

SOUND ADVICE

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A friend observed that Wall Street takes a good idea, like the securitization of mortgages to keep fresh cash coming into the housing market to support new loans and to diffuse the risk, and then makes it bad, by failing to apply standards for mortgage applicants, the promotion of "liar loans," not scrutinizing the real risk, and the coup de grace, excessive leverage by the bond buyers.

Greed played its part. Did anyone really believe even were there no bubble that housing prices could not decline? Instead, we got self-congratulation from politicians, Republicans and Democrats, who paid no attention to the underpinnings of that boom.

But more than greed, which is always with us, was the naïve dogma that free markets were the ultimate regulators, that regulation per se was bad, that it distorted markets' natural flow.

In fact, lack of reasonable regulations or, where it existed, failure to apply them made Enron possible, permitted Greenspan to worry about "irrational exuberance" and then promptly forget about it. Without the malign neglect of regulators from the Fed on down, the mortgage and the securitization industries would not have been able to build a debt market on sand.

Ironically, the hero for deregulation, President Ronald Reagan, when it came to international diplomacy, had no illusions about human perfidy. When negotiating the INF treaty with Mikhail Gorbachov, the President repeated his very wise instinct: "Trust but verify." Naively our leaders trusted the markets but failed to verify what they were doing. The resulting mischief remains.

--Gray Emerson Cardiff

Funds

Sound Advice primarily recommends individual stocks, because we think (and our track record shows) our overall portfolio can outperform not just the common benchmarks such as the S&P 500 or the Wilshire 5000 but most diversified investments as well. Nonetheless, well-managed funds, which beat these bogeys have their uses.

In some cases, though we like a sector such as biotech, we recognize our limitations to make informed recommendations, and thus rely on a top-grade manager to do that for us. In other instances, after we have introduced several stocks in a particular area, we recommend a sector fund for subscribers more comfortable with a shotgun rather than a rifle. Finally, there are a handful of master investment professionals whose wide-ranging funds have crushed their competition, and deserve to be at the core of any value-oriented investor's portfolio.

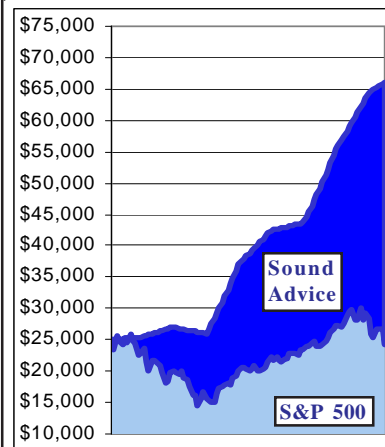
Currently our portfolio includes shares in 11 funds and 41 companies. Funds tend to get less individual attention in our monthly updates beyond noting sharp up or down moves. Effectively we transfer responsibility to the fund manager, and unless he or she does something shocking, we're content to track how the fund is faring. It's not practical to deconstruct the portfolio in the monthly updates section.

In this issue and then in the October issue, we want to mend that gap not just to catch you up on how the individual funds are faring, but also to decipher how these managers are responding to what has been a harsh market. We'll examine changes that have occurred in each fund by looking at the last two SEC filings for each portfolio to get the best perspective.

Sound Advice Annual Returns

4.88% Since 1-1-08
17.4% Since 1-1-06
18.2% Since 1-1-03
12.0% Since 1-1-00

Versus the S&P 500



Since 1-1-2000, an Investment of \$25,000 becomes:
\$25,517 with the S&P 500,
for a gain of \$517
\$66,350 with *Sound Advice*,
for a gain of \$40,833
= 79 Times More Profits

Sound Advice on Funds in the Portfolio

Dodge & Cox Stock Fund (DODGX) returned to our portfolio in the March 2008 issue after it had been reopened to new shareholders in February. DODGX was one among several highly respected value funds that had closed to new shareholders after the run-up in value-oriented stocks in 2003, because they could not invest prudently the tsunami of new cash investors threw at them.

The fund's market value had ballooned from \$4.6 billion at the start of 2000 when value investing was considered passé to \$72 billion in mid-2007 when investors could not get enough of a fund that made money between 2000 and 2002 while the S&P was losing 15% annually, and continued to outperform that benchmark during the boom years of 2003 and 2004. The key to success had been management's refusal to buy momentum tech and telecom stocks during the bubble. Instead, DODGX during the last gasp and then the first tumble in the market in late 1999 and 2000 added new positions and buttressed others as most investors bailed out of stocks. Now, as the market wobbles close to bear territory, we see management is back to refocusing the portfolio to capture bargains the market is presenting.

Eight years after beginning its strong outperformance, with the market no longer rewarding DODGX, the fund found itself in an odd situation: it was bargain season again but redemptions were draining away the cash needed to take advantage. As Dodge & Cox drily explained: "weak short-term relative returns, may have contributed to recent redemption activity."

In fact, there was a hint of urgency: "the volatile investment environment has created what we believe to be many interesting long-term equity and fixed income opportunities." The very circumstance that triggered redemptions—a falling market—for Dodge & Cox signaled it was time to become an active buyer. In short, just when they believed they could invest new cash constructively, investors were heading for the exits.

True to their word, Dodge & Cox Stock Fund has been busy. Examining the portfolio as reported at the

trading close on December 31 with the last SEC filing that presented data as of June 30, 2008, we note that among the eight positions that at least doubled in size over those six months five were in financial services (SLM Corp, **AIG**, Wells Fargo, Citigroup and Wachovia). In fact, the financial services portion of the portfolio showed the largest relative increase (+17.4%), and in terms of dollars grew the most. We also note that three positions that showed less aggressive though still substantial growth are in our own portfolio: **UnitedHealth Group** (+76.7%), **Maxim Integrated Products** (+57.8%) **Sprint Nextel** (+48.2%) as is **AIG**.

There were also large opportunistic increases such as Amgen (+377%), which got beaten down toward the end of last year and hit bottom in March. Also of interest, DODGX waded into U.S. auto stocks, initiating positions in General Motors and in Ford.

What did DODGX lighten up or sell of entirely? Energy stocks were slashed: ConocoPhillips and Chevron, for instance, were reduced almost by half, and **Wal-Mart**, which has benefited from consumers pressured by energy costs, also decreased by nearly half. McDonalds, which had been a major holding, dropped out of the portfolio, as did Union Pacific. **Johnson & Johnson** and Bristol-Myers Squibb, both large holdings, also had disappeared by June 30th.

The pattern is fairly simple: DODGX has been buying the most beaten-up sector, financials, while maintaining its consumer discretionary holdings, though substituting auto stocks for exposure to consumer companies like **Sony** and Nike.

As Dodge & Cox takes pains to explain, they invest company by company, and any sector overweight results from the market's preference for dumping entire sectors down when they fall out of favor, thus creating clustered opportunities.

So far this year, DODGX trails its benchmark, large cap value funds, by 1%, and is off 12.9%. Experience with this fund shows it produces its best years following one in which it is in the red, which, if you think about it, is just how value funds are expected to perform.

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Sound Advice on Funds in the Portfolio

Third Avenue Value Fund (TAVFX) has an even bolder commitment to financials, though that overweighting has as much to do with current market opportunities as with a long-standing preference for companies with complicated structures that hide assets' true value. Between the two portfolio tallies, October 2007 and April 2008, there is less movement than in the DODGX portfolio except that the fund has chopped its cash position from about 20% to 10% as it wades into new opportunities. Redemptions during a difficult period also have siphoned away cash.

Provocatively—and characteristically—Marty Whitman, founder and guiding manager at Third Avenue, during the financials' freefall has moved into some of the most troubled sectors such as bond insurance companies like Ambac and Radian and especially MBIA. Though in total these account for a mere 3.6% of the fund's value, they represent its fastest growing portion. When MBIA needed cash and issued \$2.6 billion in shares, Third Avenue took 15% of the offering, at a little above \$12 a share. Whitman, who has been ridiculed for getting into these companies, is indifferent to the pummeling the shares subsequently have taken. MBIA, for instance, now trades in the mid-\$8 range.

Beyond these positions the fund shows robust exposure to real estate, much of it in Asia. If we toss in holding companies, which in addition to their operating businesses own primarily a mix of securities and real estate, TAVFX has concentrated about 61% of its assets in finance and real estate, a substantial wager justified by Third Avenue's aggressive/conservative approach. The fund is aggressive in that often it goes where others don't either because the investment is controversial or obscure, and is conservative in that it buys only at a substantial discount from what it believes the investment is worth.

But back to financials. As with Dodge & Cox, exposure to financials results in part from a company-by-company analysis during a severely troubled market. There is no doubt in our mind that over the long-term financials will be extremely rewarding. They also will be very uncomfortable to own and evaluate, which suggests why Third Avenue concentrates so much of its assets in such situations.

We suggest you look at Whitman's explanation for taking a major position in bond insurance companies (<http://www.thirdavenuefunds.com/taf/documents/>

[shareholderletters/aboutus-letters-08Q1.pdf](http://www.thirdavenuefunds.com/taf/documents/shareholderletters/aboutus-letters-08Q1.pdf)).

Whitman is not particularly interested in quarter-to-quarter income statements, since these numbers are open to manipulation and, even if not manipulated, merely capture circumstances open to rapid change. Instead, he concentrates on the balance sheet to determine how well capitalized and how undervalued any company is. Third Avenue seeks to wring from GAAP reporting details that these accounting rules disguise. Whitman first made his reputation on Wall Street as a vulture investor who ferreted out value in bankrupt and troubled companies. Those same instincts have propelled his funds to market-beating returns over their 22-year history.

In the case of Cheung Kong Holdings, the fund's biggest position at 8.1% of assets (TAVFX really is even more involved with Cheung Kong, since Whitman owns a hunk of Hutchinson Whampoa, another Hong-Kong real estate and infrastructure operator that Cheung Kong controls through its 49.7% ownership), Whitman provides an excellent window on how he invests. Cheung Kong Holdings is a family-controlled but publicly-traded Hong Kong company that primarily holds and operates real estate. In Third Avenue's always valuable letters to shareholders, whenever Cheung and its peers are mentioned, there is the descriptive mantra: "very strongly capitalized companies which appear to be selling at meaningful discounts from readily ascertainable net asset values. They appear to qualify as attractive "Net-Nets," a key concept Whitman adapted from Benjamin Graham. Whitman explains how he applies Net-Net in a 2006 letter (<http://www.thirdavenuefunds.com/taf/documents/shareholderletters/aboutus-letters-06Q1.pdf>).

Finally, we recommend you take a look at a recent letter Third Avenue sent not just to its mutual fund shareholders but also to its private investors to glimpse how Whitman and his band view the current market, which has pummeled their investments. Whitman observes: "As in times past, volatile markets present excellent buying opportunities for fundamental investors focused on the long term, enabling us to take advantage of market dislocations and plant seeds for future growth." (http://www.thirdavenuefunds.com/taf/documents/pdf/Letter_to_Investors_July2008.pdf). Year to date, the fund has underperformed its peers, and is off by 18.7%.

Sound Advice on Funds in the Portfolio

The WisdomTree Dividend Top 100 Fund (DTN—NYSE), an exchange-traded fund (ETF) differs fundamentally from our other holdings. Rather than relying on active managers to shape the portfolio, it hews strictly to an established index. The portfolio captures the highest yielding shares among the 300 largest cap dividend paying stocks in WisdomTree's most comprehensive dividend-based index. The fund rebalances its portfolio once each year in December. We compared SEC filings from September 2007 and March 2008.

The selection criteria are designed to gather undervalued stocks, since a high yield can be one indicator of an underpriced stock. If you are familiar with the "Dogs of the Dow" strategy, you understand this ETF's underlying dynamic. There are complementary criteria that shape the larger universe from which DTN selects, but yield is the most obvious.

When we introduced DTN back in 2006, the portfolio was heavy with utilities and banks, though its largest position was Southern Copper, which yielded then 8.3%. Today, with a yield of 9.14% Southern Copper is the second largest position in the portfolio with a value of \$3.6 million. Note that Southern's dividend distribution depends on each quarter's profits and cash flow. Should the copper market weaken or the company have extraordinary costs, the dividend would drop. The largest dollar position at \$5.3 million now is in American Capital Strategies (ACAS—Nasdaq), a Business Development Company, which means that like a REIT it is a pass-through corporation that must distribute 90% of its profits to shareholders. Lately the shares have been hammered by short sellers, apparently naked short sellers, and now stands at \$21.66. The current yield is an eye-popping 18.6%. However, the nature of being a BDC means that profits and thus dividends can change dramatically. Compared to most REITs, its income is much more volatile.

This yield-oriented portfolio homes in on the weakest sectors of the market, and forces shareholders to put money where they instinctively are reluctant to go. If we focus on the last SEC filing, we see a continuing progression toward financials (43.3% as of 3/31/08 vs 29.2% as of 9/31/07). Among subsectors within

finance, the biggest jumps were in banks, which went from 15.5% to 20.7% of the portfolio, and REITs, which leaped from 7.8% to 12.6%.

Such shifts in search of the highest yields and other complementary measures of value are to be expected when the market shows large volatility, whether up or down. Plummeting share prices for REITs, for example, have renewed our own interest in those assets, and banks have been particularly savaged but in most cases are maintaining their dividends.

As for electric utilities, the dominant sector earlier, DTN during 2007 showed an overweighting (20%) that after the December index restructuring had diminished to 13% as other, higher yielding stocks took precedence.

Compared to Dow Jones Select Dividend ETF (DVY—NYSE), another ETF that follows a cap-weighted index of high-yield shares DTN has outperformed, though both funds remain solidly in the red.

As opposed to these general funds, which by decision or model have shifted toward financials and real estate, we also own two other funds, one dedicated to REITs and

Each fund is making a similar strategic decision as it reshapes its portfolio in the face of a depressed market. Each has committed more funds to financial services stocks, and those funds already dedicated to financials have extended their exposure to mortgage-related companies.

one to financials.

The DWS RREEF Real Estate Fund (SRO—AMEX) portfolio has remained fairly stable between the end of 2007 and March 31, 2008, the last time SRO reported its holdings. Still, there has been some fine tuning within the major REIT subclasses.

Most notable was the jump in healthcare REITs, which increased as a percentage of the entire portfolio by nearly half to 17.5%. However, there is also an intriguing change in the portfolio that comes in response to turmoil among mortgage REITs, the sector most savaged by the conjoined housing and mortgage fiascoes.

Among the four healthcare positions from 2007 all were retained without any change in size, but during the three months for which we have data, two new positions were added: Cogdell Spencer and Medical Properties Trust. The former, which only recently became a publicly traded REIT, owns medical office buildings, out-patient surgical clinics and diagnostic centers primarily east of the Mississippi, and currently pays a 7.1% yield, while Medical Properties Trust owns a larger and more diverse portfolio scattered around

Sound Advice on Funds in the Portfolio

the United States. Its yield currently stands at 10.1%. Bumping up exposure to healthcare REITs, which offer above-average yields as well as being defensive in a weak economy is a reasonable tactic.

If healthcare represents caution, mortgage-backed securities represent risk and opportunity, which brings us to the most interesting change, a more than five-fold jump in what had been a 231,000 share position in Annaly Capital Management, a mortgage REIT to 1,221,000 shares. Everyone is aware of the turmoil surrounding mortgage-related securities, but only a few recognize the profit potential in any situation that has passed from being a concern to a panic. Annaly looks to be a survivor.

As a closed-end fund (CEF), SRO trades currently at an 8% discount from its Net Asset Value, which means that the market price per share nets you the income from a portfolio with a bigger net asset value. In addition, this CEF, like many other closed-end REIT funds, employs leverage, that is it borrows money through the sale of preferred sales, to magnify its returns. Shareholders net the difference between what the REIT portfolio yields and the rate SRO pays for its loans. Currently the fund borrows about 30% of its invested funds. The discount from NAV and the leverage result in a hefty 12.6% yield.

Icon Financial Fund (ICENX) stands between the pure managed funds like DODGX and ETFs like DTN that mechanically create their portfolios according to a model that is adjusted once each year. ICENX belongs to a family of mutual funds that depend on an investing model derived from the work of Benjamin Graham, the patron saint of value investing. Their is no discretion for the manager to stray from that model.

Unlike most value investors in search of companies whose shares are declining or are stagnant for an extended period, Icon looks for sectors that not only are undervalued according to its proprietary model but also are showing relative strength over the previous six months, that is, they are not in decline relative to the rest of the market. Icon believes that when sectors assert themselves, they will

remain relatively strong for up to two years.

Investors such as Whitman at Third Avenue or the Dodge & Cox crew are indifferent to relative performance. Indeed, they often find negative relative performance attractive. One consequence of Icon funds moving between sectors is a high level of portfolio turnover that is uncommon for most value-oriented funds, where a stoic strategy of buy-and-hold over five or six years is the norm.

For example, DODGX last year had a turnover rate of 27%, which historically is very high for a fund that averages closer to 10%, but as Dodge & Cox noted, the current market compels it to reshape its portfolio to take advantage of bargains. ICFSX, because it makes wholesale shifts when switching sectors, had a 93% turnover rate, which, though high for a traditional value fund, turns out to be modest among financial services funds, which average nearly twice Icon's rate.

With this fund, sector changes tell the story. Check the chart below comparing sector weights in September 31, 2007 and March 31, 2008, the last SEC filing for the portfolio. The largest dollar shifts occurred in the banking sector, which moved from 10.8% to 14.8% and regional banks, not a distinct sector in 2007, which now occupy 14.4% of the portfolio. Also of interest, especially given what we see happening at SRO and ICFSX, mortgage REITs, though still a small part of the fund more than tripled to 3.5%. Property & Casualty Insurers nearly

ICON FINANCIAL FUND SECTOR SHIFTS

	9-31-07	3/31/2008
Asset Management & Custody Banks	7.90%	9.40%
Consumer Finance	2.60%	7.70%
Data Processing & Outsourced Services	x	3.30%
Diversified Banks	10.80%	14.80%
Diversified Capital Markets	1.90%	x
Diversified Commercial & Professional Services	3.50%	x
Insurance Brokers	4.60%	x
Investment Banking & Brokerage	15.90%	5.20%
Life & Health Insurance	11.40%	7.20%
Mortgage Reits	1.00%	3.50%
Multi-Line Insurance	4.20%	1.50%
Other Diversified Financial Services	11.90%	12.50%
Property & Casualty Insurance	1.40%	8.20%
Publishing	2.50%	x
Real Estate Management & Development	x	0.90%
Regional Banks	x	14.40%
Reinsurance	11.60%	3.10%
Specialized Finance	4.30%	1.20%
Thriffs & Mortgage Insurance	2.80%	6.50%

Sound Advice on Funds in the Portfolio

sextupled.

When we look inside the sectors, we see Icon's model acts like a traditional value investor and favors strong balance sheets with low debt and high cash positions. Other less quantitative measures such as management experience, corporate governance, and strategic planning also figure in selection. However, Icon funds always rely on numbers, which Icon asserts removes emotion from portfolio construction.

2008 has not been, so far, a good year for financial services companies, and ICFSX since entering the portfolio in January is down 24%. Given what we see in how our other funds are moving into this shocked sector, we believe the Icon fund will more than make up for its lackluster performance.

Dodge & Cox International Stock Fund (DODFX) is down 13.1% this year, which puts it ahead of its peers (-15.2%). Still, over our four year holding period it has regularly provided excellent profits.

As with the Dodge & Cox Stock Fund, management takes a bottom-up approach to investing, buying what it deems undervalued regardless of any sector or macro theme. This almost guarantees a portfolio that diverges from the standard benchmarks.

In addition to a common investing approach, DODGX shares some critical holdings with its foreign sibling. DODGX can invest up to 20% of its funds in non-U.S. investments, and they follow DODFX's lead.

The fund with one exception during the first half of the year has continued to overweight against its benchmark, the MSCI EAFE (Europe, Asia, Far East) Index, the same sectors that had been overweighted in the last report: information technology, consumer discretionary and healthcare.

The only significant sector revision involved financial services stocks, which had been underweighted by 8% in the December 2007 portfolio but in the June 2008 report represent a 5% overweighting.

As management noted even in the December 2007 report to shareholders: "In our opinion, current valuations [for financial services and real estate] reflect significant pessimism about asset quality and the long-term earnings power of these companies and represent an interesting investment opportunity over the next three to five years."

As for how the portfolio is distributed globally, there also are variations from the MSCI index. Though Europe (about 80% of the MSCI) and Japan (about equal) remained constant between the end of last year and

June 30th, underweighting for the Pacific (ex Japan) and the United Kingdom both accelerated, bringing exposure down to 50% of the MSCI EAFE. DODFX makes up for this systematic lighter exposure to its benchmark by adding exposure not included in MSCI EAFE to Africa, Latin America and Canada as well as the U.S. A notable change in how the fund is managed came earlier this year when its managers decided to hedge their currency exposure, which implies they no longer believed the dollar would remain weak. This is the first time the fund has eliminated currency risk. DODGX remains unhedged for its foreign positions. As is true for all Dodge & Cox funds, the expense ratio is rock bottom at around 0.65%.

SUMMARY

It's hardly surprising that none of these six funds is in the black this year. Scan the *Morningstar* roster of fund categories. Aside from bear market funds only Real Estate funds are up on average 0.1%.

The most striking take-away from our review is that each fund is making a similar strategic decision as it reshapes its portfolio in the face of a depressed market. Each has committed more funds to financial services stocks, and those funds already dedicated to financials, ICFSX and SRO, have extended their exposure to mortgage-related companies.

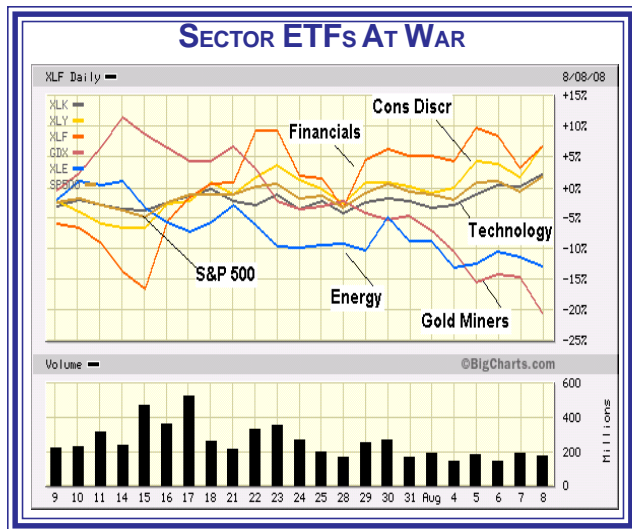
Even a fund that mimics a rigid value-oriented model, WisdomTree Dividend 100 Fund, is emphasizing financial stocks, which as their share prices eroded relentlessly have become high-yielding investments. This year we have been doing the same with our own portfolio, adding exposure to financial services and REITs, though we have little to show for that decision even if we remain comfortably ahead of the S&P 500.

Value managers are often caricatured as being cautious and risk averse, totally unlike swashbuckling, aggressive growth managers. Paradoxically it is the value managers, who are venturing into sectors such as financials and consumer discretionary stocks that growth funds have fled.

As for *Sound Advice*, we accept that you can't spend relative performance, and try to remember our favorite value mantra: you make your best profits in bear markets but you don't realize it at the time. We expect that each of these funds over time, not too long a time we hope, will validate that dictum. **SA**

Portfolio Updates

Between when we priced the July newsletter on 7/11 and this month's pricing on 8/8, the market has rallied strongly. The Dow added 5.7%, the S&P 4.6% and the Nasdaq 7.8%. The advance was hard fought. The S&P, for example, over those 20 trading days had 10 moves of 1% or more, and half of those were 2% or more. Bulls and bears confronted each other on sector battlefields: energy and natural resources, financials, consumer discretionary and technology.



The chart above shows how the battles raged, and stand on 8/8: ETFs for financials and consumer discretionary shares soared highest, technology matched the S&P 500. Energy, natural gas even more than oil, dropped significantly and gold miners were absolutely crushed. *Barron's* in its July 14th issue, just before the market turned in favor of financials, consumer discretionaries and tech, noted that over the previous 50 trading days, the market could not bounce-back after a previous day's drubbing. The depiction was depressing: every yardstick for consumer wealth, jobs, real estate, stock portfolio, access to credit was "heading in the wrong direction." Take your choice: the start of a bull market or a lunge higher in a bear market?

The unweighted *Sound Advice* portfolio added 5.3% and reflected the battle's extremes. Let's look at the largest moves.

Cintas, the July recommendation, chose July 15th to report higher than expected results for the second quarter, increasing profits and revenues for the 39th consecutive year. CTAS has responded sharply, adding 18.8%. Should the economy show any evidence of stabilizing, CTAS would have fuel to move much higher.

UnitedHealth, the June recommendation, had a less fortunate debut. It got slaughtered during its first month in the portfolio, plummeting 32%, which prompted calls to our subscription department. We noted in July "At the risk of sounding foolish, those valuations we touted last month as "too good to pass up" are even more tempting now..." UNH recaptured lost ground, adding 39.9%. What changed? Nothing obvious. Was it raw undervaluation, or perhaps recognition that fears over what the next administration and Congress might do to HMOs are being reconsidered? We're moving our Buy limit back to where it stood in the June issue at \$40.

Fastenal, which had been solidly in the black this year, extended itself further, adding 15.1%. The company continues to report more than acceptable results, and got a boost from the same winds filling Cintas' sails. If the U.S. economy is bottoming, then business should pick up for the construction, repair, and manufacturing customers FAST serves.

CarMax accelerated 24.4%, again without any compelling news as the market rushed to buy what had been battered. **Ford Convertible Preferred** regained its losses this month as consumer discretionaries surged, and closed down less than 1%. **Superior Industries**, which sells rims and wheels to Ford and other automakers, added 10.8%.

Mattel, which saw its share of the doll market decline as Bratz, a competitor's line, became the rage among little girls, has been up and down this year. The single biggest problem is the decline in U.S. sales of Barbie dolls, which once was a goldmine for Mattel, but became an also-ran to the cooler Bratz line. We noted in earlier issues that Mattel was suing MGA Entertainment, the producer of Bratz, claiming that the doll had been conceived by a Mattel employee who then moved to Bratz, and accordingly that MGA owed Mattel compensation not only for stealing its product but also the profits made from the Bratz line. A jury in Riverside, California agreed with Mattel, and though we don't yet know what the dollar award will be, we presume not only that it will be substantial but that it also will be appealed. MAT since the last letter is up 24.6%.

Whole Foods, however, had a rough month. First a federal appeals court reopened the Justice Department's case against the merger with Wild Oats, which already has been consummated. We don't think this will be undone. More serious was the quarterly results which showed WFMI's earnings due to charges flowing from the Wild Oats merger had dropped 31%, that it was

Sound Advice Portfolio for August 2008

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
DWS RREEF Real Estate Fund II	SRO	AMEX	\$12.05	14.64%	\$13.00	BUY
HRPT Properties	HRP	NYSE	\$7.78	10.80%	\$9.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$78.53	0.14%	\$100.00	BUY
Boston Scientific	BSX	NYSE	\$13.27	0.00%	\$16.00	BUY
Cintas	CTAS	NASDAQ	\$30.57	1.50%	\$35.00	BUY
Disney	DIS	NYSE	\$32.03	0.97%	\$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$40.00	6.90%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$115.29	15.54%	N/A	BUY
Fastenal	FAST	NASDAQ	\$50.60	0.91%	\$52.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$12.17	0.33%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$21.43	1.08%	N/A	BUY
Honeywell	HON	NYSE	\$51.32	1.95%	\$59.00	BUY
Insituform Technologies	INSU	NASDAQ	\$18.00	0.00%	\$21.00	BUY
Johnson & Johnson	JNJ	NYSE	\$71.55	2.32%	\$75.00	BUY
CarMax	KMX	NYSE	\$14.90	0.00%	\$18.00	BUY
Liberty Capital****	LCAPA	NASDAQ	\$15.89	0.00%	\$20.00	BUY
Mattel	MAT	NYSE	\$21.50	3.49%	\$25.00	BUY
Microsoft	MSFT	NASDAQ	\$28.13	1.56%	\$33.00	BUY
Molson Coors Brewing	TAP	NYSE	\$49.91	1.64%	\$62.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$9.13	0.00%	\$11.50	BUY
Sara Lee	SLE	NYSE	\$14.90	2.82%	\$19.00	BUY
Schering-Plough	SGP	NYSE	\$20.63	1.07%	\$28.00	BUY
Sony	SNE	NYSE	\$39.28	0.56%	\$50.00	BUY
Sprint Nextel	S	NYSE	\$8.72	1.15%	\$12.00	BUY
Superior Industries	SUP	NYSE	\$18.13	3.53%	\$24.00	BUY
Tetra Tech	TTEK	NASDAQ	\$28.74	0.00%	\$33.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$49.40	4.23%	N/A	BUY
United Parcel	UPS	NYSE	\$65.70	2.56%	\$70.00	BUY
UnitedHealth Group	UNH	NYSE	\$31.00	0.10%	\$40.00	BUY
Wal-Mart Stores	WMT	NYSE	\$57.86	1.16%	\$62.00	BUY
Whole Foods Markets	WFMI	NASDAQ	\$18.65	0.00%	\$25.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$47.41	4.31%	N/A	BUY
Xerox	XRX	NYSE	\$14.28	1.12%	\$19.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	\$25.90	4.36%	\$36.00	BUY
EnCana	ECA	NYSE/TSE	\$66.47	2.41%	\$98.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$30.95	31.61%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$49.83	3.37%	\$56.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$67.61	4.26%	\$87.00	BUY
Transocean	RIG	NYSE	\$127.16	24.45%***	\$140.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$27.78	9.54%	N/A	BUY
Aggressive Growth						
American International	AIG	NYSE	\$24.87	3.22%	\$30.00	BUY
Comcast	CMCSA	NASDAQ	\$21.72	1.14%	\$24.00	BUY
Discovery Holdings	DISCA	Nasdaq	\$20.64	0.00%	\$29.00	BUY
Ford Motor Convertible Pfrd.	F.PRS	NYSE	\$23.76	13.68%	\$30.00	BUY
Icon Financial Fund	ICFSX	800-764-0442	\$8.81	18.95%	N/A	BUY
Liberty Entertainment****	LMDIA	NASDAQ	\$25.85	0.00%	\$29.00	BUY
Liberty Global	LBTYA	NASDAQ	\$31.75	0.00%	\$35.00	BUY
Maxim Integrated	MXIM.PK	NASDAQ	\$20.65	1.89%	\$26.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$6.97	2.87%	N/A	BUY
Symantec	SYMC	NASDAQ	\$21.98	0.00%	\$25.00	BUY
Time Warner	TWX	NYSE	\$15.60	1.41%	\$20.00	BUY
Western Digital	WDC	NYSE	\$29.09	0.00%	\$41.00	BUY

*Prices as of the market close on Friday, August 8, 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 August 2008

slowing its store openings due to a weak economy, and that it was eliminating its 80 cent dividend. Just for good measure, it announced a recall for ground beef due to concerns over E.coli. The shares are down 10.8% since the last letter.

Our technology positions with one exception did well, outpacing the Nasdaq. **Microsoft**, now unburdened by concerns over what acquiring Yahoo! might mean for its shares, added 11.4%. **Symantec**, which came in higher than analysts anticipated, reported higher sales and margins in all of its businesses. Most important, the biggest increases were in its server and data management businesses that it acquired in the overpriced Veritas acquisition. You'll recall that we stepped into SYMC after the shares had been left for dead because of the despised Veritas deal. So far, so good.

Maxim, the chip maker, added 11.7%. Just before we closed the issue, management reported the highest sales in its history, up 4.2% over the previous year. As you recall, MXIM has been a pariah because of backdated options that required the company to restate several years of earnings. We are still waiting for MXIM to file these revised reports with the SEC, at which point, we expect, it will return from the Pink Sheet badlands to Nasdaq respectability. At that point, we also expect to get a pop out of the shares on route to sustained recovery and significantly higher share prices.

The exception is **Western Digital**, which reported good numbers but warned that the next quarter or two could show weaker comps than expected due to heavy inventories (a recurrent issue in the hard drive business), concerns over a slowing economy, and extraordinarily high revenues and profits in the 2007 period. We've had WDC in the portfolio nearly forever, and once it began to recover from a near-death experience back in 2001 has been on an uptrending roller-coaster that recently took it close to \$40. We've always said this is not a stock for people who want to sleep soundly, but each time it has dropped, we have encouraged those who care more about profits than sleep to open or add to their positions. It is no different this time.

Shifting over to the casualties, only one position in the natural resources portion of the portfolio had a good month, **Plum Creek Timber**, which added another 18.3%, and is approaching its all-time high after reporting higher-than-expected operating results and notching a big land sale. It doesn't hurt that the market has become less pessimistic about the economy and especially the housing sector, both of which have obvious significance for PCL.

Oil dropped 22% from its highs and closed last Friday at \$117 a barrel. At this rate, we are going to see whether our view can prevail that energy companies should still be rolling in revenue and profits were oil at \$100, and consequently that energy company shares are extraordinarily cheap again. **Icon Energy Fund** was down 10.3%, **Transocean** 12.3%, **Royal Dutch** 11.8%, **Anglo American** 10.9%, **EnCana** 19.9%, **Agrium** 22.6%, and **USAA Precious Metals & Minerals Fund** 24.8%. Whether the \$147 per barrel price was nothing more than an overheated market speaking is secondary to whether the 22% reversal is justified. We suspect it is not. We are hearing a lot about "demand destruction" due to slowing economies in the U.S., Europe and Asia, about a rebound in the dollar, and diminishing anxiety about inflation. Demand might be slowing, but that is a lull, not a long-term trend. Ditto for slowing economies. As for the dollar, we see no reason for persistent strength. Washington thanks to its spending binge of the last seven years and the first war in American history accompanied by tax cuts is now coping with an economy that probably is in recession, a credit market that is on life support and a dispirited population. The remedies will require spending more money that we do not have. Let the printing presses roll. We're still bullish about what has been savaged this month, and would be buyers.

Financials have been the recurrent disaster, but this month that turned around. **Icon Financial Fund** added 7.3%, but it was **American International Group**, the insurance behemoth, that epitomized the month. AIG since the last letter is up 7.8%, but on 8/7, the day it reported another huge writedown and its third consecutive losing quarter, the shares were in freefall, dropping 18.1%. Unnerving, especially given how beaten up the shares were even before that "correction." We're still recommending AIG but putting it into the Aggressive portion of the portfolio.

Finally, REITs again are snapping back. **HRPT Properties** in its quarterly conference call, though remaining cautious about the economy and leases, showed higher returns for the quarter. Leased space dropped slightly to 90.9%, but leases enjoyed a 9% higher rate. The report convinced the analyst whose sell recommendation after the previous quarter's numbers spearheaded a selloff to slap a buy rating on the shares. Since the last letter, factoring in the this month's dividend, the shares added 16.1%.

DWS RREEF Real Estate Fund II, which we discuss on page 4, added 16% as REITs followed financials higher this month. **SA**

Sound Advice Market Indicators for August 2008

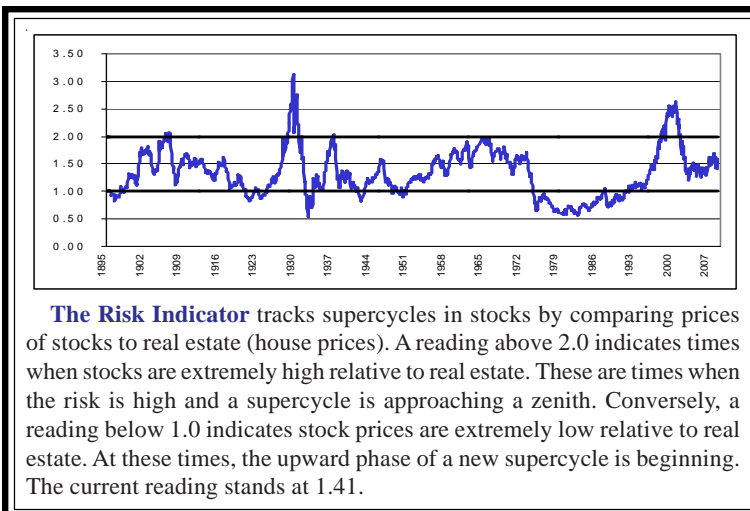
The Diffusion Index of Lagging Indicators gives “Caution” signals when all of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. Currently 38 percent of the indicators 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 30.2 percent, not counting dividends. On an annualized bases the gain was 15.8 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.

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**

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

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