

# SOUND ADVICE

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As Yogi Berra observed, "It's tough to make predictions, especially about the future," to which we add "particularly after a month like we've had."

What happens next? For those singing "Happy Days," remember that our previous issue noted the S&P had fallen 21.3%. So, take this month's boom, which compressed a bull market (+20% off of the lows) into four weeks, with some perspective.

Yes, as we've been hinting, there's reason to think we are approaching a major turning point for stock prices, but we'd be fools to go all in. We can hardly expect a repeat of the past four weeks' giddiness, so we remain cautiously constructive.

In fact, we'd hardly be shocked by a significant reversal. Bull markets insist on "giving back" some portion of extraordinary gains just as persistently falling markets insist on recouping part of extraordinary losses. What did last month mean? A prelude to a rip-roaring bull run or a mirage that draws money into the market and then vanishes?

Neither good news or runs nor bad drops or news tells us what comes next. What makes for successful investing is anticipation. Ask yourself: Is the news we got over the last month about the economy and the financial crises from Washington substantively different from what we were hearing in February and March? Yet we've just experienced the sharpest rise in equities' prices since 1933. Provided March in retrospect will be seen as the first stage in a market recovery, Wall Street sees better times. If not, not. We're leaning toward yes.

--Gray Emerson Cardiff

## What to Believe?

Here at *Sound Advice*, we've been resolutely sticking to finding value investments. We're ahead for the year by +1.2%, not great but acceptable, versus the Dow (-8.7%), the S&P (-6.7%), though the techcentric Nasdaq is up 2.8%. We are taking a tentatively constructive view of what comes next, which still remains a minority view.

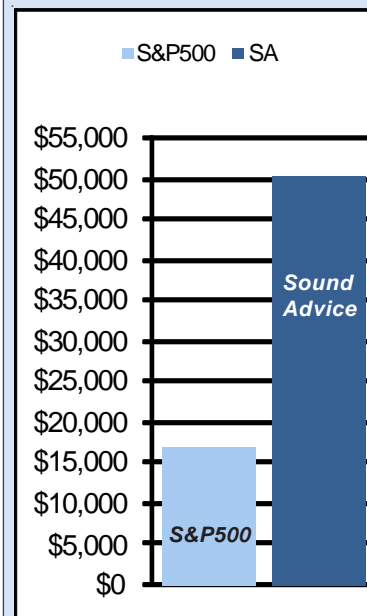
As noted in the March issue, we are approaching the cusp of a new SuperCycle, during which equities should outperform real estate. But such a turning point requires our Diffusion Index of Leading Indicators, which tracks the overall economy, to confirm our Risk Indicator, which tracks the relative value of equities versus housing prices. Provided none of the data trends we employ to trace economic activity reverses, we should have confirmation in the May issue.

But there remains plenty of pessimism about the stock market, to say nothing of the general economy. Wall Street, even at times less confusing than now, intentionally resembles a financial Tower of Babel. It's not just that different firms provide different predictions. Within firms widely divergent perspectives are spread, which permits those firms in retrospect to point to the right ones and bury the wrong.

Indeed, we now have several market analysts who market themselves as astrologists. One of the big success stories from last year was Arch Crawford, who bills himself a "financial astrologer."

Crawford essentially is a chartist who couches his predictions in astrological language. Thus, when a garden variety chartist might talk about "head and shoulder formations," Crawford writes "The 5 oppositions of Saturn to Uranus over the next two years are likely to bring a DE-Flationary environment, and severe

### Sound Advice Versus the S&P 500



**Since 1-1-2000, an Investment of \$25,000 becomes: \$16,917 with the S&P 500, for a loss of \$8,083, or \$50,555 with *Sound Advice*, for a gain of \$25,555, a difference of \$33,638 (135 percent of the investment)**

# What to Believe?

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dislocations in inflation-hedges of all types."

## **VOICES WE LISTEN TO**

In fact, we disagree with Crawford, and expect not deflation but inflation. Which of the truly dominant voices among money managers make sense to us? Bill Gross at Pimco and Marty Whitman at Third Avenue are worth listening to anytime.

Gross, in a recent posting on the Pimco website ([click here to open](#)), notes that amid the diverse voices at the firm "there is a near certain probability that the financially based global economy of the past half-century will not return, nor will we experience the steroid driven growth excesses that it facilitated." He also expects, if not rampant protectionism, a deglobalization of markets that will make national interests the decisive factor. Finally, the idolization of free markets that let financial speculation drive both financial markets and the real economy over the cliff is over. Reregulation is next. Put these forces together must result in ratcheting down of investor expectations. How low? He won't hazard a guess, but the best way to prepare for such a new world is to make sure you buy low.

Gross quotes Barton Biggs, "I am a child of the bull market," and adds: "which... meant that he bought on cyclical dips with the expectation of riding mean reversion to an upward sloping trend line of prosperity and ultimately higher peaks. In a sense, we are all children of the bull market..." In short, the past is no prologue for what Gross expects next.

If this all sounds glum, remember that Pimco has done well for itself during the last few years, and is gearing up to play a crucial role in creating a market for the questionable financial assets that must be priced and sold before we cure the financial market crises. "PIMCO intends to participate in the management of many of them, and ... should be well and healthily positioned to do so. Our recent launch of a global multi-asset fund featuring tail-risk protection is just one example. The potential participation in TALF and other

government-sponsored levered structures is another." Gross intends to take the other side of investor pessimism, a strategy that never goes out of style.

Another veteran investor gearing up to take advantage of the post-deluge market is Marty Whitman at Third Avenue, whose market-beating success as a money manager always has relied on buying distressed assets from unhappy owners.

We own his **Third Avenue Value Fund**, which ranks right up there with **Leucadia National**, this month's recommendation, when it comes to taking advantage of other peoples' problems. Whitman opens his latest letter to shareholders ([click here to open](#)) with instances of recent profitable trades involving corporate debt bought at a steep discount. Whitman focuses even more on values in equities, to which he applies the same balance-sheet analysis used to value debt. The TAVFX portfolio is full of "Net-Net" stocks, i.e. "issues where the market value of high quality assets, usually readily saleable, exceeds by a comfortable margin the market value of the company's equity capitalization after deducting all liabilities." Whitman, echoing what we observe in Leucadia's investing strategy, also appreciates tax losses as a hidden asset when evaluating a company's balance sheet.

Whitman, unlike Gross, is unconcerned with any profound change in market dynamics and presumes he can apply the same approach employed throughout his career. We see no reason why this shouldn't work. Whitman says he and his co-manager last year sank—I think that is the right word for money put into equities last year—significant cash into shares of their fund to take advantage of "the extraordinary opportunities presented by the current markets."

We've been through the most difficult market downturn of our investing career. We've retained many existing positions, and added opportunistically new investments. We're well set for a market recovery but insulated as well if it turns out we are premature. **SA**

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# Lucrative Leucadia

Value investors traditionally fare well during bear markets, because they instinctively had avoided high flyers during the now defunct bull market. Not so much this time. Value investors piled into financial services companies when they initially took a sharp drop only to discover that the drop was merely the beginning of a much deeper collapse. Some value investors who had gotten early into depressed sectors like natural resources earlier in the decade suffered a double whammy: not only did those positions undo them when the bottom fell out last year but their other holdings suffered as well. **Leucadia National Corporation (LUK—NYSE)** between when it went public in 1978 and 2003 quietly outperformed the much-lionized Berkshire-Hathaway (see chart on page 4), and between 2003 and mid-2008 soared. *Sound Advice* recommended LUK in May 2003, and rode it to nearly a triple 18 months later. In 2007, Leucadia went parabolic, doubling in price before cresting in mid-2008, after which it experienced the right side of that parabola, losing 77% of its share price. Today, LUK still outperforms Berkshire modestly in a decimated market that offers opportunities for opportunists like Leucadia and us.

### **LEUCADIA NATIONAL**

Leucadia, with a current market cap of \$4 billion, is structured as a holding company and traditionally has been a grab bag of unrelated assets. Its most recent 10K catalogues involvement “in a variety of businesses, including manufacturing, telecommunications, property management and services, gaming entertainment, real estate activities, medical product development and winery operations. The Company also has significant investments in the common stock of two public companies... one of which is a full service investment bank and the other an independent auto finance company. The Company also owns equity interests in operating businesses and investment partnerships . . . including a broker-dealer engaged in making markets and trading of high yield and special situation securities, land based contract oil and gas drilling, real estate activities and development of a copper mine in Spain.”

In addition, there’s also a 38% interest in Barbados’ primary electric utility, a plastics company operating in Mexico and Belgium, a significant investment in an Australian iron ore mining company and an assortment of smaller investments. Then there are its early stage investments in a liquid natural gas facility, development of a synthetic natural gas plant in Louisiana as well as a timber company. The thread that connects these eclectic assets is cheapness. Of the five guiding principals Ian Cumming and Joseph Steinberg, the founders and driving forces behind Leucadia preach, two of them are “Don’t overpay.”

### **CIGAR BUTT INVESTING**

Buffett says he looks for mega-market cap companies that he can understand, selling at a discount to their intrinsic value, have a high rate of return on equity and possess a brand-advantage to provide a moat against competitors. In short, he seeks superb companies at moments of weakness. But he appreciates alternate versions of value, even what he once termed “cigar-butt investing.” “A cigar butt found on the street that has only one puff left in it,” observed Buffett, “and may not offer much of a smoke, but the ‘bargain purchase’ will make that puff all profit.” Buffett, many think, had in mind Leucadia, a company he has partnered with profitably when it comes to dealing with distressed assets, which at the moment seem to be everywhere.

Leucadia does much of its hunting in bankrupt companies. For instance, LUK owns a troubled calling card company, which reminds us of the pager company, whose services already had been made obsolete by cell phones, that Leucadia bought for \$19 million in 2002 and three years later sold for a \$48.9 million profit. This pales next to its investment in WilTel, a bankrupt broadband subsidiary of Williams Companies, an energy outfit. Thanks to the wild buildout in broadband capacity during the telecom/dot.com bubble, WilTel at one point was valued at \$32.3 billion, but when Leucadia came calling WilTel’s excess capacity was deemed worthless. Leucadia paid \$330 million for 44% and in 2003 acquired the rest

## Sound Advice on Leucadia National Corp.

for \$423 million in Leucadia shares. Two years later, LUK sold WilTel to Level 3, a telecom company, and booked a \$243.9 million profit.

That last puff, however, does not always satisfy. The annual reports now and again include a deal that failed to meet expectations.

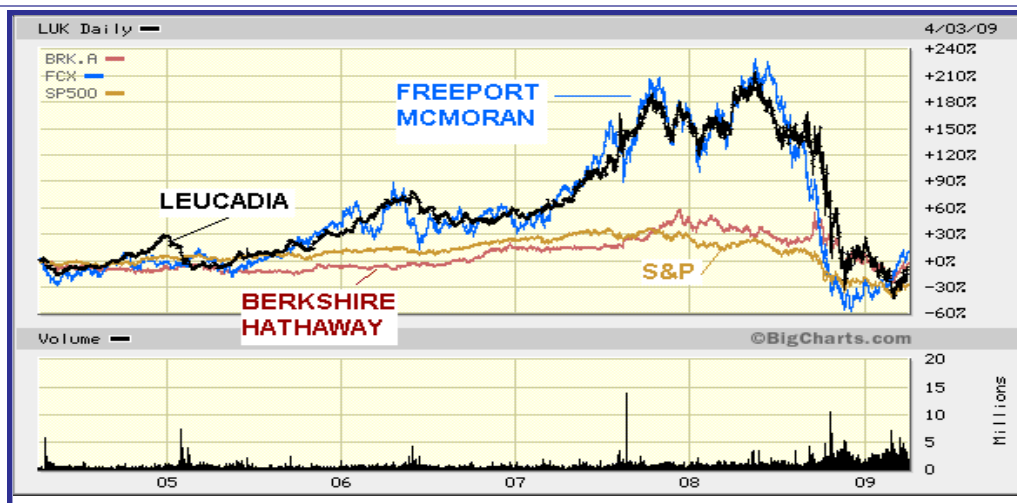
However, regardless whether Leucadia's acquisitions fly or fail, each usually brings to LUK's balance sheet Net Operating Losses (NOLs), which Leucadia can draw on to shelter its profitable ventures. Number three among Leucadia's five investing principals: "Earnings sheltered by NOLs are more valuable than earnings that are taxed!" When WilTel was sold, for instance, Leucadia retained the NOLs.

### TAKING SHAPE

Despite the grab bag tradition, Leucadia over the last few years has assumed a distinct shape, which explains why its shares went straight up during the natural resources bull market, why they collapsed, and why today are especially attractive. Put simply: Leucadia's highest profile investments over the last few years have been in natural resources. Accordingly, Wall Street started to think of Leucadia as a natural resources company (see chart above comparing LUK to Freeport McMoRan, the copper and gold miner). That Leucadia started down this path by snapping up bargains well before the market got fixated on commodities testifies to the shrewdness of its principals. That Leucadia did not lighten that exposure testifies to Cumming's and Steinberg's willingness to take a long-term perspective. From our perspective, we're happy to pick up shares now that Wall Street has punished the company.

### NATURAL BARGAINS

Cumming and Steinberg are deal makers, "old dogs



[who] can't learn new tricks," hopeful that they can find new projects yet content to sit on their hands when deals are not available and constantly worried, especially during bull markets, that equities and whole economies can be vaporized. Unlike Buffett, they never intend to mate with their assets for life. Instead, they are always looking for ways to exit profitably.

Take, for example, how they amassed and then dispersed their 72% interest in Cobre Las Cruces, the Spanish copper mine originally acquired in 1999 for \$88.5 million. After developing the mine that will begin production this year, Leucadia in 2005 exchanged 70% of Las Cruces to Inmet (IMN—Toronto), a Canadian mining company for an 11.6% interest in that company. At one point last year, with IMN trading at \$(CN)35.19 that 11.6% was worth \$(CN) 524.7 Factor in that the Canadian dollar at that point was at a premium to the U.S. dollar (it's fallen 26% from its high), and you can appreciate what a bonanza Las Cruces had been and how suddenly its value then tumbled.

In fact, Leucadia's success with Las Cruces was crucial in drawing the company into more natural resource investments. Not just finding cheap entry points played a role but also Steinberg's and Cumming's larger views of the global economy influenced their choices. In letters to shareholders going back to the early 1990s, though they choose not to identify which thinks what, each view reinforces the other: "One of us thinks the sky is falling and the Dollar is on the edge of debasement. One of us thinks that the efforts of half the global population who struggle toward the western standard of life and liberty will cause a global bull market that could last a long, long

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time.” One partner wants to hedge against a deflated dollar. The other wants to stock up to meet demand from the emerging markets. For each, natural resources is, well, the natural response.

Here are the pure natural resource assets Leucadia has accumulated over the past four years. In May 2005, Leucadia paid \$133.6 million for Idaho Timber, a processor of wood products. In 2006, it invested \$256 million in Goober Drilling, which specializes in land-based drilling rigs. Later that year, Leucadia invested \$452.2 million in Fortescue Metals Group (FSUMF.PK), a start-up Australian iron mining company. Then in 2007 Leucadia became involved in two cutting edge energy projects: a liquefied natural gas terminal on the Oregon coast and the construction of a commercial synthetic natural gas plant in Louisiana. Each is at a very preliminary stage, and, should either move into planning and construction, would require partnering with others to reach completion.

There are also significant real estate projects ranging from a planned residential community in southern California to development of a mixed use project surrounding the Panama City-Bay County Airport, which should open up the Florida Panhandle to major development. As always, Leucadia looks for advantages. In the Florida project, a developer donated the land for the airport and a \$1 billion public bond issue was floated to support the project.

The Fortescue Metals investment deserves closest attention, not just because it represents the largest natural resource position for Leucadia but also its volatile history tracks that of Leucadia and reflects what inflamed investors’ passion for the holding company. The 2006 annual report first mentions Fortescue shares, and notes that on December 31st when the annual report priced its position at \$10.46 a share and late March, just three months afterward as Leucadia was mailing the report, the shares had jumped 78% to \$18.60. And more followed until late June of 2008.

In 2006’s torrid natural resource market, buying into an iron ore mine seems not to fit the bargain

mentality we’ve attributed to Cumming and Steinberg. However, Leucadia was investing at an early stage of what appears to be a very rich project. By “early stage” we mean that Fortescue owned proven and estimated reserves amounting to 932 metric tons of iron ore in Western Australia but had no way to get it to market. Leucadia’s investment helped finance infrastructure that included a 162 mile rail line to connect the mines to Port Hedland, the expansion of the port to accommodate delivery and onloading of ore, as well as construction costs for a crushing and screening plant at the mine site along with roads and other facilities.

Leucadia sketches out that ideal market situation in its 2007 letter to shareholders (<http://www.leucadia.com/C&P%20Letters/C&P2007.pdf>). Cumming and Steinberg anticipated that at some point the raging price rises would subside as supply rose to meet demand, but they could not say when that would happen. We

found out since midsummer of last year, though it was demand sliding, not supply surging that has brought iron ore prices lower.

China still is very interested in Fortescue. Australian regulators, after considerable foot dragging, approved Hunan Valin Iron & Steel Group's bid to take a 16.5% interest the company, which, we expect, will be followed by more Chinese money. This relieves the cash crunch that had crippled Fortescue shares, and might explain why Leucadia lately has been moving higher.

### **MINING FINANCE**

Leucadia has also been investing in financial services companies and partnerships just as they did following the market disruptions earlier this decade. Cumming and Steinberg know a thing or two about how to make money from dented financial assets. For example, Berkshire Hathaway in 2001 turned to Leucadia to unwind Finova, a bankrupt lender it had acquired. Lately, Leucadia has been pouring money into a series of financial services deals, the most prominent of which involve Jefferies Group (JEF—NYSE). Leucadia has

**Cumming and Steinberg have [a knack] for buying assets when they are in the dumps, improving how they perform and then finding a willing buyer to take them off their hands....[They] prefer companies so poorly operated...that they become tax shelters thanks to their NOLs.**

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partnered with Jefferies in several investment pools. One, into which it has put \$350 million, has been savaged by the decline in its investments. The other, a high yield and special situations fund into which Leucadia has put \$600 million, is doing better and should be positioned beautifully to take advantage of mispriced assets. If Leucadia had mixed experiences with its partnerships with Jefferies, this did not discourage Cumming and Steinberg from acquiring 30% of the common shares in April 2008, a deal that even now reflects well on them.

Leucadia bought that 30% not with cash but with its own shares. At the time, LUK traded around \$52 and Jefferies around \$16. Today, LUK trades at \$13.63 and JEF at \$13.11. Jefferies during the 12 months before Leucadia bought its position already had absorbed most of the damage its shares would take in this bear market, losing half their market price, and since Leucadia came on board have, at least relatively speaking, held their value. You have to presume once the financial services industry regains its balance that Jefferies will find many ways to profit.

Even before committing to buying into Jefferies, Leucadia in 2007 had stocked up on a more precarious financial service company, AmeriCredit Corp (ACF—NYSE), which specializes in acquiring and servicing auto loans to subprime borrowers. Yes, you read that right. Cumming and Steinberg have been in and out of the auto financing business and consider well-managed ACF capable of surviving a hostile market.

For example, AmeriCredit scaled back its volume of new loans and has begun lending to less down-scale car buyers. The key will be a reanimated securitization market, into which ACF could sell its loans. That, of course, is also key to so many of the besieged financial services sectors. Unlike the Jefferies' shares, ACF has taken a beating since LUK bought in. Today, Leucadia owns 29.6% of ACF. We don't mind buying a share in a viable company that Leucadia was happy to buy at a higher price.

### ***WHAT YOU SEE IS NOT ALL THAT YOU GET***

We could continue dissecting the other businesses Leucadia operates or in which it owns a significant position, but we think you have the idea. Almost all

are works in progress, either in development such as Fortescue's iron ore operation and the Florida property development, in repair such as the AmeriCredit Corp or Jefferies purchases, in eclipse for the moment such as the interest in Goober drilling or Idaho Timber. If we look at the standard metrics, such as price to sales, cash flow, earnings or book, the results are unimpressive, even downright ugly, which hardly is surprising. Because Leucadia operates or owns shares in troubled companies, you don't find robust sales, cash flow, earnings or even book value. As Cumming and Steinberg put it: "We are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual returns."

Perhaps this explains why Wall Street historically ignores Leucadia. Also, their financial statements are almost impenetrable, since they mix so many different types of businesses Cumming and Steinberg, who assume as low a profile as a publicly traded company's CEO and President can, "speak" publicly once a year, when they issue their letter to shareholders, which invariably provide perspective.

Ultimately, if you own LUK shares, you must rely on the knack Cumming and Steinberg have for buying assets when they are in the dumps, improving how they perform and then finding a willing buyer to take them off their hands. Some deal makers go after trophy companies. Cumming and Steinberg prefer companies so poorly operated and so down on their luck that they become tax shelters thanks to their NOLs.

Leucadia does not do deals just to keep busy. In 1999, before we got involved with LUK, Cumming and Steinberg felt they could not find suitable ventures for the corporation's cash, were considering winding down the operation. They cleaned house, selling off many businesses, paid off much over their debt and distributed to shareholders \$13.58 in capital gains.

That year, Leucadia also bought back 5.2 million of its common shares. But thanks to the market collapse, particularly in telecom, new deals materialized to keep the two partners busy. We think there's plenty of new business emerging from a global economy in recession and a busted stock market to hold their attention. If you want to partner with them in what is to come—and to take advantage of the busted assets they already own—starting to accumulate Leucadia at under \$19 is a deal too good to resist. **SA**

# Portfolio Updates

*Sound Advice* enjoyed a 27.9% upswing on a total return basis since the March letter, which is enough to push us into the black for 2009. Only our bear market hedge, the **Prudent Bear Fund**, lost ground (-14.5%), as investors set aside fears that had put stock prices into free fall from the start of the year. The big winners, not surprisingly, were in sectors that had been most ruined by investor fears, while the less robust gainers were in sectors such as healthcare, which terrified investors saw as safe harbors during the roughest stretches. The March issue focused on our natural resource positions, which since December had shown some resilience. **Anglo-American** did the best, up 44.7%, even as the Royal Bank of Scotland dropped

its rating. Mining stocks outperformed the overall market as investors try to anticipate recovery of the global economy. AAUK handily outperformed its peers. The key news was a successful \$2 billion bond issue, which when added to \$1.28 billion from the sale of its remaining stake in Anglo AshantiGold and the cash saved by suspending the dividend make AAUK's balance sheet robust enough to support operations and acquisitions. There had been some concern that AAUK might do a rights offering to get the cash, and this deal ends that speculation.

**Agrium**, the Canadian fertilizer manufacturer and farm input retailer, is up 24.8% even as it tries to acquire a competitor, CF Industries Holdings, which in turn is trying to acquire yet another fertilizer company, Terra Industries. Though adding CF Industries to Agrium is an intriguing proposition, investors apparently prefer Agrium just stick to its existing assets. If the bid for CF Industries ends, AGU would rise quickly.

**Transocean**, the ultradeepwater driller, added 28.2% as oil prices moved back and forth around \$50 a barrel. The likelihood that major oil and natural gas fields will be found in easily accessible locations is small. Instead, the most probable sites will be in physically and politically difficult regions. Consider that the two recently announced major fields that energy companies want to explore and develop are off the coasts of Brazil and in the Gulf of Mexico. Both can be accessed only with the sorts of drilling platforms Transocean and two other

competitors own, and Transocean is by far the dominant player. **Icon Energy Fund** increased 19.7%. Its portfolio has shifted from energy services companies to major energy companies. Exxon Mobil and Chevron,

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its two largest positions, account for nearly a third of the entire portfolio.

**USAA Precious Metals and Minerals Fund** had a relatively weak month, up 9%, as investor paranoia that drove precious metals higher earlier in the year gave way to bargain hunting in the rest of the market. Gold might continue to lose some of its allure if equity and debt markets stabilize, but the looming problem is weaker national currencies and inflation, though few consider these outcomes imminent. Since we don't know when these issues will preoccupy the market, we're content to maintain our position.

**Plum Creek Timber** added 28.1% on no substantive news. Plum Creek, which is the largest landowner in the United States, has timber that won't get cut and milled until the overall economy and in particular the housing market recover. Its real estate can produce profits both as a source for lumber and also in itself, since much of PCL's acreage sits either in areas under development or in attractive second-home territory. Of course, no one is bidding up the price of timber or timberland, but this is money in the bank, and will take off once the economy becomes more hospitable.

The two hottest sectors were financials and consumer discretionary. The **Icon Financial Fund** was up 33.4%. REITs had a great run, **CGM Realty Fund** increased 27.8%. **HRPT Properties Trust** vaulted 38.3%. Of our two preferreds, the **Public Storage Series M** increased 22.4%, but the top performer (second best

## Sound Advice Portfolio for April 2009

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
Duke Realty Cumulative Preferred	DRE.PRO	NYSE	\$12.66	16.54%	<b>\$15.00</b>	BUY
HRPT Properties	HRP	NYSE	\$3.76	12.77%	<b>\$4.25</b>	BUY
Public Storage Cumulative Preferred	PSA.PRM	NYSE	\$18.74	8.84%	<b>\$20.00</b>	BUY
<b>Diversified Growth</b>						
Agrium	AGU	NYSE/TSE	\$37.37	0.29%	\$45.00	BUY
Boston Scientific	BSX	NYSE	\$8.39	0.00%	\$11.00	BUY
CarMax	KMX	NYSE	\$12.11	0.00%	<b>\$14.00</b>	BUY
CGM Realty Fund	CGMRX	800-343-5678	\$13.16	4.64%	N/A	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$21.04	4.47%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$67.17	2.74%	N/A	BUY
Fastenal	FAST	NASDAQ	\$37.00	1.24%	<b>\$41.00</b>	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$14.39	2.29%	N/A	BUY
Honeywell	HON	NYSE	\$30.20	3.31%	\$38.00	BUY
Johnson & Johnson	JNJ	NYSE	\$52.15	3.53%	\$68.00	BUY
<b>Leucadia National Corp.</b>	<b>LUK</b>	<b>NYSE</b>	<b>\$16.84</b>	<b>0.00%</b>	<b>\$19.00</b>	<b>BUY</b>
Mattel	MAT	NYSE	\$12.95	5.79%	\$18.00	BUY
Microsoft	MSFT	NASDAQ	\$18.75	2.35%	\$26.00	BUY
Molson Coors Brewing	TAP	NYSE	\$34.10	2.40%	\$45.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$9.50	0.00%	\$12.75	BUY
Schering-Plough	SGP	NYSE	\$23.54	0.93%	N/A	<b>SELL</b>
Sprint Nextel	S	NYSE	\$4.19	0.00%	<b>\$5.50</b>	BUY
Stryker Corp.	SYK	NYSE	\$33.29	1.20%	\$42.00	BUY
Superior Industries	SUP	NYSE	\$13.23	1.81%	<b>\$15.00</b>	BUY
Tetra Tech	TTEK	NASDAQ	\$22.12	0.00%	\$28.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$32.22	0.57%	N/A	BUY
United Parcel	UPS	NYSE	\$52.75	3.41%	<b>\$56.00</b>	BUY
UnitedHealth Group	UNH	NYSE	\$20.54	0.15%	\$25.00	BUY
Wal-Mart Stores	WMT	NYSE	\$53.80	1.25%	\$60.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$28.86	7.39%	N/A	BUY
Xerox	XRX	NYSE	\$5.00	3.20%	\$6.00	BUY
<b>Energy/Natural Resources</b>						
Anglo-American PLC	AAUK	NASDAQ	\$10.30	0%***	<b>\$13.00</b>	BUY
Icon Energy Fund	ICENX	800-764-0442	\$13.38	0.87%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$30.76	5.46%	<b>\$35.00</b>	BUY
PowerShares Water Resources ETF	PHO	NYSE	\$12.99	0.61%	<b>\$15.00</b>	BUY
Transocean	RIG	NYSE	\$65.52	0.00%	\$75.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$23.00	0.04%	N/A	BUY
<b>Aggressive Growth</b>						
Comcast	CMCSA	NASDAQ	\$14.50	1.71%	<b>\$17.00</b>	BUY
Ford Motor Convertible Pfd	F.PRS	NYSE	\$9.45	34.39%****	<b>\$13.00</b>	BUY
Icon Financial Fund	ICFSX	800-764-0442	\$4.03	0.00%	N/A	BUY
Liberty Global	LBTYA	NASDAQ	\$16.90	0.00%	<b>\$19.00</b>	BUY
Maxim Integrated	MXM.PK	NASDAQ	\$13.57	4.60%	\$16.00	BUY
Federated Prudent Bear Fund***	BEARX	800-711-1848	\$6.75	0.00%	N/A	BUY
Symantec	SYMC	NASDAQ	\$16.23	0.00%	\$19.00	BUY
Time Warner	TWX	NYSE	\$22.22	0.99%	<b>\$25.00</b>	BUY
Western Digital	WDC	NYSE	\$21.30	0.00%	<b>\$26.00</b>	BUY

\*Prices as of the market close on Friday, April 3, 2009

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

Note that all fund distributions fluctuate annually.

\*\*\*Distribution Suspended

\*\*\*\*Dividend Deferred

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

## Sound Advice: Portfolio Updates for April 2009

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for our portfolio) was the **Duke Realty Series O**, which exploded 80.7%. As we wrote in the March issue, when devastated DRE-PO was yielding 28.9% and the less savaged PSA-PM 10.6% : “We have no reason to think that Duke Realty is in peril, but we have every reason to think that the REIT market has become unhinged...” Certainly REITs along with other financial stocks got healthier on hopes that the Fed and Treasury can resuscitate the debt market, which is crucial for REITs, but during January and February panicked investors were dumping all REITs, ignoring that those with balance sheet strength and without imminent refinancing challenges were not about to go bankrupt. This month those investors ceased panicking.

**Ford Cumulative Convertible Preferred** announced it would defer its dividend, which is not entirely unexpected given how tightly Ford has been husbanding its cash. So how did the shares do? For the month, Ford common added 91.1% and the preferred 94.9%. Without the current dividend, these securities lose a primary rationale we had in our recommendation. But we will continue to hold it in our portfolio. Ford has the best chance to survive among the “Big” Three”—though we admit that this is a high-risk proposition. It is the best way to play Ford. These shares, which have a conversion ratio into 2.8249 shares of common, now should trade in tandem with the common, moving proportionately up and down in percentage terms but with a slight premium to account for the potential payment of the deferred dividend distribution.

Two other auto-related stocks put in identical, buoyant performances: **CarMax**, which runs a national chain of used-auto stores and **Superior Industries**, which designs, manufactures and distributes auto parts, primarily wheels and rims, respectively added 39.5% and 39.6%. CarMax illustrates how even a depressed revenues report with warnings that unless the market improves numbers will be terrible can still trigger buying. Wall Street, after dropping stocks on any negative news during the bear market, at least for the moment, takes bad current news and future forebodings in stride. The \$64 question is whether today’s willingness to look beyond current numbers prefaces better results or is just the market fooling itself. Historically, when the economy has worsened for this length of time, usually recovery in stock prices is close.

There were plenty of big moves to track. But almost none was event driven, that is, there is no explanation other than “market action” to explain those moves. One exception is **Schering-Plough**, which is up 33.5% after

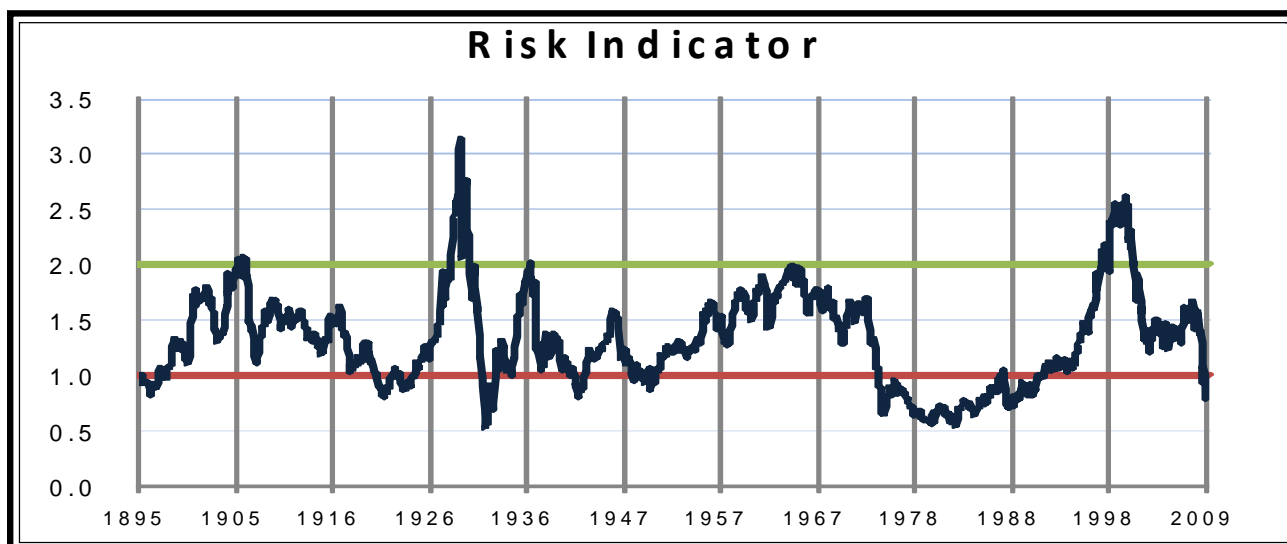
Merck offered \$10.50 in cash plus 0.5767 of its own shares for each share of SGP. SGP’s share price now depends on Merck’s. Though some think that another bidder, perhaps **Johnson & Johnson**, might emerge, we’re satisfied to take our profit and sell SGP.

Healthcare stocks this month trailed the rest of the market. **Odyssey Healthcare**, which provides hospice services, added 6.6%, **Johnson & Johnson** 8.7% and **UnitedHealth**, the health insurance giant, 14.9%. **Stryker**, which designs and makes orthopedic replacement parts and surgical supplies, ended up with a 4% gain after the FDA did not approve a bone-cement product. **Boston Scientific** was our best medical performer. It got a couple of analyst upgrades, enjoyed the benefits of improving clinical attitudes toward drug-coated stents and is seeing much better performance from its Guidant acquisition. It added 32.5%.

Media and communication also had some very strong performers. **Liberty Global**, which seeks to replicate in Europe, Asia and Latin America its creation of a U.S. national cable system cobbled out of smaller local service providers, shot up 62.7%. LBTYA, which is larger than almost all of its competitors, can benefit from tough times as competitors are forced to raise prices, cut back services, shut down or sell out. Interestingly, Liberty Global last week arranged a large refinancing of soon-to-mature debt, which testifies to its ability to tap the credit markets. **Comcast**, our domestic cable company, added 24.7%.

**Time Warner** performed a couple of corporate pirouettes this month and ended up with a closing price more than triple where it traded as of the March issue. But that is just accounting magic, the result of a reverse split. First, TWX spun off its remaining 85% of **Time Warner Cable** to shareholders of record as of March 12th (.08367 of TWC shares for each share Time Warner). Then, on March 27th, it did a 1:3 reverse stock split, which reduced the number of shares outstanding by two-thirds and automatically tripled the price of the new shares. The distribution of TWC shares is based on the pre-reverse split number of shares owned. On that basis, TWX shareholders of record on March 12th after the reverse split hold roughly one-quarter of a share of TWC for each of the post-reverse split shares of TWX (.08367 \* # of OLD shares of TWX)\*3. Got it? We are selling off our TWC shares and reducing our cost basis for TWX. **Comcast** is enough domestic cable exposure for us. Factoring in the value of our brief ownership of TWC, TWX on an adjusted basis since the last letter is up 28.7%. **SA**

## Sound Advice Market Indicators for April 2009



The Risk Indicator measures the overall risk in the stock market by plotting the ratio of stock prices to home prices. See *The Science of Making Money in Turbulent Stock Markets* for a full explanation of the Risk Indicator and the Diffusion Indexes.

The Risk Indicator was 0.96 in March. A reading this low reveals that stocks are historically low relative to house prices, and present an extraordinary value. Last month's reading of 0.79 will likely market the low for this cycle.

**The Diffusion Index of Lagging Indicators** gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. This Diffusion Index currently stands at 17 percent.

**The Diffusion Index of Leading Indicators** gives "Aggressive" signals when all four of its individual leading economic indicators drop below their respective levels of six months earlier, providing a zero percent reading. This reveals a soft economy and a ripe atmosphere for a lasting decline in interest rates.

The next signal we are looking for is an "Aggressive" signal from the Diffusion Index of Leading Indicators. This Diffusion Index currently stands at 25 percent. The only indicator that is still above its level of 6 months earlier is the indicator that measures the gap between the Federal Funds rate and the yield on 10-year Treasury bonds. This reading is based on the data for February, which is the most current data available. However, we know

from observing this spread in March, it will be below the level recorded six months earlier. Accordingly, we expect to see the Diffusion Index of Leading Indicators to give us and "Aggressive" signal when the March data is published in April.

An "Aggressive" signal coming at a time when the Risk Indicator is close to 1.0 reveals that a new Supercycle 5 has come to an end, and that Supercycle 6 is born. See *The Science of Making Money in Turbulent Markets* for a history of Supercycles (which you received with your subscription). You will also receive an updated copy when you renew your subscription.

### Track Record of the Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 produces an annual return of 17.5. During "Caution" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased at an annual rate of only 1.4 percent.

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

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