 1.06% expense ratio, inexpensive for a managed Japanese portfolio.

The fund changed managers last spring. Yoko Ishibashi, who had overseen it since 2000, was succeeded by Robert Rowland, who had managed other Fidelity funds tied to Japan. Not surprisingly, with new management the portfolio has undergone more significant changes than in any single year since

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Ishibashi arrived. The most recent filing shows the portfolio as of July 31st has lost 28 of 88 positions (32%), while adding 18. The turnover was tumultuous, doubling the 2007 ratio to 158% as Rowland almost immediately reshaped his holdings. The last triple-digit turnover ratio occurred in 2000, when Ishibashi took the reins.

What is Rowland seeking to do with these shifts? For one thing, he has not just concentrated the portfolio, he also has emphasized Japan's largest cap companies, moving Toyota Motors into first position at 9% of the portfolio. Canon is the second biggest investment at 5.7%, and is followed by two financial giants, Sumitomo Mitsui and Mitsubishi UFJ (which last week bought a 20% stake in Morgan Stanley), which together account for 8.5% of the portfolio. Pretty much everything in Japan is export oriented, but Rowland is interested in replacing companies that sell to the largest Japanese

exporters with an even greater exposure to the biggest exporters like Toyota. For example, a year ago Toyota was about 4% of the portfolio while its suppliers like Bridgestone and Denso comprised the same percentage. A year later, Toyota's prominence has doubled along with other auto makers, which account for 14.6% of the entire portfolio while their suppliers have receded. Rowland has opted for fewer moving parts.

Should Japan be part of your own portfolio? Since it represents the world's second biggest economy and plays a senior role in the world's most dynamic region, it makes sense to have exposure, especially now that the Nikkei is in the dumps. The Nikkei closed on October 3rd at 10,938, 40% below its February 2007 high. Even if you are not prepared to make a major investment in Japan's ability to recover, Fidelity Japan Fund should be part of the mix. [SA](#)

Portfolio Updates

Though the biggest headlines during the Congressional indecision about the bailout bill were generated from tumbling stock prices, a much more menacing debacle was engulfing the credit markets, where fear that counterparties were not good for their debts triggered frenzied buying of credit default swaps, effectively insurance policies bought by creditors that protected them against default by borrowers.

The fundamental problem came down not to solvency (most companies under siege had sufficient assets) but to liquidity, having ready cash or credit to convince lenders that the besieged borrowers or their insurers were good for their obligations. This is what brought down [American International Group](#). Indeed, "credit" and "credo" are related concepts. The long and the short came down to no one being willing to trust or have faith in anyone else.

Even the shortest-term lending came to a halt. Banks, institutional investors and others who lubricate the economy by buying short-term commercial paper issued by large companies to fund their day-to-day operations drew back from lending, which played havoc with

everyday commerce. For smaller companies, lines of credit that served much the same purpose were revoked by banks. The credit crunch we have written about was now a credit drought.

The gargantuan rescue plan that Congress finally approved last Friday addresses only part of the crisis. It relieves the pressure on corporate balance sheets by letting stressed banks and financial institutions offload their untrustworthy loans and derivatives onto the Treasury. It does nothing to address the snarled commercial paper market, and does little to relieve homeowners on the brink or already in default on their mortgages.

We appreciate how Paulson and Bernanke, after lurching from crisis to crisis, saving Bear Stearns, putting Fannie Mae and Freddie Mac into conservatorship, letting Lehman go into bankruptcy, nationalizing AIG, overseeing the fire sale of Merrill Lynch and the even more drastic transfer of Washington Mutual to JP Morgan, were fixated on the major financial services companies' survival, but we also wonder how they could not address meaningfully the crisis that underpins the banking chaos: snowballing foreclosures and a

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rotten housing market? The most troubling part of the Paulson-Bernanke bailout is that the nation is being asked to trust the two men to get right what they so far have gotten so wrong.

Ironically, just as Congress approved the “enhanced” rescue bill, any positive bounce for equities was drowned as numbers rained down on Wall Street that showed the U.S. economy had slowed dramatically: unemployment shot higher again, payrolls drooped and manufacturing cratered

Last Friday morning as the market waited for Congress to pass the revised bill, share prices soared. The Dow at its high was up 315 points or 3%, and once word arrived from Capitol Hill that the bill had passed, it collapsed to down 1.5%.

Debate over whether we already are in a recession, we believe, has ended. The only question is how deep and how long it will be.

In such a volatile and frankly treacherous environment, it’s hard to get any bearing on stock prices and values. We have a combination of blind panic along with extreme anxiety over how damaging this recession will be. But most of the damage has been inflicted in panic, and illuminates nothing except fear, which almost invariably is an excellent time to be a buyer.

Since the last letter was closed on September 5th, the standard benchmarks have plummeted: the Dow is down 8%, the S&P 11.5% and the Nasdaq 13.7%. Almost all of these losses occurred between Monday (9/29) and Friday (10/3). The unweighted *Sound Advice* portfolio did not escape, dropping on a total return basis 17.2% as our positions in natural resources, which have helped our returns stay well above market averages over the last couple of years were particularly weak.

The September recommendation, **PowerShares Water Resources ETF** started off fine, but succumbed to the market collapse, losing 21%. Absolutely no news about the portfolio, just plain old fear about how governments and large utilities

dependent on rate increases can fund water projects. Do we wish we had waited a month or two to recommend PHO? Don’t ask. Nonetheless, just as no specific news accounts for the share collapse, there is no change in the underlying thesis presented: water

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resources around the world are in trouble and will move to the top of public spending.

Tetra Tech, which is part of the PHO portfolio, also got clobbered, down nearly a quarter, again on no news. **Insituform**, which PHO also owns, fell 17.8%.

Among our commodity positions, there was news, none of it good. At the start of the month, continuing strength in the dollar convinced more speculators who had played long-commodities/short-the dollar to abandon that trade, and as hedge funds were pressed to raise cash, the rush out of energy, metals and other commodities turned into a stampede. **Anglo-American** fell 30.1% but had its own special micro-crisis as political change swept through South Africa, its home base, and caused investors to dump shares over concerns that a new government could extract new concessions from the country’s biggest conglomerate. **Transocean**, the deepwater driller, dropped 22.6% as oil moved back below \$100 a barrel initially in response to a stronger dollar and then as anxieties over a global recession have convinced investors that demand will shrivel to nothing. **EnCana**, the Canadian natural gas and oil company, dropped 18.7%. **Icon Energy Fund** fell 14.7%, better than its benchmark. **Royal Dutch** was off 11.8%, **USAA Precious Metals &**

Sound Advice Portfolio for October 2008

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
DWS RREEF Real Estate Fund II	SRO	AMEX	\$7.40	21.00%	\$10.00	BUY
HRPT Properties	HRP	NYSE	\$6.00	14.00%	\$8.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$41.09	0.27%	\$55.00	BUY
Boston Scientific	BSX	NYSE	\$11.05	0.00%	\$16.00	BUY
Cintas	CTAS	NASDAQ	\$27.15	1.69%	\$35.00	BUY
Disney	DIS	NYSE	\$29.54	1.05%	\$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$31.30	8.82%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$91.35	19.61%	N/A	BUY
Fastenal	FAST	NASDAQ	\$41.96	1.10%	\$50.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$9.90	0.40%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$17.99	1.29%	N/A	BUY
Honeywell	HON	NYSE	\$37.84	2.64%	\$45.00	BUY
Insituform Technologies	INSU	NASDAQ	\$14.43	0.00%	\$18.00	BUY
Johnson & Johnson	JNJ	NYSE	\$66.16	2.51%	\$75.00	BUY
CarMax	KMX	NYSE	\$12.35	0.00%	\$18.00	BUY
Liberty Capital****	LCAPA	NASDAQ	\$13.11	0.00%	\$20.00	BUY
Mattel	MAT	NYSE	\$17.53	4.28%	\$22.00	BUY
Microsoft	MSFT	NASDAQ	\$26.32	1.67%	\$33.00	BUY
Molson Coors Brewing	TAP	NYSE	\$46.38	1.77%	\$55.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$9.78	0.00%	\$11.50	BUY
Sara Lee	SLE	NYSE	\$13.17	3.19%	\$19.00	BUY
Schering-Plough	SGP	NYSE	\$16.44	1.34%	\$25.00	BUY
Sony	SNE	NYSE	\$27.99	0.78%	\$40.00	BUY
Sprint Nextel	S	NYSE	\$5.70	1.75%	\$9.00	BUY
Superior Industries	SUP	NYSE	\$17.20	3.72%	\$20.00	BUY
Tetra Tech	TTEK	NASDAQ	\$20.14	0.00%	\$28.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$39.75	5.26%	N/A	BUY
United Parcel	UPS	NYSE	\$60.76	2.76%	\$70.00	BUY
UnitedHealth Group	UNH	NYSE	\$24.11	0.12%	\$35.00	BUY
Wal-Mart Stores	WMT	NYSE	\$59.73	1.12%	\$65.00	BUY
Whole Foods Markets	WFMI	NASDAQ	\$18.00	0.00%	\$25.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$44.13	4.63%	N/A	BUY
Xerox	XRX	NYSE	\$10.00	1.60%	\$16.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	\$14.92	7.57%	\$23.00	BUY
EnCana	ECA	NYSE/TSE	\$54.74	2.92%	\$70.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$25.03	39.09%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$45.07	3.73%	\$56.00	BUY
PowerShares Water Resources ETF	PHO	NYSE	\$16.12	0.42%	\$20.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$55.59	5.18%	\$68.00	BUY
Transocean	RIG	NYSE	\$94.65	24.45%***	\$125.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$22.48	11.79%	N/A	BUY
Aggressive Growth						
American International	AIG	NYSE	\$3.86	20.73%	\$6.00	BUY
Comcast	CMCSA	NASDAQ	\$18.42	1.35%	\$24.00	BUY
Discovery Holdings	DISCA	Nasdaq	\$18.30	0.00%	\$26.00	BUY
Ford Motor Convertible Pfrd.	F.PRS	NYSE	\$14.39	22.59%	\$20.00	BUY
Icon Financial Fund	ICFSX	800-764-0442	\$8.22	20.31%	N/A	BUY
Liberty Entertainment****	LMDIA	NASDAQ	\$23.51	0.00%	\$29.00	BUY
Liberty Global	LBTYA	NASDAQ	\$27.80	0.00%	\$35.00	BUY
Maxim Integrated	MXIM.PK	NASDAQ	\$16.62	1.89%	\$21.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$7.20	2.78%	N/A	BUY
Symantec	SYMC	NASDAQ	\$16.95	0.00%	\$20.00	BUY
Time Warner	TWX	NYSE	\$12.12	1.82%	\$20.00	BUY
Western Digital	WDC	NYSE	\$18.80	0.00%	\$26.00	BUY

*Prices as of the market close on Friday, October 3, 2008

**Yield represents all distributions during previous 12 months divided by current share price.

Note that all fund distributions fluctuate annually.

***Special Distribution

***Yield represents a one-time special distribution.

****Recently spun off

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

Sound Advice: Portfolio Updates for October 2008

Minerals Fund lost 10% and **Plum Creek Timber** declined 7.1%.

What we find peculiar is that given the chaos over the last month, we can understand a frightened flight to the safe harbor of U.S. government bonds, something that supports the dollar but we are totally flummoxed by the fall in gold, which, we expected, would flourish as cash ran from all paper assets, since everything that has occurred over the past few months raises the prospects for rampant inflation both of the money supply and of prices. The U.S. government will borrow every penny of that \$700-850 billion, has already pumped around \$600 billion into the banking sector, and stands ready to lend money to automobile makers and who knows who else (California has requested a \$7 billion loan if it cannot borrow short-term, something it has been unable to do for the last 11 days). We see no basis for a stable dollar. On top of the existing and expected floods of credit, markets are waiting for the Fed to cut the rates by 50 basis points to 1.5%. Perhaps we are seeing Ben Bernanke deploy literally the figurative helicopters dropping money he conjured up in a 2002 speech. At what point investors will recoil and run for gold and other stores of value is unknown. That they will, to us, seems inevitable.

As for other commodities, we are being offered shares at bargain prices, not just bargains in terms of where they had been before, but absolute bargains. These shares first will get some support as investors put the dollar's predicament in perspective, and even more once all the pump priming takes hold, as economies begin to struggle out of recession.

Financials did marginally better than energy. The XLE, an ETF surrogate for the energy sector, since the last letter dropped 15% while the XLF, its financial sibling, is down 11.5%. **Icon Financial Fund** lost 6.5%, a triumph of sorts. The **WisdomTree Dividend 100 ETF**, which moved into financials earlier this year, was off just 5.8%. REITs got raked and offer opportunities depending on your risk tolerance. **DWS RREEF Real Estate Fund II** after making a \$1.76 distribution is off 21%, more than half of which occurred on Friday. It was a bad day for REITs in general, but particularly distressing for SRO because one of its positions, General Growth Properties (2.06% of the portfolio as of May 31st) announced it had

suspended its dividend. Based on SRO's regular distributions it now trades at a 7% discount from Net Asset Value, and even if we factor in damage from General Growth's woes, can be expected to throw off a mid-teens distribution. **HRPT Properties Trust** also got clobbered, dropping 20% to a 52-week low and now yields 13%.

And then there is **AIG**, which we blogged about on the website under the title "20% of Something is Better Than 100% of Nothing" after Washington "rescued" the company from an artificial but nonetheless real bankruptcy. The price for an \$80 billion lifeline to AIG was 79.9% of the company's equity. At that point Paulson and Bernanke realized that had they kept Lehman intact, AIG would not have been pushed to the brink.

For income investors we are at an extraordinary moment: risk-free Treasuries are yielding next to nothing, while REITs are so dimly priced that their yields far exceed the historical annual total return for equities. At some point, we are going to look back at today's prices and wonder how anyone could have resisted them.

Not even traditional safe harbors offered much protection. For example, healthcare, which is not a discretionary part of our budgets, got hit. **Schering Plough** stumbled 14.6% and **Boston Scientific**, which lost a long-fought patent battle against **Johnson & Johnson** and is on the hook for \$700 million, gave up 12% while JNJ dropped 6.4%. **UnitedHealth**, the HMO, lost 13%. Frankly, there was no place to hide as investors sold shares indiscriminantly.

Did anything do well this month? The **Prudent Bear Fund** (see page 3) was up 11%, **Microsoft** 2.6% and **Odyssey** eked out a 1% gain. **Wal-Mart** (-0.7%) and **Whole Foods** (-1.7%) were respectable. Investors see food sellers, even the high priced Whole Foods, as less dangerous. So **Sara Lee** and **Molson Coors** also held up better than the overall market, down respectively 2.3% and 4%.

As much as we would like to forget this month, we cannot and should not. We got a sharp reminder that even disciplined value investing suffers when the market falls into panic. The real question is when investors stop fixating on the end of the world and start focusing on what top-rate companies are worth after the chaos ends. **SA**

Sound Advice Market Indicators for October 2008

The Diffusion Index of Lagging Indicators gives "Caution" 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 38 percent of the indicators are above its level of six months earlier.

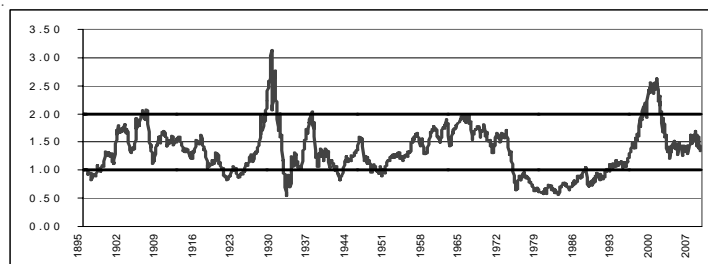
The Diffusion Index of Leading Indicators gives "Aggressive" signals when its individual leading economic indicators drop below their respective levels of six months earlier, providing a zero percent reading. This reveals a softening economy and a ripe atmosphere for a lasting decline in interest rates. The latest reading came in December 2005 as an "Aggressive". 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 below. After each "Aggressive" signal, the S&P 500 rose substantially without exception. The average gain was 29.6 percent, not counting dividends. On an annualized bases the gain was 15.5 percent per year. Confining stock investing to these times would have produced substantially more profits than a single buy-and-hold strategy.

During "Caution" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased a paltry 0.82 percent per year, a return that could have easily been beaten many times over with safe investments such as Treasuries, short-term bonds or other low-risk investments.

To assess whether a market crash is likely after a "Caution" 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 "Caution" 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 "Aggressive" 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%.

Conversely, the market does not suffer lasting declines after "Aggressive" signals when the risk level is low. For



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 1.33.

Although house prices have been dropping recently, stock prices have been dropping more rapidly, which is bringing the Risk Indicator down.

example, the 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 "Aggressive" 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 "Caution" 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.

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 use the *Sound Advice* Market Indicators to influence our approach and nature of our recommendations. When "Caution" 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 "Aggressive" 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 (See page one for the stats.). **SA**

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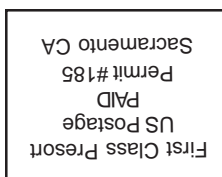
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