

SOUND ADVICE

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Some lawyers salt their talk with Latin tidbits like "cui bono," which loosely translated means "to whose good?" Perry Mason would have dispensed with the Latin and just asked: Who stands to benefit from this?

We've railed about how corrosively misleading CPI and GDP are. You don't have far to look to answer "cui bono?" Bill Gross, who runs Pimco's gazillions in bonds, believes CPI understates inflation by at least 1%. Kevin Phillips in his new book, *Bad Money*, suggests that were the BLS honest, the current real inflation rate might be around 11%. As for economic growth, the latest job report shows unemployment has leaped to 5.5%, the biggest jump in 20 years. Admission of such bad news suggests that the magicians at the BLS who last month pulled out of their hat that construction jobs absurdly had increased by 42,000 have finally run out of rabbits.

Ed Gillespie, the Counselor to the President, publicly chastised NBC last month for "bias" toward the White House. Evidence of that negativity, according to Gillespie, was the suggestion by one talking head that current figures show the U.S. economy is "just short of the official declaration of a recession." Gillespie is confused about what criteria the National Bureau of Economic Research, which is the official decider of when recessions and expansions start and stop, uses. But more importantly, given how deceptive Washington is about all the numbers it deploys to measure the economy, for the White House to lecture the media on economic objectivity is ludicrous.

--Gray Emerson Cardiff

Keynes' Animal Spirits

Wall Street guys tend to be action oriented. Indeed, branch managers at brokerages get worried when newbie brokers score too high on their qualifying exams, since it suggests they might be too cerebral to translate the brokerage's buy list and proprietary products into sales. Even at the highest levels, Wall Street rewards most richly guys who make the deals rather than those who best understand them.

In short, academic stars are less important than action stars. However, some of the most successful investors had at least one foot planted in academia, and many divided their time between the lecture hall and the stock exchange. Benjamin Graham, the father of modern value investing, after graduating from Columbia chose Wall Street over a lectureship at his alma mater, but returned to teach. On the other side of the Atlantic, John Maynard Keynes, moved in and out of Cambridge University during his brilliant career, and found time to manage the funds of his college, Kings, between 1924 and 1946, the year of his death. Over that period, Keynes racked up a 12% compounded annual return, a remarkable result given that those years included the great depression and the years leading up to and including World War II. Over the same period, the London Stock Exchange fell 15%.

Keynes' best known comment on investing is his Beauty Pageant analogy, which he included in his *General Theory of Employment, Interest and Money*. Keynes describes a newspaper contest that asks readers to select the prettiest woman among a group of 100 pictures. Those selecting the picture that receives the largest number of votes are entered in a lottery.

The naïve reader selects the picture that most appeals to him, but, notes Keynes, that strategy is unlikely to work. If the audience members think strategically, notes

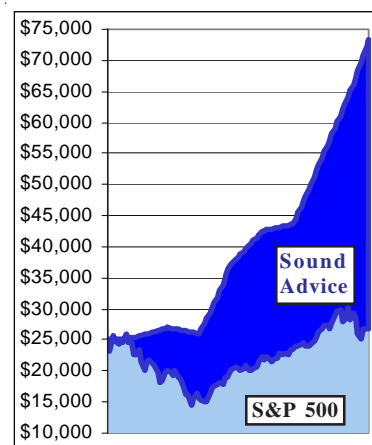
Sound Advice

Annual Returns

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Keynes and Animal Spirits

Keynes, they will select not the contestant that most appeals to them but the woman they think is most appealing to most other readers. If you can anticipate what the majority will do, you are rewarded. So too for investing. In the market, it is not a matter of selecting the company with the best future but the company that most investors anticipate will have the best future.

Keynes here is not talking about the common man—you and I—as investors, though an obsession with anticipating where public taste will tend also figures into the average investor's choices. He describes “expert professionals” who are vulnerable to mass psychology when trying to anticipate it. Rather than focusing on a company's intrinsic value over its lifespan, analysts and others whose profession is to judge or trade stocks, instead try to foresee “changes in the conventional basis of valuation a short time ahead of the general public.” Which contestant in the Wall Street beauty pageant will conventional opinion value most? At best, even when successful, this approach gives the professional investor a half-step advantage over the rest of the market. For some, that is sufficient.

As an investor, Keynes took exactly the opposite tack. He rejected what common opinion valued, and spent his time looking for opportunities where others chose not to go. He was particularly interested in unpopular companies with strong balance sheets in industries he understood. So, was John Maynard Keynes a pure rationalist who built his portfolio relying only on mathematics and probabilities? Hardly.

Keynes recognized that any rational investment strategy was limited.: “If we speak frankly, we have to admit that our basis of knowledge for estimating the yield ten years hence of a railway, a copper mine, a textile factory, the goodwill of a patent medicine, an Atlantic liner, a building in the City of London amounts to little and sometimes to nothing; or even five years hence. In fact, those who seriously attempt to make any such estimate are often so much in the minority that their behaviour does not govern the market.” Keynes readily acknowledges that since by necessity most investors, both small and large, put their money into publicly traded corporations, whose business they

never can fully understand, even prudent, long-horizon investors like himself must commit money based to some degree on “animal spirits” or “irrational psychology.” There's nothing wrong, says Keynes, with risk taking. In truth, it is essential for social and economic progress.

In fact, Keynes thought that most investors were not risk takers and preferred to follow the consensus as to where the market tomorrow might be headed. The majority ultimately had to be wrong, since the minority to make significant profits succeeded only when the majority overestimated or undervalued an investment. “[Investing] is the one sphere of life and activity where victory, security and success is always to the minority and never to the majority. When you find any one agreeing with you, change your mind. When I can persuade the Board of my Insurance Company to buy a share, that, I am learning from experience, is the right moment for selling it.”

SO WHAT?

Obviously we respect Keynes as an investor, since he sounds so much like us (on a good day for us) when it comes to fundamentals and taking the path most others decline. However, we have one disagreement with Keynes, and it concerns his hostility toward market psychology. He presumes that speculators waste their energies in trying to determine what the market will love tomorrow. In fact, though we rely on fundamental metrics to help us select the shares of companies that are historically underpriced, we also rely on investor sentiment to identify companies that repel investors. Cheap valuations are one clue. Institutional sales are another. We also like to see shares being accumulated, even when the entire market that continues to sell the shares. Hence, we always pay attention to filings from funds like [Dodge & Cox](#) or [Third Avenue](#).

This month's recommendation, [UnitedHealth Group](#), fits nicely. Cheap valuations and investor anxiety about business, political and social trends have brought the company down to valuation levels not seen in many a year, which excites our animal spirits.[SA](#)

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Healthcare Insurance is Sick

There are plenty of reasons for investors to be gunshy about medical insurance companies AKA Health Management Organizations (HMOs). The most obvious red flag is how the market has treated them. As a group, the sector is down 36% from its all-time high hit just six months ago. In a slowing economy, you might presume that defensive healthcare-related stocks, even if they did not flourish, at least would outperform the market. In this case, you'd be wrong. HMOs are once more under siege just as they were in 2000 when we recommended **UnitedHealth Group (UNH—NYSE)** to subscribers.

Looking forward, it's an election year, and investors are worried about public anger over how insurers treat their insureds, about how politicians will treat them, and the even larger issue of national health insurance. Apprehension creates opportunities that are obvious when you look at valuations that today are even cheaper than the cheap price ratios we noted in 2000. We're not saying that investors are wrong to be worried. Lower share prices are warranted today compared to HMOs' heyday during the first half of this decade. But not these prices even now, and certainly not these prices in the future.

RETURN TO THE FUTURE

Sound Advice for February 2000, the eve of destruction for an overinflated stock market, recommended UNH. Six months later, for *SA* the twinkling of an eye, we booked a 60% profit. As it turned out, we blinked way too early, since the shares rolled much higher, peaking in 2005. It's remarkable how similar the circumstances were then and now. Reading that eight-year-old recommendation, we were tempted to just cut and paste it in this issue, updating elements here and there, and then go on vacation. Instead, we will repeat only that issue's set-up paragraph:

"Doesn't everyone know that HMOs are the devil's henchmen that Congress and lawyers are lying in wait to punish them for how they treat their clients by placing profits above their contractual and moral obligation to provide medical care? Why touch a sector that has

seen vicious price competition that drove down margins and earnings?"

With the expectation that Democrats have a high probability of moving into the White House in January, and that in both the Senate and the House Democrats will enjoy heftier majorities, observers are confident HMOs' best days are behind them, that reform will bolster the rights of insureds, and meager federal budgets will trim Federal Medicare and Medicaid reimbursements to insurers.

But there is one difference this time that might explain the severe punishment HMOs have taken: slowing profits. In 2000 when concerns focused on the outcry for reform, though similar criticism is at work today, UNH back then consistently produced solid revenue and profit growth. This time there are problems across the industry that frighten investors. Indeed, UnitedHealth's remarkable record for growing sales and profit that pushed the share price skyward between 2000 and 2006 set the company up for a sharp correction when that growth slowed last quarter.

Early signs of trouble came from competitors WellPoint and Humana, both of which warned that their first quarter results would be short of expectations. When those numbers came in even below the revised targets, all HMOs tanked. As for UNH, it was not until mid-March that management, responding to a 19% drop in the share price over the previous two days, conceded it might not be on track to meet expectations, a problem blamed on a difficult flu season and somewhat higher expenses. However, UNH did not trim its numbers, saying only that "there might be pressure on first quarter and full-year results" but it was premature to make that judgment. The market, by taking the shares down 19% revealed a different opinion. In fact, this UNH press release damaged the entire sector. By the time Wall Street finished digesting UNH's ominous statement, the share price had reached what is now the top end of its trading range in the mid to low \$30s.

Five weeks later, UNH dropped a bomb. Though profits increased by 18% compared to the first quarter of 2007, that fell 5% below the bottom-end of the range UNH had projected less than three months

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before. Furthermore, UNH warned that earnings for the rest of the year would result in a 10% drop from earlier expectations. Costs were up, profits down. The Medical Loss Ratio (medical costs divided by premiums) had risen. UnitedHealth said it had lost 700,000 subscribers, primarily because it refused to cut premiums deeply enough to win some contracts. Consensus on Wall Street is that UnitedHealth and other HMOs have seen their zenith. From our perspective, we're happy to buy shares when pessimism is everywhere rather than when optimism reigns. Would you rather own UNH at \$33 today and feel somewhat queasy, or have bought it at \$59 last Christmas Eve and reveled in visions of endless profits dancing in your head?

There's been no snapback for UnitedHealth. From the day it issued that ominous press release, its shares are down 10%, while Humana and WellPoint, which also cratered along with UNH, are up 17.3% and 19.3% respectively.

Were we to apply even the mid-point valuations between historical lows and highs to current sales, we come up with a share price for UnitedHealth Group anywhere between \$60 and \$71.

UNITEDHEALTH GROUP

Eight years ago, the company was reorganizing itself into five segments, and at the start of this year again has refocused its business segments, this time into four: Health Care Services, the core business, accounts for 80% of revenues and 82% of operating profits. It covers group plans for government, mid to small-sized businesses, and individuals. It also includes Uniprise, which addresses large corporate programs (more than half of the Fortune 100 universe are clients), and Ovations, which focuses on individuals aged 50 and older, while Americhoice offers coverage to state-funded Medicaid programs in 16 states. OptumHealth (5% of revenues, 11% of operating profits) primarily provides add-on programs that deal with complex medical problems as well as behavioral needs, dental, vision, and financial services (management of health savings plans, for example). It serves more than 58 million clients. Ingenix (1% of sales, 3% of operating profits), the third segment, offers database and data management services, software products, publications, consulting services, outsourced services and pharmaceutical consulting and research services in

conjunction with the development of pharmaceutical products on a nationwide and international basis. These businesses support other in-house activities but also sell their products to others. Lastly, there is Prescription Solutions (15% of revenues, 3% of operating profits), a pharmacy benefit management program that helps clients monitor drug purchases and use.

UnitedHealth is the biggest HMO in terms of revenue and profit, though in members enrolled it trails the next most profitable, WellPoint (UNH has 31 million to WLP's 34.8). UNH last year took in \$75.4 billion in revenues and \$4.7 billion in profits versus WLP's \$61.1 billion and \$3.5 billion. Net profit margins last year ran at 5.8% versus WellPoint's 5.5%, return on total capital was 16.4% and return on shareholder equity 20%, each almost half again as high as WellPoint produced. In short, UnitedHealth Group is not just a giant but a very agile giant, which leads us to believe that it can pick itself up from current difficulties.

HMOs UNDER SCRUTINY

HMOs came into being as a way for corporate America to tame healthcare costs at a time when medical coverage for workers was the norm. Today, HMOs, which were successful in changing how physicians and hospitals charged for their services, are more often seen as the problem, not the solution. For example, the state of California at the start of this year charged PacifiCare, a recent UNH acquisition, with mishandling a massive number of claims between 2005 and mid-2007. Though the matter won't be resolved anytime soon, the rhetoric on both sides suggests the divide: regulators paint PacifiCare as a rogue operator: "after years of broken promises to Californians, it is crystal clear that PacifiCare simply cannot or will not fix the meltdown in its claims paying process," while UNH asserts most of the violations were detected by in-house audits and that no harm was done to any PacifiCare insured. California could levy as much as \$1.3 billion in fines, while UNH blamed the violations not on willfulness but on problems encountered in combining PacifiCare into UNH. New York State in January charged UNH with underpaying for care

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provided by non-UNH physicians and hospitals, blaming the problem on deceptive data in the Ingenix data base UNH uses and sells to other medical professionals. Finally, there was an option backdating scandal that took down William McGuire, who led UNH during its best years, and caused a delay in filing quarterly SEC reports that ultimately resulted in a \$502 million charge to earnings going back over 12 years.

GROWTH

Healthcare spending is the biggest segment of the U.S. economy, totaling last year about \$2.2 trillion. Costs are rising at about a 6.7% rate annually, which reflects the integration of more expensive medical procedures, equipment and drugs into common practice, and the rising number of Baby Boomers now entering their 60s. The older you get, the more medical costs you generate.

Also, there are about 47 million residents not covered by medical insurance. There is no doubt in our mind that regardless of which political party controls the White House and/or Congress, a primary issue will be not whether but how to extend some form of health insurance to those 47 million.

On Internet boards devoted to UNH shares, you learn quickly that HMOs are doomed if Democrats take the White House and increase their control of Congress. Such Demophobia extends to Wall Street. Several analysts mention that Washington will crush free enterprise and ruin HMOs as it seeks to force a cheap insurance program onto HMOs and will have even greater control over how HMOs price their services. In fact, we think the prospect of a national medical insurance program augurs well for the biggest and best organized HMOs, which means that expansion and reform of health insurance, something that almost every nation that is not an economic basketcase provides for its citizens, will benefit UnitedHealth.

Our rationale is fairly simple: UnitedHealth is the most efficient publicly traded HMO when it comes to delivery of services. Its vast network of physicians, hospitals and other service providers across the nation meets the needs of a national health insurance program. There is zero possibility that even a Democratic Congress would move away from reliance on private sector insurers to run such a national plan.

Indeed, in a sense the Baby Boomer generation already is starting to put many U.S. citizens who are not covered by health insurance into the private insurance pool as they become eligible for Medicare. UNH has been emphasizing the Medicare side of its business for years both through marketing agreements, most prominently with AARP, and acquisitions of HMOs with significant Medicare exposure.

Though many believe that national health plans dominate the business, such plans account for barely half of America's coverage. There is plenty of room to expand, especially by acquiring regional HMOs. Those deals do not just swell the membership rolls. Some are intended to introduce entirely new businesses, or to create new tools.

UNH made some of its biggest deals in 2004 and 2005: Mid-Atlantic Medical Services, which served east coast states in 2004, boosted membership by 2 million. That was followed quickly by Oxford Health Plans, which concentrated on the Metropolitan New York City market. That brought another 1.5 million clients into the fold. In late 2005, UNH made its biggest acquisition to date, PacifiCare, a west-coast HMO with nine million clients. This provided UNH with an entrée to the lucrative California and adjacent markets.

More recently, smaller acquisitions built upon those larger deals. In February, for instance, UNH bought Sierra Health Services with 825,000 clients in the southwest for \$2.6 billion, and in January announced a definitive agreement to acquire Unison Health Services, whose 370,000 clients live in Pennsylvania, Ohio, Tennessee, Delaware and South Carolina, for an undisclosed amount. The Sierra Health deal also provided heft to UNH's senior business.

Every one of these acquisitions from the start has been accretive to earnings, and is yielding even better returns over time. This suggests UNH was disciplined in its purchases. It also underlines how the efficiencies UnitedHealth had created in its existing divisions could be scaled up to improve acquired businesses. This is particularly true for its computerized data and information technology.

As for acquisitions that make UNH's stable of HMOs more efficient, UNH earlier this year acquired Fiserv Health Inc., an administrator of medical benefits that also provides care facilitation services, specialty

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UnitedHealth Price Valuations: Too Good to Pass Up

	Current Valuation	At 2005 Peak	At Historical Avg Low	At Historical Avg High
Price/Sales	0.6	1.9	0.8	1.4
Price/Earnings	9.7	25.9	14.7	26.9
Price/Cash Flow	12.9	23.3	10.9	19.8
Price/Book	2.1	4.9	2.6	4.8

health solutions and pharmacy benefit management (PBM) services, and just last week announced it had taken a minority interest in Sedgwick Claims Management Services, which designs and manages workers comp and related programs.

UNH knows what it is doing not just when adding businesses, but also when it declines business, as it did last year in passing on 700,000 subscribers whose premiums management felt would not cover their costs.

SHARE BUYBACKS

If UNH is a growth story, it also is a shrinkage story. Thanks to its fat cash flow and ability to find efficiencies to boost margins, UnitedHealth has been able aggressively to shrink its shares outstanding. With the exception of 2004 and 2005, the company has been siphoning off its shares since 1998. In the first quarter of 2008, UNH spent about \$1.3 billion for 28.3 million shares (2.3% of year-end total shares) at an average price of \$46.18, accelerating purchases into March as the share price fell below \$40. During the previous three months, UNH bought in 42.8 million shares at an average cost of \$54.85, again accelerating purchases in the final month, except during that month, December, the share price peaked, resulting in an average price of \$57.07 a share. At the start of the second quarter (ends June 30), 143.6 million shares from the board's repurchase authorization remain to be bought. The current share count is back to where it stood 15 years ago in 1993.

Not surprisingly, falling prices for UNH have rearranged the institutional investors with large positions. FMR, the holding company for Fidelity funds, for example, slashed its position by more than 40% over the past few months to 19 million shares, while **Dodge & Cox** has built a position and Warren Buffett over at Berkshire Hathaway has increased his

holdings as well. Other value investors are also starting or increasing positions in HMOs with UNH prominent among them.

VALUATIONS

After solid growth over the past few years, UNH before it went into decline was trading at premium valuations. However, as investor faith in its prospects deteriorated, those valuation ratios have plummeted below levels normally associated with market bottoms for the shares. In 2005 as the shares peaked, UnitedHealth traded at price to sales ratio of 1.9, price to earnings of 25.9, price to cash flow of 23.3 and price to book of 4.9. Only price to book was not at a historical high (6.7 in 2003). By contrast, today UnitedHealth is limping along at a P/S ratio of 0.6, P/E of 9.7, P/CF of 12.9 and P/B of 2.1. We've learned that share valuations fluctuate around certain historical averages. The trick is to buy when those fluctuations take price ratios to deep lows. Sure, at such moments most investors keep away, but that perversely is just when investors should be putting shares in their portfolios.

Were we to apply even the mid-point valuations between historical lows and highs to current sales, earnings, cash flow, or book value, we come up with a share price for UnitedHealth Group anywhere between \$60 and \$71 based on 2007 results. Needless to say, no one guarantees that valuations will rise to "average" levels. For that matter, no one can promise that 2007 results represent some "can't go lower" benchmark. However, experience tells us that valuations migrate to their historical averages and that excellent companies, as UnitedHealth certainly is, increase their numbers. With that in mind, we suggest a first buy limit of \$40, which is open to revision if we are right. *SA*

Portfolio Updates

We closed the book on the June issue last Friday, June 6th. You might recall the date. The Dow and the S&P that day dropped 3.1%, and the Nasdaq lost 3%, putting the Dow off 4.2% and the S&P 2%. Nasdaq remained in the black. We got clobbered too last Friday, though not as badly, which left our portfolio for the month up 0.8%.

CarMax, the May recommendation, which sells used cars nationally, though it started out strong, gave all of its gains back, and as skepticism about the U.S. economy convinced investors that no one would be buying anything ever again, the shares ended the month down 9.6%. Auto stocks in general were weak. GM and Ford fell hard as sales slipped further. Even mighty Toyota is having problems. Nonetheless, KMX remains an attractive proposition. We noted in the May recommendation

that Berkshire Hathaway, which opened a position in KMX beginning last year, as of 12/31/07 increased that investment substantially from 13.9 million shares to 21 million, which represents 9.6% of KMX shares outstanding. During those three months, KMX fell about 13%, which suits Buffett fine, something we noted when recalling his comment at this year's annual shareholders meeting that he happily would pay big money to see his entire portfolio drop by 50% (we presume he expects he'd have the cash to take advantage of such bargains). Some investors find such sentiments absurd. Not us. Another auto play, **Ford Cumulative Convertible Preferred** gave back 10.5%, a significant portion of the gains it enjoyed in the weeks following the surprise quarterly profit and expectations that 2009 would be profitable for a company that not long ago was a whisper-candidate for bankruptcy. The cause? Ford now says that it will break even next year at best, blaming stagnant sales of big SUVs and trucks. As for the Kerk Kerkorian/Tracinda tender offer for 20 million shares of Ford Common at \$8.50, a 29% premium to where the shares closed for this issue, Kerkorian says he remains committed to acquiring the shares. However, the tender filing gives him an out. While we expect he will continue to build his position, we expect him to do so opportunistically, which means that he won't be paying \$8.50 a share.

Superior Industries, the designer and manufacturer of auto rims and other auto equipment, dropped 7.3% despite reporting very good results for the last quarter. As with the Ford preferred, it is still nicely ahead this year, but until investors decide that auto stocks are not going to vaporize, these companies will be up on any

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TECHNOLOGY

Electronic Data Systems is being bought by Hewlett-Packard for \$25 a share. The news broke just as the May issue had been set up by the printer. Thanks to that news, EDS is up 30% since the last letter. Though we think EDS had it remained independent would have returned a bigger profit. There is a slight chance disgruntled shareholder groups could void the deal, which either is a reason to take the money and run, or to wait and see. We're sellers.

Western Digital, perhaps the most punctually volatile position in our portfolio, is at it again, but this time it is to the upside, adding 28% since the last letter. Why WDC has taken off is somewhat puzzling, since Seagate, the biggest U.S. disk drive manufacturer, was stagnant over the same period. We're walking our buy price a bit higher, but are starting to wonder if this story is coming close to completion.

Symantec, which stumbled badly after acquiring Veritas in 2005 and thus made itself worth looking at, seems to be getting better performance from that division, while maintaining solid results from its core business, security for personal computers as well as

Sound Advice Portfolio for June 2008

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
DWS RREEF Real Estate Fund II	SRO	AMEX	\$14.02	12.58%	\$16.00	BUY
HRPT Properties	HRP	NYSE	\$7.42	11.32%	\$8.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$92.41	0.12%	\$98.00	BUY
American International	AIG	NYSE	\$33.93	2.36%	\$40.00	BUY
Boston Scientific	BSX	NYSE	\$13.49	0.00%	\$16.00	BUY
Disney	DIS	NYSE	\$33.01	0.94%	\$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$43.58	6.34%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$122.01	14.68%	N/A	BUY
Fastenal	FAST	NASDAQ	\$48.77	0.94%	\$52.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$14.52	0.28%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$23.82	0.97%	N/A	BUY
Honeywell	HON	NYSE	\$54.01	1.85%	\$64.00	BUY
Insituform Technologies	INSU	NASDAQ	\$17.74	0.00%	\$21.00	BUY
Johnson & Johnson	JNJ	NYSE	\$65.76	2.52%	\$73.00	BUY
CarMax	KMX	NYSE	\$18.58	0.00%	\$24.00	BUY
Liberty Capital****	LCAPA	NASDAQ	\$15.21	0.00%	\$20.00	BUY
Mattel	MAT	NYSE	\$19.85	3.78%	\$25.00	BUY
Microsoft	MSFT	NASDAQ	\$27.49	1.60%	\$33.00	BUY
Molson Coors Brewing	TAP	NYSE	\$58.07	1.41%	\$62.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$10.69	0.00%	\$11.50	BUY
Sara Lee	SLE	NYSE	\$13.27	3.17%	\$17.00	BUY
Schering-Plough	SGP	NYSE	\$19.88	1.11%	\$22.00	BUY
Sony	SNE	NYSE	\$50.30	0.44%	\$55.00	BUY
Sprint Nextel	S	NYSE	\$9.04	1.11%	\$12.00	BUY
Superior Industries	SUP	NYSE	\$20.20	3.17%	\$24.00	BUY
Tetra Tech	TTEK	NASDAQ	\$26.21	0.00%	\$29.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$55.08	3.80%	N/A	BUY
United Parcel	UPS	NYSE	\$68.59	2.45%	\$76.00	BUY
UnitedHealth Group	UNH	NYSE	\$33.03	0.09%	\$40.00	BUY
Wal-Mart Stores	WMT	NYSE	\$58.37	1.15%	\$62.00	BUY
Whole Foods Markets	WFMI	NASDAQ	\$28.50	2.53%	\$35.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$49.88	4.10%	N/A	BUY
Xerox	XRX	NYSE	\$13.39	1.19%	\$19.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	\$32.24	3.50%	\$36.00	BUY
EnCana	ECA	NYSE/TSE	\$92.60	1.73%	\$98.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$35.99	27.18%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$46.08	3.65%	\$50.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$82.79	3.48%	\$87.00	BUY
Transocean	RIG	NYSE	\$143.50	24.45%***	\$162.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$35.53	7.46%	N/A	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	\$21.94	1.13%	\$24.00	BUY
Discovery Holdings	DISCA	Nasdaq	\$25.65	0.00%	\$29.00	BUY
Electronic Data Systems	EDS	NYSE	\$24.45	0.82%	N/A	SELL
Ford Motor Convertible Pfrd.	F.PRS	NYSE	\$32.61	9.97%	\$41.00	BUY
Icon Financial Fund	ICFSX	800-764-0442	\$9.70	17.21%	N/A	BUY
Liberty Entertainment****	LMDIA	NASDAQ	\$26.47	0.00%	\$29.00	BUY
Liberty Global	LBTYA	NASDAQ	\$35.44	0.00%	\$45.00	BUY
Maxim Integrated	MXIM.PK	NASDAQ	\$23.00	1.89%	\$26.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$6.25	3.20%	N/A	BUY
Symantec	SYMC	NASDAQ	\$20.21	0.00%	\$25.00	BUY
Time Warner	TWX	NYSE	\$15.27	1.44%	\$20.00	BUY
Western Digital	WDC	NYSE	\$38.93	0.00%	\$41.00	BUY

*Prices as of the market close on Friday, June 6, 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 June 2008

networked computers. After the Friday massacre, however, it is up only 1.1% since last month.

Maxim Integrated, the analog and digital chip designer and manufacturer, added 11.8%. The next shoe to drop for MXIM will be it getting right with the SEC over its delayed filings. Once that happens, MXIM will be released from its exile on the Pink Sheets, and can resume trading through Nasdaq, which should give it a boost. The larger story is improved sales.

Sprint-Nextel, which snapped back to life after a consortium including Intel and cable companies agreed to underwrite its WiMax technology. There also are swirling rumors that someone else might like to own part or all of Sprint-Nextel. Given the shares rapid rise from what admittedly was a six-year low since mid-March (+65%), this month's 3.6% fall is tolerable.

HEALTHCARE

In a slowing economy, healthcare stocks traditionally do well. So far, it's been a mixed bag. However, we've gotten good results from some recovering positions, especially **Schering-Plough**, which since the last letter is up 6.6%, and 43.8% since hitting bottom after the world fell in on top of it in early April following the American College of Cardiology session.

Boston Scientific is good by just 0.5% since the May letter as Wall Street waits for some obvious evidence that Boston has escaped from the damage its stent business has suffered. Meanwhile, its heart-rhythm device business that it acquired when overpaying for Guidant, is doing better.

Johnson & Johnson also has gotten dinged by drug-coated stent problems, both about efficacy and competitive advantages, and since the May letter is off 1.2%.

Odyssey Healthcare, which operates hospices and home-hospice services nationally added 5.8%, and continues to crawl back. A recent acquisition has helped, but there also seems to be a change in investor opinion.

NATURAL RESOURCES

As we close the book this month, oil is at an all-time high: \$138.54 a barrel. **EnCana** announced last month that it would split into two companies, one focused on natural gas, ECA's largest component, and another on oil. In the context of exploding prices, this reorganization whetted investors' appetite, pushing ECA is up 7.8%.

Royal Dutch, which along with the other mega multinationals had lagged companies like ECA that are more

pure exploration and development plays, is also playing catch-up. It has added 4% in the past few weeks. Given the feverish jump in energy prices, the drop in **Transocean** (-6.6%) is counterintuitive, since even were oil and natural gas to retreat significantly, demand for RIG's ultradeepwater drilling services would remain higher. **Icon Energy Fund**, which does remain overweighted toward the services sector, however is 3.1% higher.

Agrium, our Canadian fertilizer manufacturer, is up 6.6% as food prices are in the headlines. Metals shares, which have tended to move in tandem with energy, split: **Anglo-American** fell 3.4%, but **USAA Precious Metals & Mineral Fund**, which is overweighted toward gold but does own industrial metal miners added 2%.

The best performer, however, was **Plum Creek Timber**, which had been hurt by the decline in real estate prices (it sells land for "higher purpose" uses such as recreation and development) and to the withering of new construction. PCL is up 11.8% on word that it would sell \$500 million of timberland to a conservation group.

FINANCIALS AND REITS

American International Group seems unable to get out of its own way, dropping 15.3% on a daily double of negative news. First, it sold \$20 billion in securities to buttress its balance sheet, and then was notified the Justice Department is investigating how it priced swaps derived from subprime mortgages. Justice is just raking up old news, but the announcement drove AIG down nonetheless. We still believe AIG is a flat-out (but currently flattened) bargain. We'd understand if you disagreed.

The reasons for AIG's decline, of course, go beyond its particular problems. The entire financial services sector remains in tatters, which explains why **Icon Financial Fund** fell 7.2%

REITs, which we touted along with financials in the April issue, are doing better for us. **DWS RREEF Real Estate Fund II**, which we introduced just in February, is up another 4.6% since the last letter (11.6% in all).

HRPT Properties Trust, which DWS RREEF includes in its portfolio, is up 1%. The REITs are moving on a combination of their very attractive yields, (both still generate double-digit yields), and the belief that perhaps the worst of the real estate debacle is about to crest. SA

Sound Advice Market Indicators for June 2008

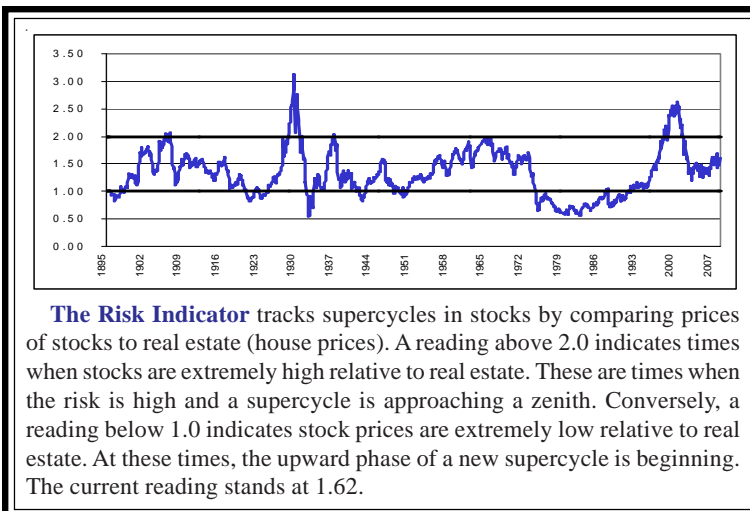
The Diffusion Index of Lagging Indicators gives “Caution” signals when all of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. Currently 75 percent of the indicators is 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 31.2 percent, not counting dividends. On an annualized bases the gain was 16.2 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 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.

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
Dec-05	1,248.29	Jul-05	1,234.18

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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