



The Natural Gas Disparity



So far this year, the *Sound Advice* portfolio is up 12.3 percent. We have had some help, a tailwind from the rise in the overall market of 9 percent (as measured by the S&P 500). Twenty-two of the 26 *Sound Advice* model portfolio positions are up, two are essentially unchanged, and two are down slightly. We have an average gain of 31% based on the prices at which each stock or mutual fund was recommended. See pages 5, 6, and 7 for a progress report on each of our recommendations.

This month we focus on the yawning difference between the cost of two forms of energy – oil and natural gas. We have a historical aberration, which means money is to be made sooner or later.

We also focus on one of our core holdings - CommonWealth REIT. The stock price is offering a tremendous discount on the value of the underlying portfolio. Here is real estate at 50 cents on the dollar.

We still have the green light from our Diffusion Indexes (see pages 10 and 11). While we continued to see some job growth, we still have a glut of foreclosed houses impeding a robust recovery (see pages 8 and 9). Italy is officially in a recession, which is indicative of the problems in Europe, and the dampening effect Europe will have on the US economy. However, all of this is leading to a low interest rate environment – the primary fuel for a bull market in stocks.

As usual, we will have to watch our steps and try to stay in the right stocks and mutual funds. And it will be more fun with a tailwind.

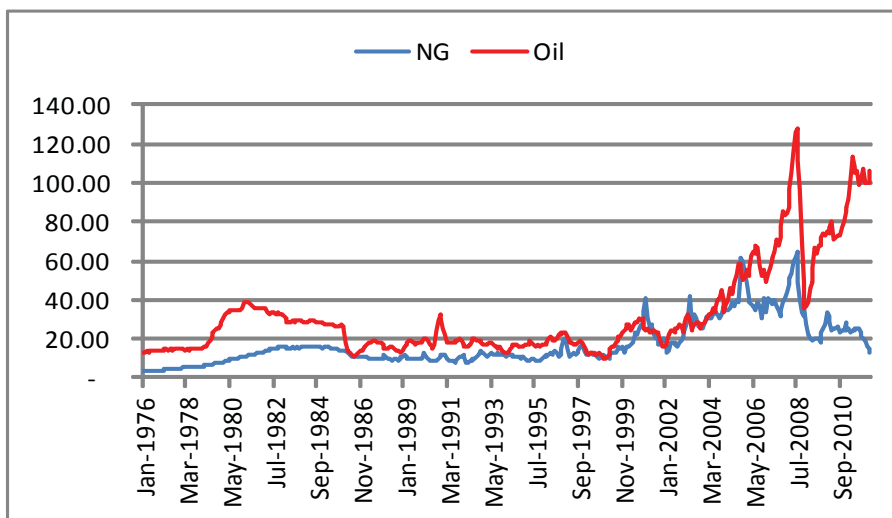
-Gray Emerson Cardiff

The price of oil -- the world's benchmark for the cost of energy -- is north of \$100 per barrel again. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. (This value is approximate because various grades of oil have slightly different heating values.) So if a barrel of oil is say, \$100, that is the cost of 5.8 million BTUs of energy.

On the other hand, the market price for natural gas today is \$2.27 for one million BTUs. To buy 5.8 million BTUs will cost \$13.17 (5.8x\$2.27). So the same amount of energy is available for approximately 13.17 cents on the dollar -- if it is in the form of natural gas.

As the chart below shows, this is not a normal situation. The red line shows the price of a barrel of oil since the mid-1970s. The blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. Note that for most of the time (36 years), the two forms of energy are closely aligned. This stands to reason. After all, energy is energy, and it should cost approximately the same regardless of the form in which it comes. However, that is not the case today. Note the current yawning gap between the costs of these two forms of equivalent amounts of energy. For 5.8 million BTUs, it costs approximately \$100 if it is the form of oil, but only \$13.17 in the form of natural gas.

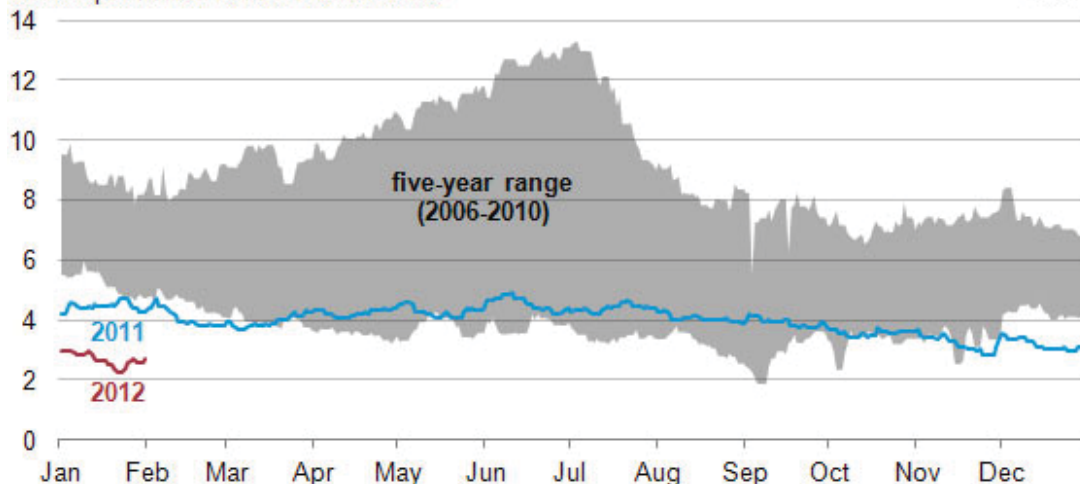
The Cost of Energy Equivalents of Oil and Natural Gas



So the question becomes whether or not we should expect today's disparity to be a more or less permanent situation, or is it an anomaly? If the gap is going to close anytime soon, there is money to be made because the price of natural gas is certain to rise from its 11-year low, and the industry is going to become more active.

One explanation for the disparity is the fact that the market for oil is a world market, where the market for natural gas is not. Oil is transportable which makes its price subject to the world's supply and demand balance. Natural gas is not as readily transportable around the world because it first must be liquefied by maintaining its temperature at -260°f. Therefore, natural gas is more of a continental market.

Spot Henry Hub natural gas price
dollars per million British thermal units



ETF (FCG-NYSE) that tracks a changeable index of natural gas exploration and development companies, but we prefer a vehicle with more flexibility.

This brings us to the only mutual fund that concentrates on the natural gas industry, the [Fidelity Select Natural Gas Fund \(FSNGX\)](#), one of Fidelity's stable of tightly focused sector funds. The fund has a relatively new manager, Ryan Oldham, who has been at the helm since mid-2010. and who is no stranger to energy. He worked

as an analyst for Canadian energy companies and global exploration and development firms.

When the fund's management is bullish on natural gas, the fund will emphasize more-price-sensitive sectors of the industry which include energy-services along with exploration and production companies. When pessimistic about gas prices, the fund will turn to more defensive sectors of the natural gas industry, such as pipelines, utilities, and integrated oil companies.

The fund's current top holdings represent a cautiously optimistic position. The two largest holdings are Apache Corp (11.4%), and Anadarko Petroleum (11.2%). These are both independent producers that generally offer better appreciation potential than shares of integrated companies. Yet they are established companies with financial strength and interests in both oil and natural gas.

The next largest holding (9.1%) is Duke Energy which is a holding company of utilities – clearly a defensive position.

The Williams Companies is the fourth largest holding (6.4%) which gathers, processes, and transports natural gas throughout the United States. This company is well positioned to fill the growing demand for new infrastructure to capture new supplies of domestic natural gas.

Sempra Energy, the fifth largest holding (6.1%), is a natural gas play. It was formed by the merger in 1998 of two California utilities, San Diego Gas and Electric and Southern California Gas. Its activities include unregulated power plants, gas pipelines and storage, liquefied natural gas, commodities, and power trading.

Another large holding is Devon Energy which has a broad portfolio of growth-oriented oil and gas assets, and a solid balance sheet to aggressively develop these resources. The company's balanced production and reserve mix should help the firm generate attractive profits even in the face of continued low gas prices.

Chesapeake Energy is another holding which is an independent exploration and production company of both oil and natural gas. It is the nation's largest independent producer of

The US market for natural gas is currently glutted. An unusually warm winter has been suppressing demand while production has increased. Prices have been trading at their lowest levels in many years. Take a look at the above chart.

Meanwhile, demand for oil has been accelerating, especially from China, and supplies are threatened again in the Middle-East. When the US was the dominant source of demand for oil imports, a surge in the price of oil, like those that took place in the 70s, would send the US into a recession which would bring down the demand for oil imports, and the price of oil would come back into line. Now that we have China's demand as a dominant force, and burgeoning demand from other developing countries, the price of oil is likely to be bolstered for the foreseeable future.

Still, energy is still energy. To the extent one form can be substituted for another, the price per BTU should be approximately the same.

There is an extensive infrastructure of pipelines across the US to deliver natural gas, certainly within every metro area. Fifty-five percent of all US homes are heated with natural gas. That still leaves nearly half that are not, and the conversion is relatively simple and inexpensive. When it comes to generating power, 31% is generated by natural gas in the US, but the rest is not. Natural gas has 30% less harmful emissions than those come from oil, and 45% less than those from coal. And Japan's unfortunate nuclear accident has cast a pall over developing more sources of nuclear energy for the foreseeable future.

The US is self-sufficient in natural gas with only 9 percent imported from Canada. At approximately 13 cents on the dollar versus oil, natural gas is bound to have a growing role in America's energy needs as well as independence from importing oil.

The question then becomes how to invest? Some think the purest investment is an ETF (UNG—NYSE) that supposedly tracks NG prices. Instead, it relies on futures to play energy prices virtually. But futures do not track spot prices and can be distorted by trading strategies. There's another

natural gas with a stake in every significant US natural gas play. It is a leader in successful extraction from shale with rights to drill on prime properties like the Marcellus, Haynesville, Barnett, Granite Wash, and Eagle Ford shales.

These top holdings suggest that FSNGX is well positioned to benefit from an expanding natural gas industry. Yet defensive holdings in utilities along with companies with oil interests has provided diversification and balanced risk. Although natural gas prices have declined since the first of the year, this fund is up 6.9% -- evidence that the investment strategy of this fund is working.

This is an excellent time to add FSNGX to your portfolio. If you already own this mutual fund, we are recommending you add it again to your position.

The Best REIT You Can Buy

CommonWealth REIT (CWH) owns 516 properties leased to approximately 2,000 tenants. Properties are located in central business districts (CBDs) and suburban areas with concentrations in six metro areas: Philadelphia, PA; Oahu, HI; Metro Chicago, IL; Metro Denver, CO; Australia and Metro Washington, DC.

The True Value

Many analysts rely on the "book" value of a company's real estate as a number that represents the value of the company's real estate. But the book value can be deceiving because it merely reflects what the company paid for its real estate. That could have been many years ago. The book value is also reduced by depreciation, an arbitrary number that has nothing to do with actual value.

To find the true value of a stock like this, we pull out the book value from the balance sheet, and substitute the market value of the real estate. The market value of commercial real estate is based on the net operating rental income it produces (after deducting operating expenses but before deducting any debt service payments). The net operating income from the real estate portfolio is shown on the company's income statement.

The most common and accepted method of valuing real estate is simply by the yield of the net operating income from the real estate portfolio. In real estate parlance, this is called the "capitalization rate". The math is similar to determining a bond yield: the higher the yield, the lower the price of the bond, and vice versa. Most real estate appraisers agree that capitalization rates currently range from 7 to 9 percent depending on the type and location of the real estate. To be conservative, we could use 9 percent, the high end of this range, to put a market value on the real estate portfolio.

To determine the value of the real estate portfolio at a 9 percent yield (capitalization rate), we divide the net operating income rental income by 0.09 to get the value (because the real estate would provide a 9% yield at this value).

Plugging the market value of the real estate into this REIT's balance sheet reveals that the stock is worth north of \$48 per

share, approximately double the current depressed price of the stock.

Of course, when we see a value like this, our question is "what are we missing?" So we start looking for fundamental problems.

It is no secret that rental rates on office properties have been declining in recent years. Wall Street spends most of its time over-reacting, and hates negative trends just about as much as it loves positive ones. It will put a steep discount on companies with negative growth and a huge premium on those with growth prospects.

Of the 72 million square feet owned continuously by CWH since January 1, 2010, the "same store" occupancy was 84.6% compared to 85.7% leased one year ago -- a decline of 1.1 percentage points. The same store fourth quarter net operating income (NOI) was lower by 10.9% compared to the prior year's fourth quarter. As a result of declining rental income, funds from operations (FFO) were down by 13.7% in 2011 to \$3.39 per share from 3.93 in 2010.

Of course, it is only natural to project this negative trend into the future, and discount the stock heavily until the downtrend is visibly reversed. However, a deeper look reveals that this downtrend is already reversing.

The Shift to CBDs

Since the beginning of 2008, management has been repositioning the portfolio from suburban properties into high value central business district (CBD) office properties. CWH has since acquired \$3.3 billion of CBD office buildings which now represent 45% of the portfolio.

The benefits of the repositioning into CBD office properties from suburban markets is becoming evident. The weakness in funds from operations is attributable to the suburban properties. During the fourth quarter, leasing activity (new leases and renewals) in the suburban office portfolio resulted in a 5% decline in rents. By contrast, leasing activity in the CBD office portfolio resulted in an 8% increase in rents, and occupancy in the CBD office portfolio increased 20 basis points.

Lease Expirations

A concern could be that a substantial amount of leases are about to expire, resulting in an immediate and substantial reduction of rental income. However CWH does not have exposure to a substantial amount of their leases expiring in any one year. In 2012, 5.3 percent of the leases expire, approximately half of which is in CBD office buildings and industrial properties located in Oahu, Hawaii. The company is confident that the Hawaii space can be renewed or leased to new tenants at the same or higher rental rates. However, the remaining half is located in suburban office buildings elsewhere. Although management believes the suburban office space can be renewed or leased to new tenants, the cost could be high based on the current market environment. If the fourth quarter is an indication, the result will be a decline of approximately 5% in rents. However, whatever the decline,

it will only be on approximately 2.6% of the portfolio.

Looking beyond 2012, there are no years with a substantial amount of expirations: 4.7 percent of all leases expire in 2013, 4.0 percent in 2014, and 4.0 percent in 2015. From 2016 through 2020, annual expirations range from 1.8 percent to 5.4 percent. No single tenant is responsible for more than 2.0 percent of total rented square feet.

In addition, rental rates do not appear to be high on expiring leases. Rental rates average \$1.41 per square foot per month for those expiring in 2013, \$1.34 in 2014, and \$1.84 in 2015. After 2016, rental rates on annual expirations range from \$0.81 to \$2.18. On all leases, regardless of expiration dates, the annualized effective rent per square foot was \$15.96 per square foot in 2011, which was up from \$14.18 in 2010.

Funds from Operations

Another problem could be that the funds from operations (FFO) are not sufficient to cover the dividend, causing the market to question whether the dividend is sustainable. This is a valid concern because this REIT has a history of paying out more than it earned for a while, and then cutting the dividend. However, funds from operations available for common stock in 2011 were \$3.39 per share -- 169 percent more than the \$2.00 per share annual dividend.

We also look at "normalized FFO" which differs from FFO because we exclude non-operational and extraordinary losses and gains, such as those related to acquisition costs or property sales. In the latest quarter, normalized FFO was \$3.38 per share, nearly the same. So the \$2.00 per share dividend is well-covered. Normalized FFO is useful information because it can be compared to prior periods. Compared to 2010, normalized FFO declined 10.7%, somewhat less than the reported 13.7% decline in non-normalized FFO.

Related-Party Management

REITs typically have a staff of employees manage their properties. However, unlike most REITs, CWH has no employees. Its properties are managed by an outside company, REIT Management and Research (RMR). CWH and RMR have officers and relatives of officers in common, which make the payment of management fees a "related person transaction." One of the Managing Trustees, Barry Portnoy, is Chairman and majority owner of RMR. He also serves as managing trustee of other REITS which were spin-offs of CWR.

In addition, another Managing Trustee and the president of CWH, Adam Portnoy, is Barry Portnoy's son, and is an owner, President, Chief Executive Officer and a director of RMR.

RMR is paid by an agreement that is peculiar in the real estate industry. In addition to being paid a property management fee based on a percentage of rental income (3%), RMR is also paid a business management fee based on the value of the properties. When a property is acquired that RMR has been previously managing, the business management fee can be based on the value carried previously by the seller rather than on CWH's acquisition cost. This unusual management structure can produce conflicts of interest and potentially

excessive fees.

Management fees to RMR totaled \$69.5 million in 2011, which amounted to 7.6 percent of the gross rental income from the properties. These fees are high. Traditional fees typically range from 4 to 6 percent, depending on the scale and nature of the management services. It certainly seems that CWH could hire its own staff for less cost. If, for example, CWH spent \$17 million less on management, its normalized FFO would not have declined in 2011 from 2010.

Although we would like to see an arms-length management arrangement and lower management fees, the amount of the fees is factored in to the calculations of value and FFO.

Anti-Takeover Provisions

Another problem is the fact that the bylaws of this REIT prohibit any shareholder (other management and affiliates) from owning more than 9.8% of outstanding shares. This provision inhibits a change in control or a takeover to acquire the assets. In the event a person or group of persons acquires 10% or more of the outstanding common shares, management is entitled to purchase additional shares or other securities or property at a discount. In addition, certain provisions of Maryland law may have an anti-takeover effect.

Without this provision, this REIT would be an obvious takeover candidate because the real estate could be acquired for close to 50 cents on the dollar through the purchase of the REIT's stock. Absent this provision, this REIT's stock would not be trading at such a discount. Suitors would certainly be bidding up the stock in takeover attempts.

Conclusions

The down trend in office rents is scary and is a large factor in the discount the stock is offering. The lack of arms-length transactions with management and excessive fees is distasteful, and so are the anti-take-over provisions. However, these are the reasons we can buy into a large real estate portfolio at 50 cents on the dollar.

We noted that \$17 million would have erased the decline in normalized FFO. While that seems like a lot, it is less than 2 percent of the gross income from the real estate portfolio. We are starting to see the benefits of the shift to CBD properties. When Wall Street sees first signs of sustainable growth, the discount is certain to shrink which will bring us a capital gain. Meanwhile, we can collect a secure 10% dividend -- a yield that is off the charts these days in comparison to other investments.

This is an excellent time to add CWH to your portfolio. If you already own this REIT, we are recommending you add it again to your position.

Portfolio Updates

So far this year, the *Sound Advice* portfolio is up 12.3% compared to the 9% rise in the S&P500. Twenty-two of the 26 *Sound Advice* model portfolio positions are up, two are essentially unchanged, and two are down slightly. We have

an average gain of 31% based on the prices at which each stock or mutual fund was recommended. Here is a progress report on our recommendations since the first of January.

Agrium (AGU) is up 22.5% this year, extending our profit to 581%. It is tempting to take our profit, but this stock is still strong and the fundamentals still look good. This is North America's largest manufacturer of nitrogen-based fertilizers. High prices for agriculture are driving farmers around the globe to invest in the products which aid them in growing their crops.

AHM Healthcare (AHS) is up 12.9% this year but it is still cheap. This company provides temporary healthcare staffing services to the healthcare industry, ranging from nurses to physicians. When we first recommended this stock in early 2011, it rocketed 45% in three months. The share price has since pulled back, affording another buying opportunity. The rationale is a two-fer. AMN is not just an opportunity to invest in healthcare, which is traditionally a non-cyclical industry, but it is also a chance to buy into a health care business that will benefit from a recovery in the economy.

Boston Scientific (BSX) is up 9.6% this year after being severely battered. The stock is still scraping the bottom of its historical price ratios. Price to sales has not been this low for the last decade, nor has price to book value. International sales are picking up both in first world economies such as Japan but also in emerging economies in Asia and Latin America. Also, a new generation of stents is being introduced abroad (and shortly here in the US). Problems with the cardiac rhythm are being resolved, and new products for minimally invasive procedures are rolling out. Wall Street is beginning to take notice.

Comcast (CMCSA) is up 24.9% this year, extending our profit to 61%. CMCSA reported favorable earnings since our last issue. Its acquisitions of AT&T's vast cable assets and Adelphia's cable business helped it become the largest cable company with 21.5 million subscribers. It recently purchased the controlling interest in GE's NBC Universal division, which in addition to TV stations owns several lucrative cable channels as well as other content assets. Comcast's purchase of media makes sense, since it has the transmission system to magnify the value of these assets.

Hambrecht & Quist Life Sciences Fund (HQL) is up 15.1% this year, extending our profit to 30%. HQL is a superior way to gain exposure to biotech. The most explosive profits in the entire healthcare industry can be found here. HQL is an attractive way to participate on a diversified basis, especially given the larger discount from NAV.

Johnson & Johnson (JNJ) is essentially unchanged for the year. JNJ can be seen as a mutual fund for healthcare,

since its multitude of divisions (200 and counting) dominate most of the businesses in which they operate. Compared to valuations during the last recession (2002), JNJ is markedly cheaper today. The balance sheet is bulletproof, one of the best in America. All the product safety issues they have had recently will be behind them, and they have a strong pipeline of products. We have a small profit and the news ahead can only get better.

Leucadia (LUK) is up 17.6%, bringing our profit to 29%. This is a holding company with a portfolio managed by Ian Cumming and Joseph Steinberg who have been compared to Warren Buffett in their success at identifying lucrative investments that can be purchased substantially below their intrinsic value.

Masco (MAS) is up 15% since the first of January, increasing our gain to 61%. We added MAS to the *Sound Advice* portfolio in October last year at \$7.49, when it was languishing in the doldrums along with the rest of the housing industry. MAS manufactures everything from kitchen cabinets and faucets to windows and paint. Although losses had wiped out earnings, a significant portion of those losses represented the writing off of goodwill, which represented the price paid for acquisitions in excess of their tangible book value. However, we believed that the worst was over and the risk was out of the stock. The rise has been so fast that we advise waiting for a dip below \$11.50.

Maxim Integrated Products (MXIM) is up 7% this year, extending our profit to 40%. MXIM designs and distributes mixed-signal semiconductors, and is known for its sophisticated design of analog circuits. It has also carved out a position in high-volume chips for the handset market, where its power-management chips manage battery lives.

The company is in excellent financial health with \$1.0 billion of cash and plenty of cash flow to support operations and pay its quarterly dividend of \$0.22 per share (a 3.6% yield at the stock's current price). Even if MXIM's price ratios merely rise to the valuations of its average years, the share price will triple.

Paychex (PAYX) is up 4.8% this year. We have a small profit of 14% but expect more ahead. The company's core business is payroll services and focuses on small to medium sized companies, so its revenues and earnings directly mirror the employment situation. Naturally, the stock took a beating when the economy tanked. However, the company has kept sales and earnings stable, which has pushed valuations to very attractive levels. This is a classic "buying straw hats in winter" opportunity that offers considerable potential for capital appreciation as well as a nice yield.

Pfizer (PFE) is essentially unchanged and so is our



profit of 23%. Pfizer continues to develop new drugs and to supplement in-house products. It is also partnering with other companies, especially junior firms long on new products but short on funds as well as marketing muscle, to complete drug testing and market these products. An aging population and international expansion are creating new markets.

Seligman Premium Technology Fund (STK) is up 15.4% this year. This is a closed-end fund with a conservative twist that provides some cushion from the tech sector's often rough ride. This fund sells covered options against its portfolio which lowers volatility and produces cash income. This fund has a 10 percent annualized yield.

Stryker (SYK) is up 5.4%, bringing our profit to 24%. It is best known for its orthopedic devices: artificial knees and hips, but it's much more. Stryker currently generates 45% of sales from its orthopedics division, 38% from its medical and surgical equipment division and 17.2% from its neurotechnology and spine segment. We expect this last category to expand most rapidly. Management has been buying back shares, and we agree.

Symantec (SYMC) is up 13.7% this year. As the world moves to smart phones, hackers are starting to find security holes. SYMC, the dominant supplier of software for computer security, is the company to plug them. This relatively new arena for Symantec products is difficult to gauge, but we expect this facet will catch investor interest. Meanwhile, the shares are cheap on a relative basis.

Tellabs (TLAB) is down 4% this year, close to the same price since its inclusion into the portfolio. Tellabs designs and manufactures hardware for the telecommunications industry, which in a world of exploding demand for wireless communications should be a bonanza of a business. Tellabs has been slow to move its product lines as telecom service migrates into wireless.

Now, however, Tellabs is fast-tracking development of new products for wireless service. There's no question that the explosion of smart phones, tablet computers and wireless communication is testing the limits of telecom infrastructure. Tellabs should be able to gain a significant portion of that market. Tellabs' balance sheet holds \$2.91 per share in cash and cash equivalents (short-term government debt or commercial paper) with no long-term debt. Other assets and liabilities on the balance sheet offset each other. Subtract that \$2.91 from the current share price and you are buying the entire business for practically nothing. We think there is very little downside risk at the current stock price and loads of upside.

Tetra Tech (TTEK) is up 11.6%, extending our profit to 56%. This company designs and engineers water and other projects that are potential targets for terrorists, so the company is incorporating security infrastructure into its work, and believes this could be a lucrative business. In addition, TTEK has gotten involved in Iraq, clearing explosives from battle fields, which is an extension of work it does for the military. We think the biggest potential business for TTEK

lies outside the United States in countries like China and India, where environmental concerns have been at best an afterthought. Only now are their governments starting to recognize the consequences. As governments around the world make this a priority, Tetra Tech should be a prime beneficiary.

Third Avenue Focused Credit Fund (TFCVX) is up 6.9%, bouncing off the low end of its trading range and sporting a 7.5% yield. TFCVX prides itself on its research and risk management, and in a difficult market such as 2011 it was busy putting \$190 million into existing positions that were selling at 68% of par, and selling off positions that had risen above its upper limit (108% of par). We do not have a profit here yet, but we think there are rich opportunities in distressed credits.

Transocean (RIG) is up 35.9% this year. It operates the largest fleet of ultra deepwater drilling rigs in the world. Although high energy prices are generally a plus for Transocean, the company can flourish when oil prices remain above \$70 a barrel, a level that energy companies consider sufficient to justify aggressive exploration and development programs. The stock is down nearly 50 percent from its March 2011 high of \$85.98 due primarily to the disaster in the Gulf of Mexico. Earnings are expected to continue to be poor this year. RIG incorporated in Switzerland where dividends are proposed and voted on annually. In February, management did not recommend paying a dividend for 2012 to keep its balance sheet strong. The stock dipped 5% on the day of the announcement and has since recovered. A brighter day lies ahead and we think this stock will continue to recover.

UnitedHealth Group (UNH) is up 8.6% extending our profit to 70%. It is among the largest Health Maintenance Organizations (HMO) in the United States, and continues its strong recovery. The company's strong financial position should facilitate expansion through investment in technology, research and development, and strategic acquisitions. Although we have a good profit, we are sticking with it for now. This year's earnings should be close to \$5.00 per share, so the stock has a P/E close to 10 which is attractive for a company with growth prospects.

USAA Precious Metals & Minerals Fund (USAGX) is up 4.2 percent this year, extending our profit to 28%. This fund is widely recognized as the best diversified way to invest in precious metals. Mark Johnson, who has managed the fund for the past 17 years, has shown a talent at making the right decisions during his tenure, and, since we consider funds managed by industry veterans superior to index funds, we cannot think of a better way to play gold and precious metals than this fund.

Xerox (XRX) is up 4% this year. For a time, XRX teetered on the edge of bankruptcy due to excruciatingly poor management. However XRX has new management and a new focus that builds on the company's hardware which has always been innovative. Xerox has plenty of opportunities to maximize revenues and profits. Its commercial printing presses (called "digital printing") represent the next-

Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Associated Estates Realty Corp	AEC	NYSE/Nasdaq	15.30	4.44%	18.25	BUY
Commonwealth REIT	CWH	NYSE	18.16	11.01%	22.00	BUY
Retail Opportunity Invest. Corp.	ROIC	NASDAQ	11.98	3.34%	13.50	BUY
Diversified Growth						
CGM Realty Fund	CGMRX	800-343-5678	28.71	0.91%	--	BUY
Comcast	CMCSA	NASDAQ	29.61	2.20%	30.00	BUY
Johnson & Johnson	JNJ	NYSE	65.10	3.50%	71.00	BUY
Leucadia National Corp.	LUK	NYSE	26.74	0.93%	30.00	BUY
Masco	MAS	NYSE	12.05	2.49%	11.50	HOLD
Paychex	PAYX	NASDAQ	31.55	4.06%	35.00	BUY
Pfizer	PFE	NYSE	21.54	4.09%	23.00	BUY
Stryker Corp.	SYK	NYSE	52.40	1.62%	60.00	BUY
UnitedHealth Group	UNH	NYSE	55.02	1.18%	56.00	BUY
Xerox	XRX	NYSE	8.28	2.05%	9.00	BUY
Energy/Natural Resources						
Agrium	AGU	NYSE/TSE	82.19	0.55%	90.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	32.49	0.17%	--	BUY
Tetra Tech	TTEK	NASDAQ	24.10	0.00%	28.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	31.83	0.25%	--	BUY
Aggressive Growth						
AMN Healthcare	AHS	NYSE	5.00	0.00%	7.00	BUY
Boston Scientific	BSX	NYSE	5.85	0.00%	8.50	BUY
H&Q Life Sciences Fund	HQL	NYSE	13.20	8.18%	15.00	BUY
Maxim Integrated	MXIM	NASDAQ	27.86	3.16%	29.00	BUY
Seligman Premium Growth Fund	STK	NYSE	18.08	10.23%	20.00	BUY
Symantec	SYMC	NASDAQ	17.80	0.00%	20.00	BUY
Tellabs	TLAB	NASDAQ	3.88	2.06%	5.00	BUY
Third Avenue Focused Credit Fd	TFCVX	800-443-1021	10.16	7.46%	--	BUY
Transocean	RIG	NYSE	52.16	0.00%	60.00	BUY

ROWS IN **BOLD** INDICATE A CHANGE IN ACTION OR LIMIT

Prices as of Monday, March 12, 2012. See our website for live pricing and buy limits.

<http://www.soundadvice-newsletter.com/members>

Yields on funds do not include distributions of capital gains. Note that all fund distributions fluctuate annually.

generation for the printing industry. After having survived a near-death experience, the stock is cheap. But earnings are growing again.

REITs – Income with Growth

CGM Real Estate Fund (CGMRX) is up 6.8% this year, extending our gain to 50%, and we think more profits are ahead. This fund put on quite a fireworks show between 2003 and 2007. We got back into it again after the 2008-09 crash in REIT prices. The good years of this fund are really good.

Associated Estates Realty Corp (AEC) is down 4.1% for the year. This is a good value because the price of this apartment REIT is 30% below the equity value of its portfolio, and the yield is 4%. Apartment properties are one of the most

successful REIT sectors over the last two years as demand for apartments has surged thanks to the abrupt fall in home ownership. AEC is upgrading the quality of its portfolio which should bring a capital gain ahead.

Retail Opportunities Investment Corp (ROIC) is up 1.2% for the year. This REIT merged as an IPO in October 2009, a relatively odd moment to come to market. The REIT sector had just been decimated by the 2008 melt-down. This is precisely what attracts us to this REIT because it started with a fresh slate in a real estate market replete with bargains. It started with \$400 million in cash, no debt, and no problem legacy properties. As new cash flow is added by additional properties and tenant upgrades, the dividend continues to rise, and so should the price of this REIT.

The rising swell of home foreclosures began in 2007 as a symptom of faltering real estate markets across the country. But as the swell turned into a tidal wave, falling real estate prices have compromised the assets of the US banking system and the fabric of the US and worldwide economies. Indeed, the state of the nation's real estate markets and the economy have become one and the same. Clearly, the recession cannot be fully put behind us and a recovery kick into full gear until the inventory of foreclosed homes stops overhanging the market.

We have seen all this before. It was back in the 1980s. After years of loose and questionable lending practices, regulators were forced to liquidate hundreds of savings and loans and dump their foreclosed real estate onto an already-depressed real estate market. As values dropped, the downward spiral continued until most of the real estate was sold at steep discounts. The crash was worse in some parts of the country, but the damage to the whole US economy was substantial. Does this sound familiar?

We have the same situation today. It's like the old good news/bad news jokes, except this is no laughing matter. The bad news is that today's crash has been damaging to both real estate prices and the national economy.

The good news is that we have the tools to determine when the bad news will be over. This will give us a tremendous opportunity not only to invest in real estate for pennies on the dollar at the right time, but also in other investments as well as those that benefit from a recovering economy.

The Key Indicator

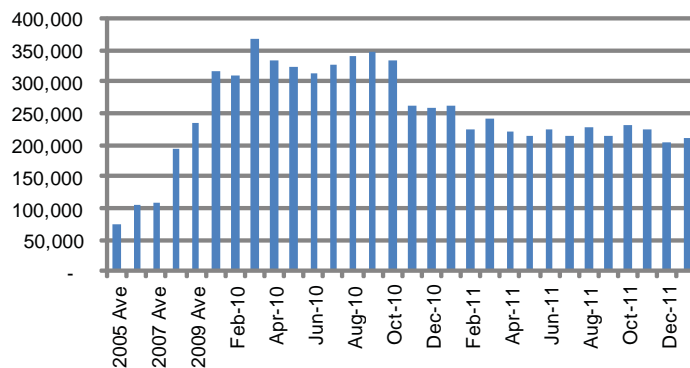
The secret is to focus on foreclosure rates. Realty Trac in Irvine, California has an extensive database. You can access foreclosure information on local markets from their website www.realtytrac.com. We use some of their data here to gauge the state of the nation and its real estate, and plan to continue to do so in future issues of SoundAdvice.

What we are looking for is a significant decline in the number of foreclosures. When this happens, the bulk of the overhanging inventory of foreclosed properties will have been digested, and the real estate recovery can then begin as well as in the economy. In the late 1980s, this was the best indicator for knowing when the recovery was near. As foreclosure rates dropped, the ensuing recovery began. For nearly two decades, fortunes were made from real estate purchased for pennies on the dollar during the S&L Crises of the 1980s.

The following chart shows US foreclosure rates. In 2005, foreclosure rates averaged 74,892 properties per month. In 2006 and 2007, foreclosures were slightly above 100,000 per month. However, by January 2010, foreclosures climbed to over 300,000 per month, and foreclosures continued at over 300,000 each month through October.

We saw the beginnings of a decline in the 2010 fourth quarter. At first, the decline was due largely to a freeze in foreclosures by several major lenders. The downtrend continued as Federal and state foreclosure prevention efforts

US Foreclosure Rates - Monthly Averages



allowed distressed homeowners to stave off foreclosures. However, foreclosure rates remained stubbornly high throughout 2011.

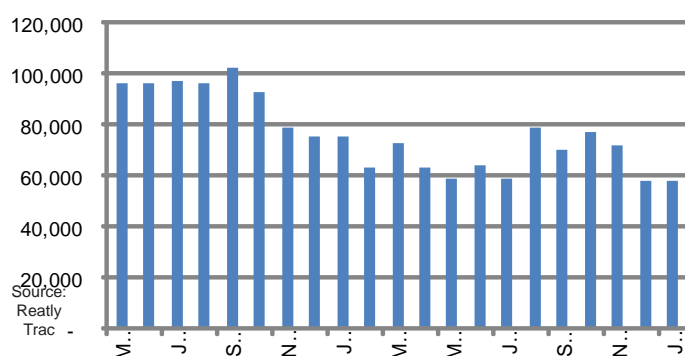
Dissecting the Foreclosure Process

It's important to keep in mind that the foreclosure process is comprised of three distinct stages: new default filings by lenders; then auctions as lenders attempt to sell these properties; and finally, bank repossessions of those properties not sold through auctions. The sheer number of foreclosures is actually the aggregate of the number of properties in each of these three stages.

We can get an early glimpse of a change in trends by focusing on changes in the first step of the foreclosure process: new default filings. After all, a significant change in the first step of the foreclosure process must ultimately lead to a significant change in the aggregate number.

The following chart shows new default filings in the US by month since May 2010. Through October 2010, new default notices were hovering around 100,000 per month. However in November 2010 they began declining. Although new default rates have declined slightly in recent months, they

US New Default Notices

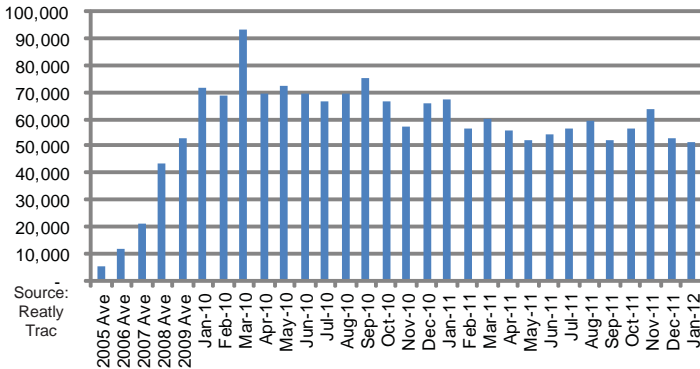


remain stubbornly high.

One fourth of the nation's foreclosures have been in California for the last few years. The following chart shows all stages of the foreclosure process in California (including auctions and bank repossessions).

In 2005, California foreclosures averaged 5,138 properties per month. Foreclosures doubled in 2006, and

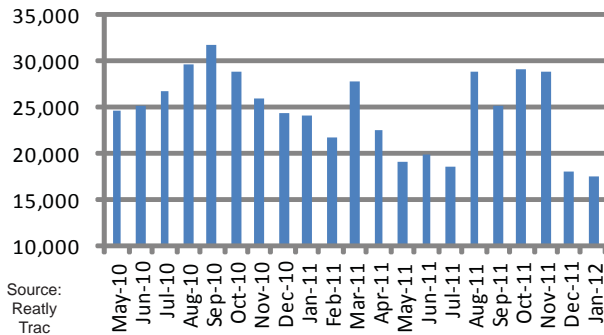
California Foreclosures - Monthly Averages



again in 2007, and again in 2008. By 2010, foreclosures were close to 70,000 each month, with a spike of 93,000 in March. Foreclosure rates remained high in 2011, with no significant change in January 2012.

Below is a chart of new default notices in California. In August 2011, new default notices in California jumped a whopping 55 percent to 28,961. After a decline in September by 13 percent, new default notices in California increased in October to 29,240 and in November to 28,897, but then

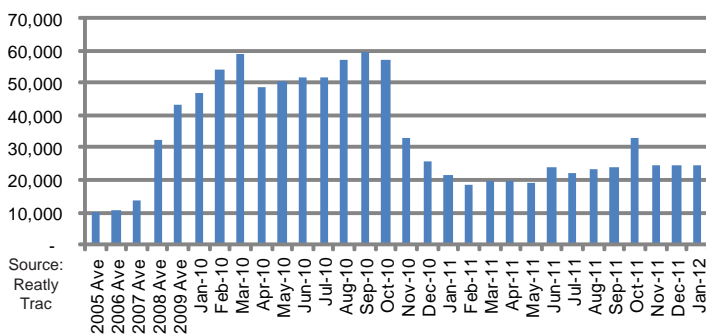
California New Default Filings



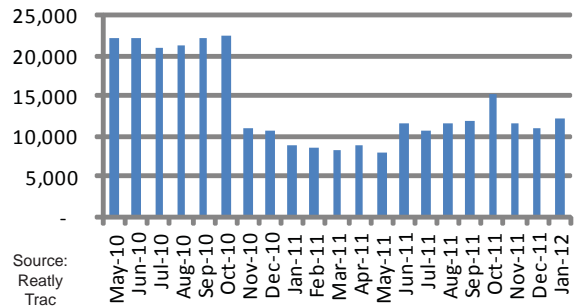
dropped sharply in December and January.

Florida is the next highest foreclosure state with 11 percent of the nation's foreclosures. See the chart below. Foreclosure rates climbed from 10,000 per month in 2005 and 2006 to 47,000 in January 2010, and stayed in the 50-60,000 range through October. Then the monthly rates

Florida Foreclosures - Monthly Averages



Florida New Default Filings

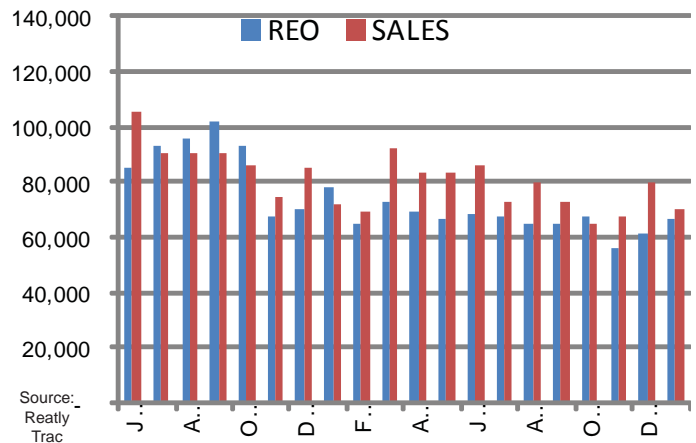


dropped sharply through May 2011. However, foreclosure rates have been creeping up again, and spiked in October.

As an indication of what lies ahead, new default notices have been increasing in Florida during the second half of 2011, and continued to increase in January 2012.

The Inventory

At the other end of the foreclosure process is what the banks have not been able to sell. This inventory is called "real estate owned", or REO for short. Each month more REO is added to the inventory. However, each month there are a number of properties sold from the inventory. Below



is a chart of the REO (in blue) and sales (in red) since June, 2010.

On balance, there have been 142,123 more properties sold than have been added to the REO inventory, or 10.6 percent of the current inventory of 1,336,360 foreclosure properties listed for sale.

Conclusions

Not much REO is selling. The decline of new default filings in California is the only bright spot. Otherwise, there is no conclusive evidence that the crisis is getting any better.

We will be tracking foreclosure metrics closely both nationally and in key states in these pages of SoundAdvice to be among the first to know when the end of the foreclosure crisis is at hand. Stay tuned.

Capital Competition: Real Estate versus Stocks: The SoundAdvice Risk Indicator

There are few forces that are more important to a market's destiny than the amount of capital that is available to it. In a normal situation, capital will flow easily between markets as their underlying conditions change. But if a market becomes dangerously superheated, it will absorb a larger proportion of available investment capital than economic conditions and market demand can justify. This change will be reflected not only in the rising market's prices but also in the prices of competing markets, which will be lower than their underlying fundamentals would indicate they should be. Over the last 100+ years, we can see this titanic struggle between the stock market and its foremost competitor for investment dollars: real estate.

To reveal this phenomenon, we have set up an equation in which we divide the Standard and Poor's 500 Stock Index average by the median price of a new house for each month over the last 100+ years. This equation exhibits an elegant financial minuet as each market has taken turns outperforming the other.

As we look at the historical data, we find that there is a range in which the price disparities are so strong that they are too great to be accounted for by the fundamental economic conditions underlying each market. Every time prices get into these danger zones it has meant that the prices in one market or the other have gone too high, and that they are in imminent danger of falling.

We can, therefore, label this new tool a "Risk Indicator," since it will allow us to locate the point at which prices are so high when compared to competing markets that they have come loose from their moorings and are on the verge of declining or underperforming the other market.

What is too high? When stock prices are very high relative to house prices, the Risk Indicator will rise over the line

marked 2.0, revealing a high-risk time for stocks. In contrast, when the indicator drops below the line marked 1.0, it means that it is a very low-risk time to buy stocks. Notice from the chart how the Risk Indicator has oscillated back and forth, revealing the ongoing struggle between Stocks and houses for investment capital. We have labeled these long vacillations Supercycles.

The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$8,065,235 in stocks and to \$1,154,787 in houses.

But though an investment begun with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the Risk Indicator he would have made \$320,559,976, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the Risk Indicator would have provided.

These figures illustrate why it is so important to remain aware of the Supercycles that are at work within markets. A recent example was during the 1998-2000 stock market mania, when most investors were chasing high-tech stocks, our *Sound Advice* portfolio was buying Real Estate Investment Trusts (REITs.) Most investors got killed with 75 percent-90 percent losses during the ensuing decline. However, REIT shares during the same period soared 25 percent, and had locked in nearly double-digit dividends. When the bear market ended in late 2002 and tech stocks recaptured some of their losses, REITs rolled to mind-boggling highs as speculation drove them to excess that climaxed in 2007.

The SoundAdvice Risk Indicator

The latest reading for the Sound Advice Risk Indicator is 1.57. This reading reveals that stock values are below average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

See *The Science of Making Money in Turbulent Markets* for a complete explanation of the Sound Advice Risk Indicator and its track record. (You received a copy of this book with your subscription, and you will also receive an updated copy when you renew your subscription.)



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

If the Supercycles identified by our Risk Indicator are the solemn, inexorable seasons that roll across the market's landscape, business cycles are the highly visible, sometimes serene but frequently blustery fronts and storms that we actually perceive as weather. The Risk Indicator has given us a reliable tool to determine the investment season in the stock market. This information is all-important; there will be no heat waves in January, no blizzards in July. But in our search for fair winds, we need to know more than the season. We also must be able to predict the shorter-term weather -- the bull and bear markets that fluctuate along the path of Supercycles.

The data we need is contained in the leading and lagging economic indicators published monthly by The Conference Board. We have hand picked the most sensitive of these economic indicators to produce our "Diffusion Indexes" which function with amazing accuracy as predictors of the birth of cyclical bull and bear markets in stocks.

To construct our Diffusion Indexes, we observe changes in each of our selected indicators over a six-month period. For every indicator that is unchanged from its value during the six month span, we will attach a value of one half point (0.5). If an indicator falls below its level six months prior, it will be given a value of zero. If an indicator is higher than it was six months before, it is assigned a value of 1.0. The sum of all of these figures will be expressed as a percentage of the total number of indicators. If, for example, one indicator is up (+1) at the end of a six-month period, one is unchanged (+0.5), and one is down (0), the diffusion index will be (1.5)/3 or 50 percent.

When the Diffusion Index of Leading Indicators drops to zero, it is time to buy stocks aggressively, regardless of how negative the atmosphere may be. This is not just an empirical coincidence. It is also logical. In order for all of the leading economic indicators to be giving off a zero value compared to six months before, it is nearly certain that the economy as a whole must be very soft, which is the atmosphere necessary to produce a lasting decline in interest rates.

The Diffusion Index of Leading Indicators: As far back as February and March 2009 we were projecting that our Diffusion Index of leading indicators soon would hit zero and mark an important buying opportunity. We made that projection by assuming that the leading indicators would not improve in the current economic environment. In fact that signal arrived in March, very close to the bottom, officially

giving us an "Aggressive" signal.

An "Aggressive" signal coming at a time when the Risk Indicator is close to 1.0 reveals that Supercycle 5 has come to an end, and that Supercycle 6 is born. The current reading of the Diffusion Index of Leading Indicators is 50 percent, which does not change our market perspective. That will change only with a signal from the Lagging Indicators.

The Diffusion Index of Lagging Indicators gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading which would reveal an overheating economy with immediate inflationary pressures ahead. Our next signal will come from this Index. This Diffusion Index currently stands at 66.7 percent.

Track Record of the Diffusion Indexes

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 produces an annual average return of 23.7 percent. During "Caution" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased at an annual rate of only 1.62 percent during caution periods.

Aggressive	S&P	Caution	S&P
Sep-74	68.12	Apr-76	101.90
Nov-79	100.00	Oct-83	167.65
Dec-84	164.48	Jun-85	188.89
Jul-86	240.18	Aug-87	329.36
Mar-88	265.74	Jun-88	270.68
Mar-89	280.00	May-89	313.93
Oct-89	347.40	Mar-93	449.74
Feb-97	798.38	Dec-98	1,141.00
Oct-00	1,429.40	Dec-00	1,320.28
Jun-03	974.50	May-05	1,191.50
Jul-06	1,276.66	Mar-08	1,325.43
Apr-09	865.33		

See *The Science of Making Money in Turbulent Markets* for a complete explanation of the SoundAdvice Diffusion Indexes and their track record. (You received a copy of this book with your subscription, and you will also receive an updated copy when you renew your subscription.)

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