

## The Shift to Value

Our *Sound Advice* Model Portfolio did very well in November. Our strongest gain of 39 percent came from oil refiner Valero (VLO). In second place was a gain of 36 percent from NCR, the leading provider of retail point of sale machines. In third place was a gain of 27 percent from our Hersha Hospitality preferred. JP Morgan climbed 20 percent. Our RTP preferred stock, whose company owns retail malls, rose 15 percent.

We saw extraordinary strength in industries that have been fallow most of the year, all of which are highly sensitive to a reopening of the economy, from oil refining to retail, banking, and hospitality. This new life was suddenly sparked by Pfizer's November announcement of the 90 percent efficacy in its phase 3 trials of its Covid-19 vaccine. Moderna announced even better results a week later, reinforcing expectations of a revival of the economy.

The vaccine news followed the presidential election. In the weeks leading up to the elections, markets were anticipating a "Blue Wave", when the polls were showing Democrats significantly ahead. With a blue sweep, Democrats would control both Houses. Chuck Schumer would become the majority leader of the Senate and set the agendas. This would facilitate pushing through the massive stimulus package sponsored by Nancy Pelosi, igniting a robust economic recovery, along with a resurgence of inflation, a falling dollar in the currency exchanges, and rising long term interest rates. The two Senatorial races in Georgia kept that from happening, at least for now because a majority was not reached for any of the Georgian candidates. Run-off races take place on January 5, 2021. Democratic victories in both would give Democrats 50 seats in the Senate, which would result in a majority along with a vote from the vice-president in a tie.

While the Blue Wave remains a possibility, the encouraging news on vaccines took over the market because it brings expectations of an economic recovery without the Blue Wave stimulus package. The difference was evidenced by the leap in stocks in industries that are too large to be artificially stimulated by government spending, and can only recover by a natural recovery, such as airlines, hospitality; even cruise lines and energy.

The *Sound Advice* Model Portfolio is well positioned for either a natural recovery sponsored by vaccines or a Blue Wave (or both). Holdings are value-oriented and economically sensitive, and will benefit strongly from economic vitality regardless of the reason.



Gray Cardiff, Editor

Investment returns in prior years have been calculated independently by the Hulbert Financial Group and concur with ours. From 2000 through 2019, the *Sound Advice* model portfolio averaged a 9.8% annual return versus 4.0% from the S&P 500.

### Still Cautious

Since wide distribution of a safe and durable vaccine is still many months away, and Covid-19 cases are soaring as we enter the winter months, the path to recovery is not likely to be smooth. While our portfolio presents a host of values, the rest of the market does not.

### Sound Advice Stock Market Indicators

The *Sound Advice Risk Indicator* (page 10) remains substantially above 2.0, revealing that the risk in the stock market is still historically high. Additionally, the *Sound Advice Diffusion Index of Lagging Indicators* (page 11) is still in caution mode.

### Another Steadfast Measure

In addition to the *Sound Advice* indicators, we can see that the market is substantially over-valued by traditional measures. The price/earnings (P/E) ratio is above 27 based on the trailing twelve-month (TTM) operating earnings of the S&P 500 companies. This is a very high P/E, which makes it a very high-risk time for most stocks.

As we note regularly, a reliable way to evaluate the S&P 500 index is to measure it against the "operating" earnings of the individual 500 stocks that make up the index.

We use *operating* earnings, which are cash earnings without special, non-cash charges included in so-called GAAP (generally accepted accounting principles) earnings which include non-cash write-offs such as depreciation, impairment charges because of falling commodity prices, or charges for bad loan reserves. Each quarter, companies report GAAP earnings, but they also report *operating* earnings which reflect actual cash results.

Most of the time, the trailing twelve-month (TTM) price/earnings (P/E) ratio based on *operating* earnings remains very stable. During the last recession, the P/E on the TTM operating

## Earnings Projections for the S&P 500

Quarter Ending	Quarterly Earnings	Actual/Projected	TTM Earnings	Value of the S&P 500 @TTM 18 P/E	Difference From the Current S&P 500
12/31/2019	39.18	Actual	157.12	2828	
3/31/2020	19.50	Actual	138.63	2495	
6/30/2020	26.79	Actual	125.28	2255	
9/30/2020	37.80	Actual	123.27	2219	
12/31/2020	36.53	Projected	120.62	2171	-40%
3/31/2021	37.45	Projected	138.57	2494	-31%
6/30/2021	40.06	Projected	151.84	2733	-25%
9/30/2021	37.84	Projected	157.62	2837	-22%

Earnings projections are by S&P Senior Index Analyst, Howard Silverblatt who publishes extensive data of the S&P 500 companies. See <https://us.spindices.com/documents/additional-material/sp-500-eps-est.xlsx>

earnings averaged 17.8 while staying within a narrow range, with a low of 17.09 and a high of 18.36.

Since the last 2008-09 recession, the P/E of the S&P 500 has averaged 18.03 based on the TTM operating earnings. To gauge a reasonable value for the market currently as well as a likely path of stock prices ahead, we can reasonably apply a P/E of 18 to the rolling TTM total of operating earnings. The operating earnings projections for the companies comprising the S&P 500 are shown in the table above.

It is worth noting that based on an average P/E of 18, the current downside risk for the S&P index is substantial. The TTM operating earnings of the companies that comprise the S&P 500 index are projected to decline to \$120.62 in the fourth quarter. At a P/E of 18, the S&P 500 index would be 2,171, which is 40 percent below today's level of 3,622.

By the third quarter of 2021, TTM operating earnings are projected to increase to \$157.62, very close to pre-Covid operating earnings recorded in the fourth quarter of 2019. Even assuming this projection is not optimistic, a P/E of 18 still puts the S&P 500 index 22 percent below today's level.

### Fading FANGMA Stocks

Most of the year, the market has been dominated by the "Stay at Home" stocks, as evidenced by the superior performance of the FANGMA stocks – Facebook, Amazon, Netflix, Google, Microsoft, and Apple. The heavy weighting of these 6 stocks in the S&P 500 pushed that index to new heights. Most portfolios have under-performed the S&P 500 index for this reason.

However, these stocks have become bloated and extremely over-valued. On average, these six FANGMA stocks are now sporting a TTM P/E above 60, which assumes a growth rate that is inconceivable to achieve. By conventional standards, a P/E of 30 is high and assumes a robust and uninterrupted growth rate. The FANGMA stocks are priced for perfection, which makes them highly

vulnerable. Any minor disappointments, which could include simply slower growth, are apt to cause serious downdrafts in these stock prices. After the encouraging news on vaccines, these stocks have stagnated as interest turned to better values.

## The Portfolio

All of the *Sound Advice* model portfolio recommendations are summarized in the table on page 9 and sorted by investment objective categories and then in alphabetical order. Our portfolio recommendations are made in accordance with our current cautionary mode.

### An ETF for Downside Protection

Because of the unusually high downside risk in the S&P 500, we are including the **ProShares UltraShort S&P 500 (SDS)** as a necessary holding in the *Sound Advice* model portfolio. This ETF essentially short-sells the market and will benefit from down-drafts in the S&P 500. It is designed to produce two times the daily fluctuations of the S&P 500 index. A decline of say, 1.0 percent in the S&P 500 will cause SDS to increase by 2.0 percent. Conversely, an increase in the S&P 500 will cause SDS to decline in the same fashion. We have been tracking SDS and confirmed that it is performing as it should, with daily premiums and discounts within 0.5 percent. It is also very liquid.

### Real Estate Stocks

Our three cumulative preferred stocks climbed substantially in November. They are inherently safe because any unpaid dividends must be retroactively restored first before any common dividends can be paid. Additionally, in the event of a liquidation of the company, these preferred stocks have a "Liquidation Preference" which must be paid out in full before any proceeds are paid to common stock-holders. In all three cases, these preferred stocks still are trading significantly below their respective Liquidation Preferences, offering a unique and solid opportunity.

There is substantial equity in the common stocks of all three companies, evidencing that the market does not expect liquidation to be plausible. Accordingly, these preferred stocks should be trading close to their liquidation values, but they are not.

These preferred stocks have a relatively small number of outstanding shares, so we recommend using limit orders rather than market orders.

**Hersha's Preferred D (HTPRD)** rose 27 percent in November. These preferred shares have a liquidation preference of \$25 per share but are trading close to \$19 per share. Evidently, the market does not consider liquidation likely because the price of common stock (HT) still reflects substantial equity. At the end of 2019, value of the company's properties provided equity to fund the \$25 Liquidation Preference with enough left over to provide equity of approximately \$24 for each share of common stock. Even if the properties were liquidated at 68 cents on the dollar, there would still be sufficient equity for the \$25 liquidation preference for the preferred shares. Since the pandemic started, Hersha has contracted to sell five hotels that are within 10 to 20 percent of pre-Covid-19 valuations.

Hersha has survived three recessions and it looks like it will again. During the third-quarter, the company reopened ten hotels, bringing the current open and operating hotel count to 37 of its 39 wholly-owned hotels, generating 36.2% occupancy, with 27 hotels breaking even. At the corporate level, a 55-60% occupancy at 45% RevPAR decline is needed to include interest expense and administrative costs. Earlier this year, the company negotiated a suspension on its debt covenants until the end of June 2021.

The open New York City hotels generated 40 percent occupancy with demand driven by professional sports teams, elective healthcare patients, media business, government group business, and the first signs of corporate travel. Hersha's properties break even at 35-40% occupancy with revenue per average room RevPAR at a 65 percent decline from pre-Covid levels. It is estimated from industry analysts that 20% of New York's total room count (approximately 25,000) will be permanently closed. As demand returns, increased hotel closures, combined with the shrinking construction financing market and higher costs to build in the city, will alleviate the rate headwinds that New York City hotels have been facing over the past several years.

To conserve liquidity, the company suspended dividends for preferred and common stocks. All unpaid preferred dividends must be restored before dividends on the common stock can be resumed. The preferred dividends in 2019 amounted to 26 percent of the company's funds for operations (FFO), which means that it will be relatively easy to restore the preferred stock dividends prior to the resumption of common stock dividends.

The resumption and payment of dividends of \$1.64 per share (annually) on the preferred D would provide above an

8.9 percent current annual yield based on today's stock price. In addition, just the prospect of a resumption of the dividend would propel a steep recovery in the price of the stock back to its Liquidation Preference value of \$25. This would mean a 35 percent profit.

**RLJ's \$1.95 Series A Cumulative Convertible Preferred (RLJPRA)** rose by 10 percent in November. This preferred stock is also presenting an exceptional value. This is the only RLJ preferred stock and the dividend in 2019 amounted to only 6.8 percent of the company's FFO.

This preferred stock has a Liquidation Preference of \$28.50 per share. Because this preferred stock is a small portion of the company's capitalization, the value of the company's real estate portfolio would have to drop to 27 cents on the dollar from its 2019 value before the full liquidation preference of this preferred stock would be jeopardized. The market does not think that will happen because the common stock is reflecting substantial equity. A rise to the liquidation value would provide a 24 percent profit.

The Company reopened 27 hotels during the third quarter, bringing the total of the Company's open hotels to 96 which is 93 percent of the total portfolio of 103.

Although RLJ reduced its dividend on the common stock to enhance liquidity, it is continuing to pay the dividend on the preferred stock at the annual rate of \$1.95 per share, providing a current yield of 7.8 percent. If any dividends are suspended on this preferred stock, they would have to be made up before any dividends on the common stock could be paid. However, a suspension of the preferred dividend appears extremely unlikely.

**RPT Realty 7.25% Series D Cumulative Convertible Perpetual Preferred (RPTPRD)** rose 15 percent in November. This preferred stock pays an annual dividend of \$3.62, which is a yield of 7.6 percent. This is the only RPT preferred stock for RPT Realty. This is a convertible preferred stock, convertible into 3.7758 shares of the common stock (RPT).

To preserve liquidity, RPT suspended the dividend on the common stock, but is maintaining the dividend on its preferred stock. The preferred dividend only absorbed 6.6 percent of the company's funds from operations (FFO) in 2019, which means it is relatively secure.

This preferred stock has a Liquidation Preference of \$50 per share which was well-covered at the company's 2019 property values. Because this preferred stock is a small portion of the company's capitalization, the value of the company's real estate portfolio would have to drop to 36 cents on the dollar from its 2019 value for the full Liquidation Preference to be jeopardized.

As in the cases of our other preferred selections, evidently the market does not think that will happen because the common stock is reflecting significant equity, which implies that the preferred stock is worth its full liquidation preference value of \$50. A rise to \$50 would provide a profit of 25 percent.

RPT Realty is a real estate investment trust (REIT) that owns 49 shopping centers across the eastern US, consisting of urban-infill neighborhoods, and power center properties with national chain store tenants, market-leading supermarket tenants, as well as a strong lineup of smaller national retailers.

RPT saw a rebound in leasing during the third quarter by leasing 103 thousand square feet with credit tenants including Nike, Sephora, Burlington and Bank of America. At the end of the quarter, 94% of stores were open and operating, up from the low of 41% in April. Ninety percent of rent and recovery income had been paid by collecting 89% of second quarter 2020 rent and 94% of third quarter rent.

**Third Avenue Real Estate Value Investor Fund (TVRVX)** climbed 15 percent in November. Management has a similar approach to ours because it is very price conscious, especially in relation to net asset value. Just as we do at *Sound Advice*, they eat their own cooking – they invest a substantial amount of their personal assets into their funds.

TVRVX has an advantage over other mutual funds during recessions. Unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities. It is a global real estate fund which means it is not confined to US real estate with low cap rates which translate to high valuations. Management looks for growth more than current income by focusing on real estate operating companies which, unlike REITs, can reinvest profits back into the business. Management also searches for opportunities in different aspects of a real estate company's capital structure by investing in senior debt in addition to equity.

### Medically-Related Selections

Both of our selections make medical devices and products which are well-suited for an aging population. They have both been negatively impacted by deferrals of elective surgical procedures during the COVID-19 pandemic. However, these deferrals have built up a pent-up demand because most of these procedures are essential and need to be performed sooner or later to treat debilitating, painful, and sometimes life-threatening conditions.

**Boston Scientific (BSX)** remained essentially unchanged in November. Shares were under pressure in November because of the delay in launching two of its transcatheter aortic valve replacement (TAVR) clinical programs. However, the company has a pipeline of products with growth progress across the board.

This company has been a global medical technology leader for three decades by providing a range of high-performance solutions aimed at addressing medical needs and reducing healthcare costs in a wide range of critical areas, including cardiac rhythm and intervention, oncology, urology, and neuromodulation. The company's stream of new inventions acquisitions continues to add to promising growth prospects.

The company recently had a comprehensive investor presentation in which it updated all of its products and progress which is too extensive to review here. To see the massive array of the company's products and treatments, go to the company's website, [bostonscientific.com](http://bostonscientific.com) and then to "Past Events" and click on the Investor Update at TCT 2020.

**Stryker (SYK)** rose by 15 percent in November. The company reported strong earnings at the end of October despite postponements of medical procedures and restrictions imposed to slow the Covid spread. The company had increases across the board, from overall sales revenue, organic sales revenue, operating income, and operating earnings which were up 12 percent.

Stryker provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products. Its orthopaedic devices for artificial knees and hips lead the industry. SYK has a very high return on equity which is propelled by its strong balance sheet and its ability to make strategic acquisitions.

### The Best in Biotech ETFs

Biotech companies offer the most explosive profits because they are the source of the world's top breakthrough drugs. Their stocks are often volatile, making diversification essential. This can be accomplished by investing in a diversified electronically traded fund (ETF) investing exclusively in a portfolio of biotech companies.

We are recommending two top performers. Both of our selections have been strong and surpassed previous peak prices reached earlier this year; before the Coronavirus pandemic arrived. This relative strength underscores the vitality of the industry and these selections.

**ARK Genomic Revolution Multi-Sector (ARKG)** climbed 24 percent in November. This is an actively managed biotech ETF investing in companies expected to benefit by incorporating technological and scientific developments and advancements stemming from mapping the human genome. Breakthroughs and advancements have cut the cost substantially of mapping the human genome which is opening new opportunities and putting this sector on the cutting edge of new innovations. ARKG has been our stellar performer,

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delivering a 144 percent profit in 2020.

**Virtus LifeSci Biotech Products (BBP)** rose 7 percent in November. This is a passively managed biotech ETF that weighs the portfolio selections essentially equally, as opposed to the more typical practice of weighing selections according to market capitalization. This is an important aspect because biotech ETFs who weigh their portfolio selections essentially equally have been the best performers by far because they have larger investments in smaller biotechnology companies which are acquisition targets for large pharmaceutical companies looking for ways to revitalize their drug portfolios by scooping up smaller companies.

### Small Caps

Small caps and this fund are bound to continue to benefit from a shift to value as investors look for undiscovered bargains. Small caps are relatively small companies that are pure plays on the early stages of new industries and inventions. They have more dynamic and entrepreneurial management, and they are much more likely to be the target of an acquisition or merger, which is usually quite profitable. Numerous studies show that small caps perform better over the long run than the market as a whole.

**Third Avenue Small-Cap Value Investor Fund (TVSVX)** rose 15 percent in November. This fund invests in companies with small capitalizations using the same value-oriented approach as it does with its real estate value fund (TVRVX). Management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value, and the ability to consistently grow NAV, with an initial targeted holding period of three to five years. A patient and price conscious acquisition is a critical first step in both protecting capital and in realizing an attractive investment return.

### ETFs for Rising Bond Yields

Our ETFs for rising bond yields jumped substantially on the initial favorable vaccine news in November. They settled back on the news of continued increases in Covid-19 cases and the fears of the near-term damage that the US and the rest of the world may suffer during the winter months. However, the jump on the favorable vaccine news is encouraging evidence that these ETFs are bound to be profitable over the longer term.

Since the beginning of this year, the money supply has increased by 43 percent. For centuries there has been an undeniably strong correlation between changes in the money supply and changes in the inflation rate in developed countries. According to the widely held correlation, this money supply growth should bake in a corresponding increase in inflation. This correlation is based on the fact that the velocity of money remains relatively stable, which is the case most of the time historically. However when changes occur, they are important because the rate at

which money flows is as important as the quantity of it.

The velocity of money is defined as the frequency at which one unit of currency is used to purchase goods and services within a given period of time. The velocity of the money supply is reported quarterly and is expressed as a ratio of the total money supply. Until 2020, the quarterly velocity of money has been steady at close to 5.5, meaning that the money supply is normally used 5.5 times during a typical quarter. However, the velocity has dropped this year substantially. The third quarter has yet to be reported, but during the second quarter, the velocity dropped to 3.87, which was a substantial drop from the historical norm.

This drop revealed a sharp change in spending patterns. Instead of spending at the usual rate, people held on to more cash. This is understandable under the specter of the pandemic and its impact on the economy. The recent slowdown in velocity is also consistent with past recessions when velocity has slowed markedly. However, as the economy recovers and confidence returns, consumer spending will increase, which accounts for 70 percent of GDP. The velocity of money is bound to return to normal levels. As a result, the increased money supply will begin turning over more rapidly, pushing up inflation.

### Three Choices

The prospects of increasing inflation means that bond yields will rise from today's historically low yields. We recently added ETFs to the portfolio that will benefit from rising long-term Treasury bond yields. We have had these ETFs in the portfolio previously but abandoned them earlier this year when it became clear that the breakout of COVID-19 was going to deflate the economy. However, the subsequent increase in the money supply and ultimate increase in money velocity makes these investments viable again.

The three choices differ in the amount of leverage used. You can choose among them depending on your investment objectives and risk tolerance.

The **Direxion Daily 20 Plus Year Bear 3 Shares (TMV)** uses 3:1 leverage.

The **Proshares UltraShort Lehman 20 Plus Year Treasury (TBT)** uses 2:1 leverage.

The **Proshares Short 20 Plus Year Treasury (TBF)** uses no leverage.

The price action of these ETFs is based on the changes in long-term Treasury bond indexes, only in the opposite direction, and then multiplied by the leverage each ETF uses. For example, a decline of say, 1.0 percent in their respective benchmark bond indexes will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent.

We can see from the following table that historically since 1980, investors have demanded a real return of 3.1% on long-term treasury bonds. That means 30-year treasury bonds should be yielding close to 5 percent with an inflation rate in the vicinity of 2 percent.

**Historical Real Rates of Return**

Years	30 Yr Note (Avg. Yield)	CPI Annual Increase	Real Rate
1980-84	12.0	7.6	4.4
1985-89	8.4	3.6	4.8
1990-94	7.7	3.7	4.0
1995-99	6.3	2.4	3.9
2000-04	5.7	2.6	3.1
2005-09	4.5	2.6	1.9
2010-14	3.6	2.0	1.6
2015-18	2.9	1.9	0.9
Average			3.1

If we only look at recent history, since 2000, which has been a low inflationary period, investors have demanded a lower real return of 1.9 percent. This would still put the yield on long-term treasury bond yields close to 4 percent with an inflation rate in the vicinity of Federal Reserve’s target of 2 percent.

The table below shows the approximate upside potential of our selected ETFs at the end of 2021 at various long-term Treasury bond yields. The first row shows today’s ETF prices at today’s long-term Treasury bond yields. Note that the approximate price of these ETFs would rise dramatically as Treasury bond yields rise.

Target Date	Bond Yields	ETF Prices		
		TBF	TBT	TMV
11/30/2020	1.57	15.59	16.10	52.21
12/31/2021	2.00	16.87	18.39	60.32
12/31/2021	3.00	19.20	23.22	83.82
12/31/2021	4.00	21.08	27.11	102.70

With long-term bond yields bouncing off historic lows, the downside of these ETFs is limited and the upside potential is significant, which provides an attractive reward/risk ratio.

**The Erosion Factor**

These ETFs suffer from erosion because they decline slightly faster than they increase with an equivalent change in bond yields, particularly with higher leverage. To gauge this factor, we can assume that Treasury bond yields simply tread water, rising and falling by an unusually large amount, say, 0.03 percentage points (3 basis points) every day, and thus go nowhere. By the end of 2021, TMV would decline by 5.0 percent, TBT by 2.3 percent, and TBF by 0.6 percent. While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

**Special Situations**

The rest of our portfolio falls into other market sectors, with companies that are presenting extraordinary values within their respective industries. Here they are in alphabetical order:

**Apple (AAPL)** rose 10 percent in November. The company has \$191.83 billion in cash in its company’s coffers. Although that is down by \$14 billion from one year ago, it still amounts to \$10.70 per share. However, subtracting this cash from today’s stock price still does not make it a good long-term value currently. The stock price needs to retreat from peak levels to make AAPL a value proposition. Our buying target remains \$100 per share.

**Intel (INTC)** rose 9 percent in November. Intel has the size, diversity, industry dominance, and financial health to make a relatively safe investment in a high-growth, and often high-risk business. Intel can leverage new technology into its existing large platform without introducing unacceptable risks.

As we have been pointing out in recent issues, Intel is developing a key role in providing infrastructure for 5G networks. The company recently added 18 new products in this segment. These are bound to be vital for the 6 million 5G base stations forecasted to be in place by 2024. Estimations are that Intel will capture 40 percent of this market by the end of 2021.

The company expects its earnings to be \$4.90 for 2020. Based on that guidance, the stock is trading close to a P/E ratio of 10. Such a low P/E is normally reserved for companies with poor growth prospects and weak balance sheets. Nothing could be further from the case with Intel.

In November, CEO Bob Swan posted an open letter to President-elect Biden, which calls for increasing U.S. semiconductor manufacturing.

*“Your planned investment in American-made goods is critical to U.S. innovation and technology leadership. According to the Semiconductor Industry Association, the US accounts for just 12% of global semiconductor production capacity, with more than 80% taking place in Asia. Rising costs and foreign government subsidies to national champions are a significant disadvantage for US semiconductor companies that make substantial capital investments domestically. A national manufacturing strategy, including investment by the US government in the domestic semiconductor industry, is critical to ensure American companies compete on a level playing field and lead the next generation of innovative technology.”*

**International Business Machines (IBM)** rose 11 percent in November. IBM announced in mid-November a definitive agreement to acquire [Instana](#), an application performance monitoring company. Instana’s enterprise observability platform automatically builds a deep contextual understanding of cloud applications and provides actionable insights to indicate how to best prevent and remedy IT issues that could damage the business or reduce customer satisfaction -- such as slow response times, services that aren’t working or infrastructure that is down. The acquisition further advances IBM’s Hybrid Cloud and Artificial Intelligence (AI) strategy and strengthens its AI-powered automation capabilities.

When AI-infused automation is applied to business processes and IT operations, it can help shorten the time

between identifying an issue and responding. This is critical as unforeseen IT incidents and outages, for example, can cost businesses in both revenue and reputation.

Once Instana’s capabilities are integrated into IBM, customers will be able to feed these insights into its super-computer it calls “Watson”, which can “think” like a human. The information could then be compared to a baseline of a normal operating application, with AI triggering alerts to resolve issues quickly before negative impacts to that transaction or activity. This can help eliminate the need for IT staff to manually monitor and manage applications, freeing these employees to focus on innovation and higher value work.

IBM is priced for little or no growth. Any positive developments will bode well for capital gains. IBM has been showing strong growth from its Cloud and Cognitive Software segment, offering technology consulting services to customers modernizing legacy cloud services to work on scalable public platforms, including IBM Cloud, Amazon AWS, Microsoft Azure, Google Cloud, and even Alibaba. The hybrid cloud market is expected to grow by at least 20 percent annually for the foreseeable future. The financial strength of the company makes the per share \$6.52 dividend solid, for more than a 5 percent yield.

**Invesco S&P 500 Equal Weight Consumer Staples ETF (ticker symbol: RHS)** rose 9 percent in November. RHS is unique because it invests equal amounts in a collection of 33 consumer staple stocks within the S&P 500 index and rebalances the investments at the beginning of each calendar quarter. This practice has given RHS a superior performance because it gives investors exposure to many consumer staple stocks that are under-weighted in most portfolios, making them targets for new investment capital. The current portfolio is shown in the table.

Consumer staples are those unexciting products we use every day without much thought, ranging from food, beverages (including alcohol), household goods (including cleaning supplies), hygiene products, and tobacco. These are products that people are unable (or unwilling) to remove from their budgets regardless of their financial situation. The nature of these products makes this sector defensive and much less vulnerable to recessions and bear markets.

**JP Morgan Chase (JPM)** came back to life in November. Although it jumped 20 percent, it is still substantially below its peak levels and is presenting a compelling value. In 2020, JPM has taken substantial (GAAP) loan loss charges in the first three quarters to account for potential future losses. This means that future negative events have been largely accounted for, making future results more likely to be positive.

Over the longer term, JPM will benefit strongly from a recovery because today’s relatively flat yield curve traditionally becomes steep, widening the cost of borrowing, which is based on short-term interest rates (deposits & CDs), and the income from lending which is based on long-term interest rates.

## Invesco (RHS) Portfolio of Consumer Staples

Company Name	Weight %
Church & Dwight Co Inc	3.34
McCormick & Co Inc Non-Voting	3.34
Walmart Inc	3.23
Conagra Brands Inc	3.23
Clorox Co	3.18
Monster Beverage Corp	3.18
Costco Wholesale Corp	3.15
The Kraft Heinz Co	3.15
Procter & Gamble Co	3.13
The Kroger Co	3.12
Philip Morris International Inc	3.09
General Mills Inc	3.08
Mondelez International	3.08
The Hershey Co	3.07
Hormel Foods Corp	3.07
Coca-Cola Co	3.06
Kimberly-Clark Corp	3.05
Kellogg Co	3.04
Altria Group Inc	3.04
PepsiCo Inc	3.03
Constellation Brands Inc A	3.02
Lamb Weston Holdings Inc	3.02
Campbell Soup Co	3.01
Archer-Daniels Midland Co	2.99
Brown-Forman Corp Class B	2.97
JM Smucker Co	2.95
The Estee Lauder Companies	2.93
Sysco Corp	2.92
Colgate-Palmolive Co	2.92
Walgreens Boots Alliance Inc	2.82
Tyson Foods Inc Class A	2.78
Molson Coors Beverage Co B	2.70
Coty Inc Class A	2.42

**NCR Corp (NCR)** climbed 36 percent in November. Strong earnings and the encouraging vaccine news put NCR in the spotlight.

NCR makes automatic tellers (ATMs), retail point-of-sale (POS) workstations, self-service kiosks, and other self-service checkout systems. Prior to the Covid pandemic, 485 million people used NCR products every day. The crisis scared shoppers as well as stockholders. We have been saying that there is room for substantial growth for NCR in the US and around the world when the crisis passes. Last year, NCR earned \$3.54 per share. Based on those normalized earnings, the current price of this stock is incredibly cheap. The Trailing 12 month earnings are now \$3.39. Even with November’s rise, the stock is still cheap with a P/E under 10.

**Valero Energy (VLO)** jumped 30 percent on the Monday when Pfizer announced its 90% efficacy results from its phase 3 trials. An end to the pandemic means increasing demand for refined fuels in the foreseeable future, especially for airplanes and autos as travel picks up. VLO rose 39 percent during November.

The company has been maintaining the dividend which annualizes for \$3.92. Management has been maintaining the dividend because it believed that demand was bound to improve in the near future. Even after the extraordinary jump this month in the stock price, the yield is still 6.9 percent.

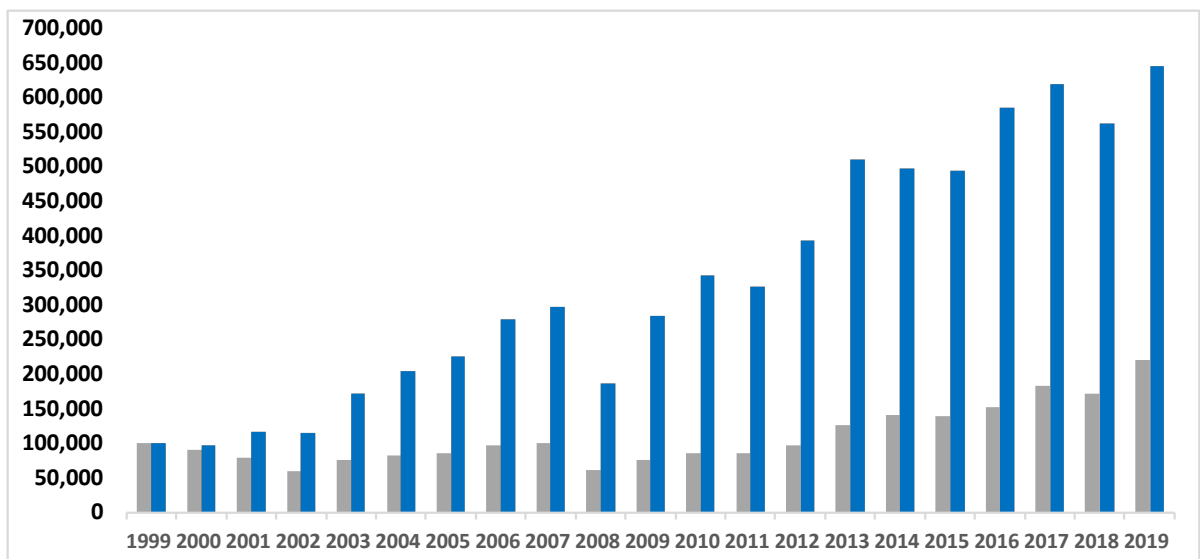
Valero’s long-term viability is enhanced by its joint-venture partner with Diamond Green Diesel, which is producing renewable diesel at large profitable margins even during the COVID-19 pandemic. Renewable diesel is made from animal or plant waste material which reduces greenhouse gas emissions up to 80 percent because it only releases as much carbon dioxide that the material originally contained. Renewable diesel does not gel at low temperatures which means it can be easily transported through pipelines. Use for sustainable aviation fuel is expected to be a primary escalating demand factor.

Meanwhile, Valero has the flexibility to refine substantial quantities of a variety of crude oil types. The company also has access to the US pipeline network for delivery to its gulf coast locations. This flexibility and access allows Valero to capture the highest margins among its competitors because it can take advantage of the temporary local gluts of crude, whether it’s low or high-quality crude, or light sweet (low sulfur) or heavy sour (high sulfur), and receive the best discounts for its feedstocks.

Low oil prices add profits to petroleum-based products because profits come from the “crack-spread”, the difference between the cost of oil as a feedstock and the price of refined products, predominantly gasoline and jet fuel. A lid is bound to be kept on oil prices for the foreseeable future as major oil producers compete for portions of the petroleum market, including OPEC nations, Russia, and US frackers.

### Sound Advice versus the S&P 500

This chart shows the growth of \$100,000 invested in the S&P 500 (in gray), which would have grown to \$219,925, versus \$643,554 if it was invested in the *Sound Advice* recommendations (in blue).



## Portfolio Summary Table

This table is updated and live on our website:

www.soundadvice-newsletter.com

Income with Growth	Symbol	Price / NAV	Yield	Action	Limit
Hersha Hospitality Trust - Preferred D *	HTPRD	\$18.82	0.00%	BUY	\$21.00
International Business Machines	IBM	\$123.52	5.28%	BUY	\$129.70
RLJ Lodging Trust - Preferred A *	RLJPRA	\$24.61	7.92%	BUY	\$26.00
RPT Realty 7.25% Preferred D *	RPTPRD	\$47.12	7.69%	BUY	\$50.00
Valero	VLO	\$53.77	7.29%	BUY	\$56.46
Growth with Moderate Income					
Intel	INTC	\$48.47	2.72%	BUY	\$50.89
Invesco Consumer Staples ETF	RHS	\$149.86	2.12%	BUY	\$157.35
JP Morgan Chase	JPM	\$117.88	3.05%	BUY	\$123.77
Growth					
Apple	AAPL	\$119.53	0.69%	HOLD	\$100.00
Boston Scientific	BSX	\$33.15	0.00%	BUY	\$34.81
Genomic Revolution Multi-Sector	ARKG	\$81.70	0.00%	BUY	\$85.79
NCR Corp	NCR	\$27.67	0.00%	BUY	\$29.05
Stryker Corp	SYK	\$233.33	0.99%	BUY	\$245.00
Third Avenue Real Estate Value Investor *	TVRVX	\$22.80	0.00%	BUY	\$23.00
Third Avenue Small-Cap Value Investor Fund *	TVSVX	\$17.27	0.00%	BUY	\$17.00
Virtus LifeSci Biotech Products	BBP	\$51.58	0.00%	BUY	\$54.16
ETFs for Rising Bond Yields					
Direxion Daily 20+Treasury Bear Shares 3X Leverage	TMV	\$52.21	0.00%	BUY	\$54.82
Proshares Short 20+Treasury - 2X Leverage	TBT	\$16.10	0.00%	BUY	\$16.91
Proshares Short 20+Treasury - No Leverage	TBF	\$15.59	0.00%	BUY	\$16.37
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	\$13.37	0.00%	BUY	\$14.04

**Notes to the table:** The right hand column is the highest recommended price limit for purchases.

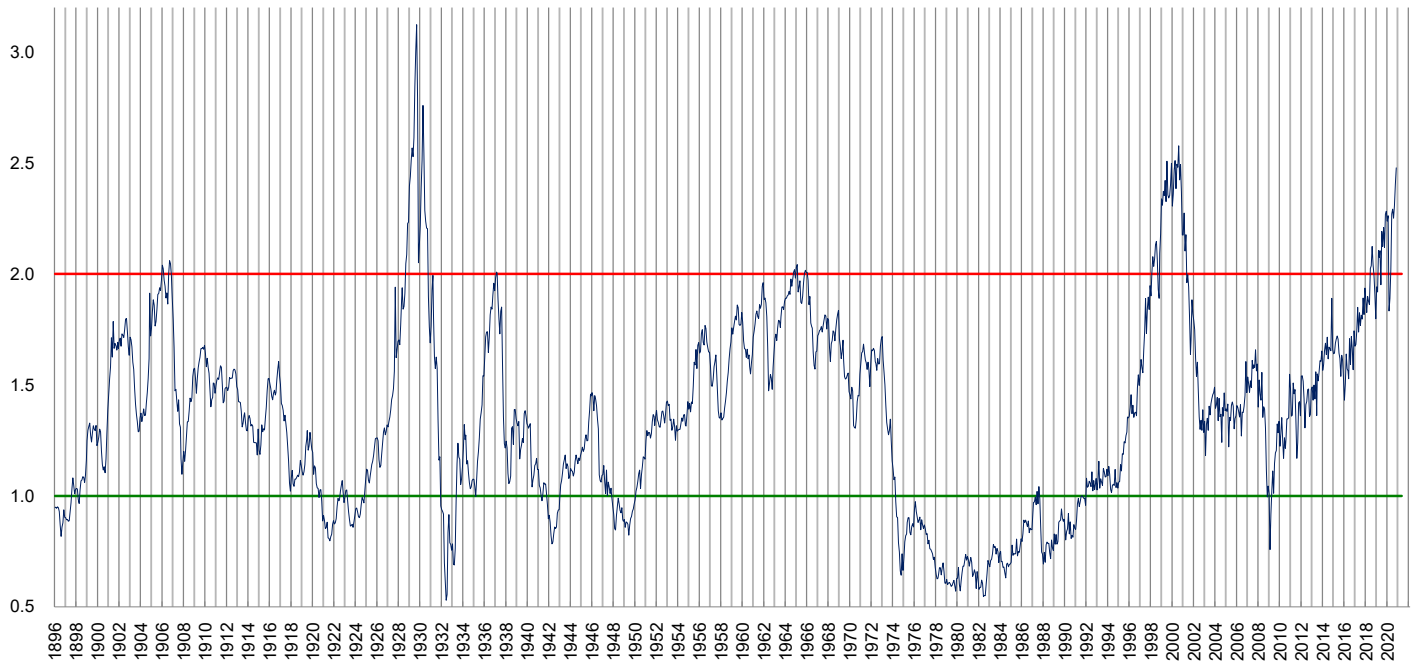
\* It is not possible to offer live pricing.

**General Comments:** Our statistics are based on the assumption that \$10,000 is invested in each position. When a new position is added, we assume the same \$10,000 amount is invested in the new recommendation. When we recommend adding to a particular position, as we have done over the years, we assume another \$10,000 is invested again in that position.

If you are picking and choosing, you can focus on the sector of the portfolio that matches your investment objectives. Alternatively, you may have a higher degree of comfort with certain industries, funds, or stocks because of past experience or your profession. In that case, you may want to invest more heavily in one sector, or in one or more individual recommendations.

As always, broad diversification will temper volatility, add to safety, and improve long-term performance.

## 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 120+ 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 based on the ratio of the S&P 500 Stock Index to median price of new houses 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 label this new tool the **Sound Advice** "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 under performing the other market.

What is too high? When stock prices are very high

relative to house prices, the **Sound Advice** 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 **Sound Advice** 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.

But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing, had an investor followed the signals of the **Sound Advice** Risk Indicator, he or she would have made \$567 million, or 26.5 times more money than by simply holding stocks though the ups and downs.

A brief walk through history shows just how reliable this indicator is. The first recorded time the Risk Indicator rose above 2.0 was in February 1906, after the eight-year-old Dow-Jones average doubled since 1903. The market peaked in September of 1906. A massive sell-off in October would later be labeled the Panic of 1907. Stock prices trended downward for 14 more years until the end of 1921 while, searing inflation after World War I boosted house prices 48 percent. The combination of falling stock prices and rising real estate prices forced the Risk Indicator to fall below 1.0 in 1920, just in time for the Roaring 20's when stock prices tripled. Then, in October 1928, the Risk Indicator rose above 2.0 again. On Tuesday, September 3, 1929,

**The New York Times**

*"Cardiff's equation reveals an elegant financial minuet as each market takes turns outperforming the other."*

the Dow peaked at 318.17. The October crash marked the beginning of a decline that lasted until July 8, 1932. Houses had declined only by 15 percent compared with the 85 percent loss in stocks. The relative superior performance of houses caused our Risk Indicator to fall below 1.0 at the beginning of 1932.

As America's GNP began posting positive gains and with 46 percent growth in three short years, stock prices would triple. Then the Risk Indicator crossed 2.0 in March 1937. This time, the signal came only one month after the zenith in stock prices. As stock prices retreated 50 percent, house prices remained relatively steady, causing the Risk Indicator to fall below 1.0 again in June 1941, within 9 months from the bottom.

As U.S. corporations expanded to meet growing demand, and the economy came to a rolling boil during the Eisenhower years, the stately rise would multiply stock prices by ten times until November 1964, when the Risk Indicator crossed over 2.0 again. The stock market would continue to climb into 1968, and then crashed into late 1974, wiping out the inflation-adjusted gains scored by investors since 1954. However, a switch to an investment in houses would avoid all that and double in price by the time the next signal came for stocks in May 1974, as the Risk Indicator fell below 1.0 again, as the Dow careened below 700.

It would not be until March 1998 when the Risk Indicator would cross 2.0 again, after stocks were up by more than tenfold. The Dot-Com bubble would push stocks higher into early 2000, but then began another 50 percent retracement. A switch to houses would produce a 44 percent gain through the end of 2008 while stock prices were lower by 17 percent. In February 2009, with the Dow careening below 700 once again, the Risk Indicator quietly dropped below 1.0 to 0.77 as the S&P tumbled under 700. Since then, the stock market has delivered stunning gains as the S&P 500 has quadrupled. For the sixth time in the last 125 years, the Risk Indicator rose above 2.0 again in July 2018. The Risk Indicator remained above 2.0 through the high-point of the market in February 2020.

**With the latest median house price at \$331,600 in September (the latest data) and with the S&P 500 at 3621, the *Sound Advice* Risk Indicator reads 2.48, revealing the risk in stocks is very high.**

As remarkable as the *Sound Advice* Risk Indicator has been, it does not pinpoint the exact time. In the past 125 years, its signal has ranged from being only one month after the zenith to as much as four years early. While the Risk Indicator has been early, it has never been wrong. An expensive crash was inevitable. This time, the signal was 8 months prior to the peak.

To help us narrow down the timing as well as gage the potential severity of an upcoming decline, we have our Diffusion Indexes.

## Business Cycles and Stocks: The **SoundAdvice** Diffusion Indexes

### Track Record of the **SoundAdvice** Diffusion Indexes

After each "Aggressive" signal, the S&P 500 climbed an average of 30.8 percent. During "Caution" signals, the S&P 500 either crashed, meandered, or climbed, recording an average increase of 4.2 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Mar-15	2,080.0	May-15	2,111.9
Sep-17	2,492.8	Jan-18	2,823.8
Ave +/-	30.8%		5.5%

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 **Sound Advice** Diffusion Indexes, we observe changes in each of our selected indicators over a six-month period, and take the percentage of those increasing.

When the **Sound Advice 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 soft economy is providing an atmosphere for stable or declining interest rates.

This Diffusion Index gave us a zero reading in April, 2009, close to the bottom, officially giving us an "Aggressive" signal. That signal came at a time when the Risk Indicator was below 1.0, which revealed that Supercycle 5 came to an end, and that Supercycle 6 was born.

The **Sound Advice 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. This reading reveals that the US economy is strong enough to put upward pressures on interest rates.

#### Current Status

The Diffusion Index of LAGGING Indicators has been in caution mode. **The latest data for September (reported in late October) caused a 33 percent reading.**

Our next signal will come from the Diffusion Index of LEADING Indicators, when it drops to zero. **The latest reading for September was 100 percent.** We remain in Caution mode until the Diffusion Index of LEADING Indicators drops to zero.

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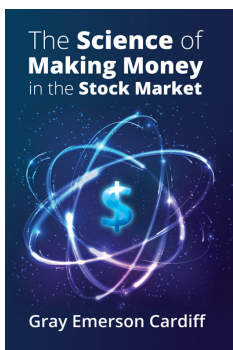
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