SoundAdvice **The Best Risk-Adjusted Returns in Both Up & Down Markets from 2000-2015** - Hulbert's Financial Digest

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What Oil Glut?

The *Sound Advice* Portfolio is up 9.8 percent this year, as compared to 4.0 percent for the S&P 500. We have an average profit of 58 percent based on the prices at which each position was recommended.

This month we are adding Apple (AAPL) - see page 6, and selling Pfizer (PFE) - see page 5.

-- Gray Emerson Cardiff, Editor

Cushing, Oklahoma, is not a tourist destination. Unless you are in the oil business, you may not have heard of it. Until the US fracking boom, it was a sleepy small town in the middle of the northern half of the state. However, these days Cushing is not sleepy anymore. Cushing is home to the largest oil hub in the US, where a spidery network of pipelines converges into a sprawling array of huge crude oil storage tanks.

It is no secret that Cushing's oil tanks are brimming with oil. This supply overhanging the market is often cited as the reason for persistently low oil prices. However, the glut is not as large as is perceived, and in reality, there is actually not much of a glut.

Lease Stock

On October 13, 2016, the Energy Information Administration (EIA) quietly changed the way it reports US oil supplies. The quantities now no longer include "lease stocks", which is the amount of oil sitting at drilling sites (oil leases) or in pipelines, trucks, and rail cars. In the oil patch, many operators do not count this oil as production until it is transported off the site and goes into storage. Removing lease stocks from the data reveals a reduction of close to 30 million barrels which amounts to 6 percent of reported US supplies.

Condensate Distortion

What the EIA is still not removing from its data is the amount of condensate that it is including in US oil production and supply figures. However, the financial markets do not consider condensate to be crude oil. In fact, futures contracts forbid condensate to be included in the delivery of crude oil. Moreover, crude oil price quotes specifically exclude condensate.

The oil industry uses specific gravity to measure how heavy or light petroleum is relative to water. The American Petroleum Institute (API) rebranded the specific gravity measure for oil as API gravity. At the heavy end of the spectrum is Canadian Crude from tar sands with an API of 20 or less. Lighter crudes have higher API gravities. West Texas Intermediate (WTI) is light crude, with an API gravity in the vicinity of 40. Anything above 45 is considered condensate.

Even Congress Knows the Difference

Back in December 1975, Congress enacted the Energy Policy and Conservation Act which made it illegal for anyone in the US to export crude oil abroad. The Act was in response to the 1973 Arab oil embargo to protect US consumers from oil price volatility by keeping as much oil in the country as possible to meet domestic needs.

However, as the US fracking boom got underway, and an abundance of condensate started flowing from fracking gas wells, the ban was adjusted to allow condensate to be exported. The industry responded by constructing plants and equipment (splitters) specifically designed to separate condensate for exporting.

Gathering the Data

In early 2014, the EIA made its first effort to categorize US production by API but noted that data was lacking and inconstant because many state-level regulators did not collect it. The data gathering efforts have improved since early 2014, and the EIA now reports US oil production by API. This breakdown can be found in a rather obscure report -- table 5 of the EIA's report numbered 914 (EIA-914) called Petroleum & other Liquids. The data is even broken out by state, although data for Alaska is still not available. The EIA's summary for the lower 48 states is shown in the following

US Oil Production by API Gravity

API	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Volume	Share
<=20.0	438	435	435	438	426	409	410	408	405	407	397	405	418	4.8%
20.1-25.0	234	246	250	230	249	237	203	178	168	167	172	161	208	2.4%
25.1-30.0	692	628	647	689	701	642	763	733	714	692	667	847	701	8.1%
30.1-35.0	1,203	1,264	1,151	1,095	1,105	1,207	1,081	1,179	1,181	1,188	1,168	981	1,150	13.3%
35.1-40.0	1,848	1,818	1,739	1,640	1,592	1,538	1,567	1,558	1,633	1,571	1,588	1,647	1,645	19.1%
40.1-45.0	2,552	2,547	2,563	2,578	2,491	2,497	2,522	2,572	2,469	2,488	2,518	2,495	2,524	29.2%
45.1-50.0	951	933	972	1,043	1,043	1,077	1,038	1,008	918	922	834	867	967	11.2%
50.1-55.0	459	471	488	469	481	469	470	469	439	418	371	357	447	5.2%
>55.0	503	498	512	519	552	547	527	504	475	465	458	441	500	5.8%
Unknown	97	110	105	80	62	55	60	53	57	59	61	46	71	0.8%
Total	**8,977**	**8,950**	**8,861**	**8,782**	**8,703**	**8,678**	**8,639**	**8,663**	**8,458**	**8,377**	**8,235**	**8,247**	**8,631**	**100.0%**
Above 45	**21.3%**	**21.3%**	**22.3%**	**23.1%**	**23.9%**	**24.1%**	**23.6%**	**22.9%**	**21.7%**	**21.5%**	**20.2%**	**20.2%**	**22.2%**	

Source: Energy Information Administration's (EIA) table 5 of 914 (EIA-914), Petroleum & other Liquids.

table.

The red line of percentages is our addition to the table, which shows the percent of the total oil production that is considered condensate with an API of 45 or higher. Note that condensate is consistently above 20 percent, and averages 22.2 percent for the 12 month period.

What this means is that the reported figures each week regarding US oil production, even after the recent 6 percent reduction for lease stocks, are still overstated by approximately 22 percent. This also means that the oil in US storage tanks is likely to be close to 22 percent condensate – not actually oil as far as the financial markets are concerned.

The Real Supply

The latest data is for the week ending October 21. The EIA reports that there are 468 million barrels sitting in the US storage tanks. This tally does not include lease stocks but it does include condensate. Although this 468 million barrels is down by 44 million barrels since the peak in April, it is still 115 million barrels higher than was sitting in US storage tanks at the end of 2014 when there was no oil glut.

If 22 percent of US oil production has been condensate, then close to 22 percent of the supply in US storage tanks is also condensate. Subtracting 22 percent leaves 365 million barrels of actual crude oil. This is only 12 million barrels more than existed at the end of 2014 prior to the glut. By this reasoning, one could conclude that we do not have an oil glut, or at least not much of one.

The Cushing Dumbbell

The oil in the Cushing's storage tanks is a blend of light and heavy oils (including condensate), because it receives supplies from many sources, from Canada with an API of 20 or less, as well as condensate from the US fracking patch with API's of 45 and higher.

Cushing blends this wide range of API products in its storage tanks, and strives to meet an average API ceiling of 42. However, the industry complains that the blend is not consistent because it has a high proportion of oil at the light and heavy ends of the spectrum, with a smaller proportion in the middle range which is used for profitable products such as diesel.

According to Dennis Sutton, a former crude quality expert with Marathon Petroleum Corp who now heads the Crude Oil Quality Association, *"You end up with a dumbbell-like material rich in front and back ends, neither of which refineries find most profitable."*

Another example is Phillips 66, which has refining operations for its wells in the Mississippi Lime shale that are within 70 miles of Cushing. In order to reduce its supply from Cushing, Phillips has added transportation equipment to gather production directly from its wells. President Tim Taylor says *"With Cushing, you can get a blended barrel that hits the spec* [42 API], *but it's not as consistent as you'd like."*

To deal with crude oil blends that have been spiked with condensate, refiners have pricing formulas they call gravity banks that compute a discounted price for such blends.

The blended oil sitting in US oil tanks has been tainted with condensate, which makes it less desirable than pure crude oil. This explains why the US still imports close to 6 to 7 million barrels of oil per day while an abundance of blended oil is sitting in domestic tanks.

The so-called US oil glut is not as large as is widely perceived. In fact, as far as actual pure crude oil is concerned, there is not a supply glut at all. This sets the stage for a recovery in energy stocks. Here are the *Sound Advice* selections.

Energy/Natural Resource Selections

Chesapeake Energy (CHK) has taken a beating from the crash in oil and gas prices. However, the company has a portfolio of 8 million net acres of oil and gas assets carried at a book value of $70 billion. CHK's debt load makes it an aggressive investment but the company is also making aggressive moves to reduce that debt. Chesapeake expects to sell more than $2.0 billion in assets this year, and has also announced approval of a $1.5 billion loan which will be used to pay off other debt maturing in 2017 and 2018; extending liquidity into mid-2020. The company also can tap into a $4 billion credit facility that does not mature until 2019. These moves greatly enhance CHK's prospects.

Chevron (CVX) is a vertically integrated oil company which means it has operations in all phases, from exploring and drilling (upstream), to transporting and refining (downstream). Profits vary from these stages of production, depending on price demand for oil and for refined products. High oil prices boost margins from drilling but squeeze margins from refining. When oil prices are low, profit margins expand from refining. Management has pronounced the annual dividend as “sacrosanct” which provides an attractive yield and limits the downside risk.

At the end of October, CVX reported surprisingly high third quarter earnings of 68 cents per share. Not only were earnings positive for the first time in 3 quarters, they were nearly double expectations. The company also raised its dividend to a $4.32 annual rate (the 29th consecutive annual increase) which gives the stock a 4%+ yield.

Fidelity Select Natural Gas Fund (FSNGX) is a diversified way to participate in the recovery of the natural gas industry through strong companies. Natural gas provides the same energy as oil for pennies on the dollar, and natural gas is more environmentally friendly.

The drop in the price of oil brought the energy-equivalent costs of oil and natural gas closer, but a substantial disparity still exists. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. At $50 a barrel, that is the cost of 5.8 million BTUs. However, with the current market price for natural gas close to $2.79 for one million BTUs, 5.8 million BTUs will cost $16.18. So the same amount of energy is available for approximately 16 cents on the dollar, if it is in the form of natural gas rather than oil.

The updated chart shows the historic relationship between the costs of these two forms of energy. The red line shows the price of a barrel of oil since the mid-1970s. The blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. The fact the natural gas provides energy for pennies on the dollar will translate into an expanding natural gas industry.

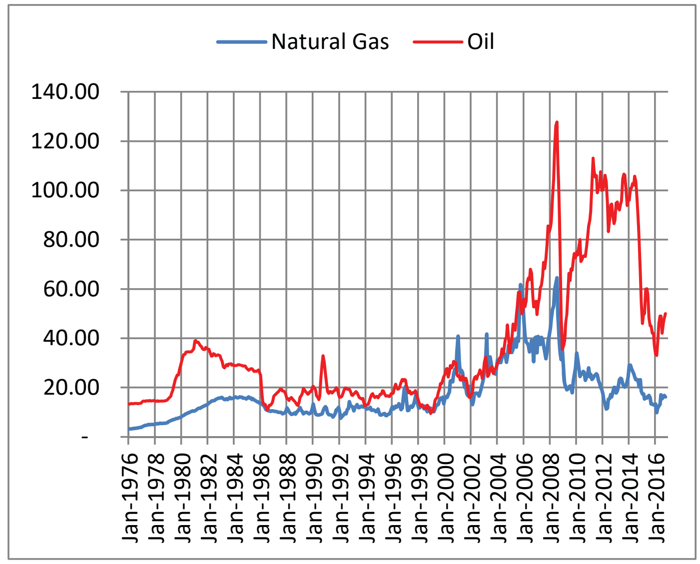
ICON Energy Fund Class S (ICENX) is also a diversified way to participate in the recovery with a basket of substantial companies. The hallmark of this fund has been its ability to look for changes within the energy sector to capture value, rather than simply depending on rising oil prices. This fund is a good way to capture today’s values and profit from the recovery and changing landscape on a diversified basis with professional management.

Freeport-McMoRan (FCX) is the world’s largest copper producer. It also has significant oil and gas assets in the Gulf of Mexico which it acquired at the top of the market in 2013. This was particularly unfortunate because FCX took on a large amount of debt to make the acquisition. The added leverage, along with sinking prices on these commodities, decimated FCX.

In late October, FCX reported earnings of 16 cents per share. This compares to a 15 cent loss a year ago and is further evidence of the company’s survival and recovery. The stock rose 8 percent the day of the report.

FCX is still laden with $19 billion of long-term debt which the company is reducing. In addition to selling its stake in its African copper operation to a Chinese mining firm for $2.65 billion, Freeport initiated a $1.5 billion stock offering to reduce debt further. FCX has also agreed to sell its Deepwater Gulf of Mexico

The Cost of Energy Equivalents of Oil and Natural Gas



properties to Anadarko Petroleum for $2 billion, and its California oil and gas properties for $592 million. CEO Richard Adkerson says that these moves clear the path for Freeport to get its balance sheet in order without being forced to sell its highest quality assets. Carl Icahn remains the largest FCX shareholder with 88 million shares, which means moves are being made under his supervision.

Transocean (RIG) makes deep-water drilling rigs and leases them to major oil producers around the world. RIG has been sharply impacted because the utilization of its rigs has fallen along with the drop in oil prices. We continue to recommend RIG because of its prospects for survival. The company reports a backlog of orders totaling $14.6 billion, nearly all of which is for ultra-deep water floaters. The long-term profit from RIG should be very good from here. Deep-water drilling is still a necessary source for the US and the world’s oil needs, especially as US fracking drops off.

Valero Energy (VLO) is the largest oil refiner in the US. It owns 15 refineries with a capacity for 2.9 million barrels per day. The company also has 7,400 retail outlets in the US, Canada, UK, and Ireland. Valero is the most complex refiner in the US, which allows it to purchase lower quality crudes when they are priced at the most advantageous discounts. This flexibility allows VLO to capture the highest margins among its competitors. Valero’s refineries are also well positioned geographically, even for accessing the low-cost Maya crude from Mexico.

Profitability in refining is a function of the so-called “crack spread”, the difference in the amount a refiner pays for crude oil and the amount for which it sells the resulting refined products such as gasoline and jet fuel. Fluctuations in these prices compress and expand margins which can make refining stocks volatile and somewhat unpredictable in the short run. In the case of Valero, however, the current valuation is compelling.

In October, VLO reported third quarter earnings of $1.33 per share that far exceeded expectations of $0.93. Revenue was also well above estimates. VLO is a great value with a strong

Hospitality REITs Comparison Table

Company Name	Symbol	Recent Stock Price	Dividend Yield	Stock Market Cap Rate	Portfolio Value @ 7.5% Cap Rate ($Millions)	Stock Value	Discount (-) Premium (+)
RLJ Lodging	RLJ	19.72	6.7%	11.7%	6,436.1	40.40	-46.4%
Hospitality Properties	HPT	27.36	7.5%	10.5%	10,941.6	47.98	-43.0%
Hersha	HT	17.82	6.3%	10.0%	2,305.0	27.71	-32.3%
Host Hotels & Resorts	HST	15.48	5.2%	9.7%	18.6	21.20	-27.0%
Apple Hospitality	APLE	18.03	6.7%	8.6%	4,705.6	21.37	-15.6%

The table above shows the "Stock Market Cap Rate" (what the stock price is paying for the underlying real estate portfolio) for several comparable hospitality stocks. The "Stock Value" column shows the current value of the stock assuming the underlying portfolios are valued using a cap rate of 7.5 percent, which is close to the average cap rate on recent hotel transactions. The last column shows the discount or premium at which the stock is trading based on a 7.5 percent cap rate valuation of each company's real estate portfolio.

balance sheet and solid growth potential. The quarterly dividend was recently increased again to $0.60 a share, for a yield above 4 percent.

Real Estate Selections

As in the case of bond yields, low interest rates have pushed down real estate capitalization (cap) rates to historically low levels. (The cap rate is the cash yield before debt payments are considered.) As a result, commercial real estate prices are historically high. This means that the average real estate investment trust (REIT) does not present a particularly good value. Accordingly, the *Sound Advice* portfolio only includes real estate stocks offering an extraordinary value now.

Two examples currently exist in the hospitality industry: Hersha (HT) and RLJ Lodging (RLJ). Both are selling at deep discounts to their net asset values, with high dividend yields close to 6 percent, and present outstanding values. The table above shows the comparative values of hospitality REITs.

Hersha Hospitality (HT) is a real estate investment trust which owns and operates high quality upscale hotels in urban gateway markets. The Company's 55 hotels totaling 8,654 rooms are located in New York, Boston, Philadelphia, Washington DC, Miami, and select markets on the West Coast. HT is selling at a discount to its hotel assets.

Many of HT's major properties have been undergoing renovations and not producing their full income potential. Even with ongoing renovations in 2015, the year saw an 18.7 percent growth in funds from operations (FFO). The first 3 quarters of 2016 saw strong growth as well. As renovations are completed and rooms are put back on line, revenue and FFO should climb substantially higher. New acquisitions will also contribute to growth, along with sales of less-attractive properties.

During the last 2 years, Hersha has reported several hotel transactions it made at cap rates ranging from 5.4 to 8 percent. To be on the conservative side, we can establish a main street cap rate at the high end of this range, of 7.5 percent.

Based on the latest trailing four quarters' financials, including the most recent 2016 third quarter, and using 7.5 percent cap rate to evaluate the company's portfolio, we value HT at $27.71 per share which is substantially higher than the current price. The dividend yield is attractive and lowers the risk profile.

Hersha has repurchased $186.6 million of its common stock during the last three years.

RLJ Lodging Trust (RLJ) has a large, geographically diversified portfolio of 125 hotels, branded by Marriott, Hilton, Hyatt, and Embassy Suites with over 20,000 rooms. Rather than traditional full service hotels, RLJ emphasizes "focused-service" or "compact full service" hotels, where only specially chosen services important for guests are offered. The most important amenity is an attractive, modern room offering quality features for the basic necessities – sleeping, bathing, and working. Excluded or minimized are amenities such as large restaurants, spas, and meeting rooms. Overall, the hotels are mid- to up-scale, but with reasonably-priced rooms. This concept translates into a larger portion of revenue from the rooms. The company has been upgrading its assets by purchasing properties in high growth markets with high barriers to entry. Management expects a significant ramp up of growth from recent acquisitions.

RLJ is also selling at a steep discount to its hotel assets. Based on the latest trailing four quarters' financials reported, and using a 7.5 percent cap rate to evaluate the company's portfolio, we value RLJ at $40.40 per share which is considerably higher than the current price. The high dividend yield is attractive and lowers the risk profile.

Retail Opportunities Investment Corp (ROIC) is a real estate investment trust (REIT) that specializes in the acquisition, ownership and management of grocery-anchored shopping centers located in densely-populated, metropolitan markets across the West Coast. ROIC began as an IPO in 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains. ROIC buys distressed retail properties with high-quality demographics, refurbishes them, and then leases them at a premium.

In late October, ROIC reported another quarter of strong earnings based on a 4.0 percent increase in same-center net operating income. So far this year, FFO is up 12.7 percent. Year to date, ROIC has acquired $332 million of 8 grocery-anchored shopping centers. Two were acquired in the third quarter, one in Monterey, California, and one in Portland, Oregon. More acquisitions are underway for the current fourth quarter. As new properties are added, along with tenant upgrades, FFO is bound to continue rising. The dividend yield is attractive which lowers its risk profile, along with the company's relatively low debt.

Third Avenue Real Estate Value Investor Fund (TVRVX) is loaded with good values substantially below NAV with strong growth prospects. Management has a similar approach to ours because it is very price conscious, especially in relation to net asset value. The managers expend great effort analyzing financial statements, visiting companies and their properties, and assessing management teams in order to come up with their estimates of intrinsic 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 a number of distinguishing characteristics. This is a global real estate fund. 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. Also unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities.

Medically-Related Selections

This sector is defensive because medical needs persist regardless of financial conditions. The world's demographic aging trends, and the commensurate increase in medical care needs, translate into strong growth prospects for this industry. However, for the near-term, a Clinton victory poses a threat to pharmaceuticals, such as **Pfizer (PFE).**

Hillary Clinton has been critical of drug industry pricing for 25 years and is likely to focus on the drug industry if elected president. In the early 1990s, as First Lady, Hillary mounted a war against big drug companies in an effort to socialize medicine, sending pharmaceutical stocks into a nosedive. When she failed and gave up, these stocks were fabulous bargains.

If Hillary is elected, she could have the opportunity to appoint a new head of Centers for Medicare & Medicaid Services (CMS) with the mission of constraining drug prices paid by them. She would only need 60+ votes in the Senate, which would be possible, especially if Democrats win control there. A vote from a Republican-controlled House would not be necessary.

Another concern is a ballot in California. This measure proposes to limit the prices the state's Medicaid system (MediCal) pays for drugs to the prices paid by the Veteran's Administration which pays lower prices than any government entity. Federal law prohibits Medicare from negotiating with providers to receive lower prices, but this ballot is an attempt to get around the Federal law. Of course, this could set a precedent for other states, causing cascading initiatives.

We originally recommended Pfizer at $16.24. We still think the company has promising drugs and treatments. However, in view of imminent political risks for the pharmaceutical industry, **we are selling Pfizer (PFE),** and taking our approximate 100 percent profit.

Boston Scientific (BSX) produces medical products well suited for an aging population. The company's mission is to transform lives through innovative medical solutions that improve the health of patients around the world. BSX 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. BSX has more than 900 US patents. In October, BSX reported earnings of $0.27 a share, which was in line with expectations.

Stryker (SYK) provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products, although SYK is best known for its orthopedic devices for artificial knees and hips. Continued growth is assured by accelerating demand for joint replacements on aging US baby boomers. As life expectancies continue to increase (and obesity trends continue), more and more hip, knee, and spinal procedures will be needed. Stryker's cash-rich balance sheet and strong cash flow give it avenues for continued diversified growth through acquisitions.

At the end of October, SYK reported third quarter earnings of $1.39 per share, slightly above expectations. The company now expects 2016 earnings to be $5.80 per share.

Tekla Life Sciences Investors (formerly Hambrecht & Quist Life Sciences Fund - the symbol is still HQL) is in our portfolio because the most explosive profits in the entire healthcare industry can be found in biotech companies. Over the last 10 years, biotechnology has become a major industry and the source of the world's top breakthrough drugs. Biotech companies tend to be high risk and high reward investments which makes diversification essential. This fund is an excellent way to invest in this sector.

Small Caps

Numerous studies show that small caps perform better over the long run than the market as a whole. They 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. Small caps also tend to be domestic companies without substantial overseas exposure, and therefore are not buffeted by the currency fluctuations that often haunt larger companies. Here more than ever, attention to value is paramount.

Third Avenue Small-Cap Value Investor Fund (TVSVX) invests in companies with small capitalizations using the same value-oriented approach as it does with its real estate value fund. TVSVX management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value (NAV), 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.

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.

Agrium (AGU) is a Canadian company offering a broad mix of agricultural products, from wholesale fertilizers to retail farm products, aimed at increasing the efficiency of food production. AGU products will be in growing demand as arable land continues to disappear around the world while population and per-capita income increases. This translates into a need for greater crop output per acre through the expanding use of AGU's products. Most of AGU's earnings come from its retail stores, offering farm products with the balance coming from its wholesale sales of fertilizers, mostly nitrogen-based but also from potash and phosphates. This diversification protects AGU from swings in the markets and brings steady sources of free cash flow for future growth.

Alcoa Aluminum (AA) is splitting its upstream and downstream operations into two separate companies. The upstream operations of mining bauxite, alumina, aluminum, along with cast products and rolling mill operations retain the Alcoa name and the stock symbol "AA". The new downstream company will be called Arconic, with the stock symbol of "ARNC" and will combine its value-added businesses to precision engineering along with advanced manufacturing of aerospace structures, jet engines, automotive and commercial transportation markets. The split will enhance management's ability to focus on core operations, allocate capital, target investment opportunities, and customize employee incentives and recruitment.

Apple (AAPL) was added to the portfolio in our email update of October 11, 2016. It was on that day that Samsung announced that it would stop production on its new Galaxy Note 7 smartphone "for the benefit of consumers' safety". This was after a string of reports that the device was exploding in a fire. Even the replacement phones started bursting into flames, and the largest US carriers stopped selling the phones.

Samsung has been Apple's fiercest competitor. Samsung has had 22.4 percent of the market share of smart phones – nearly double that of Apple's 11.8 percent share, which was actually down two percentage points from a year earlier. This decline was reflected in the third quarter earnings reported in late October.

Slightly more than one-half (57%) of Apple's revenue comes from its iPhones, so any change in iPhone sales growth is huge for Apple. A gain of just one percent in market share translates to 14 million iPhones, which would add 7 percent to revenue.

The demise of Samsung's latest Galaxy Note 7 phones, and the damage to Samsung's reputation for the foreseeable future, has flung open the doors for a significant new growth path for Apple's iPhones. This is especially true in China, where Samsung had a strong position, and where Apple's sales declined 33 percent during the last year.

In addition to gaining market share from Samsung, Apple has just released its new iPhone 7 which is introducing a new upgrade cycle. One of the primary reasons Apple's iPhone sales have been languishing recently is due to a lack of upgrade cycle since the iPhone 6 was introduced a few years ago. Improvements over the iPhone 6 include water resistance, 40 percent faster processor and connectivity speed, double the storage capacity, enhanced camera quality to nearly professional grade, and 20 percent longer battery life.

The new iPhone 7 is coming at an opportune time. Apple's iOS operating system is known to attract new users and it is best at keeping them. Once acquainted with Apple's ecosystem of robust third-party applications (apps), iCloud backup, and other integrated services and products, users tend not to stray to Androids or other platforms. This loyalty gives Apple the ability to sell new iPhones and other products to customers at premium prices.

Apple has a pristine balance sheet, with as much cash as long-term debt. APPL has the highest A++ financial ratings from both Value Line and Morningstar. However, the stock market has been giving APPL a below-average price/earnings (P/E) ratio (approximately 14) because of slow and even negative growth prospects. Now, however, with a stronger growth path, Wall

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Street is bound to give APPL a higher P/E.

The consensus is that Apple will earn $8.96 per share in 2016. In the spirit of being conservative, let's estimate $8.50. The P/E ratio for the S&P 500 is close to 17. Giving AAPL a 17 P/E raises the stock price to $145 – a substantial increase from today's price. The consensus for next year is $9.50 per share (prior to the Samsung news). A 17 P/E would push AAPL up to $162.

A solid dividend of $2.28 per share provides a yield that is higher than a 10-year Treasury bond (which offers no growth and plenty of downside with rising interest rates). If earnings are on a growth path, so is the dividend.

Ford (F) is in our model portfolio because it is an extraordinary value. Ford's new all-aluminum F-150 truck, which gets close to 30 miles to the gallon, has been Ford's best-selling vehicle in the US for 34 consecutive years, and the company's most profitable product.

In late October, earnings came in above expectations but were hurt by a $600 million recall to replace faulty door latches on 2.4 million cars and trucks. There were also costs in revamping its Kentucky truck plant to launch production of its Super Duty truck with aluminum sides. These costs are now history and should leave a brighter day ahead. Ford stock is selling at a huge discount to the rest of the market. The dividend yield is close to 5 percent which lowers the risk.

NCR Corp (NCR) makes automatic tellers (ATMs), retail point-of-sale (POS) workstations, self-service kiosks, and other self-service checkout systems. 485 million people use NCR products every day, and there is room for substantial growth in the US and around the world.

In October, NCR reported very encouraging third-quarter 2016 results, surpassing both earnings and gross revenue expectations. Earnings were 87 cents per share on revenue of $1.68 billion. The strength was primarily due to higher Software and Service revenues. The results prompted the company to raise its 2016 earnings expectation to range between $2.97 and $3.02. The stock jumped 14 percent on the day of the announcement. We have noted that NCR is an undervalued stock. Even after the jump, at $35 the stock is still selling at less than 12 times earnings, which is far below the market average.

Symantec (SYMC) is the dominant supplier of software for computer security and protection against viruses and other nuisances through its leading flagship brand, Norton. Nearly all of the Fortune 500 companies are Symantec customers. If there ever was a more certain growth industry, protection from cyber espionage is it.

In the final days of October, SYMC announced a partnership with Blue Coat to integrate its cyber threat intelligence capabilities with artificial intelligence. Symantec's products are now blocking 500,000 additional attacks per day and process eight billion security requests across these products every day for 175 million consumer and enterprise endpoints, 63 million email users, and 80 million web proxy users.

Symantec also announced that it has developed an innovative technology that leverages machine learning and advanced image analysis in order to uncover new phishing campaigns. (Phishing is the practice of creating an official-looking but fake popular website for the purpose of snagging passwords and credit card numbers.) SYMC has furnished a nice investment return this year, especially considering its $4.00 dividend paid in February.

Tetra Tech (TTEK) is a leading company in water technologies and environmental remediation with a healthy balance sheet for growth in strategic markets. Two recent acquisitions of Coffey and INDUS corporations have swelled TTEK's backlog of contracts and increased prospects for more Federal contracts in the IT sector. The company's backlog is now $2.3 billion, which reveals a robust pipeline with major government organizations like the US Department of State, US Army Corp. of Engineers, and the US Air Force, which should continue to bolster growth.

Xerox (XRX) is continuing to transform from a seller of printers and copiers to a company providing information technology (IT) services and document outsourcing (printing as a service). The services side now amounts to 55 percent of revenues. XRX will be splitting into two companies by the end of the year; one with the printers and other equipment and the other offering the IT services. The company predicts that the split will save $2.4 billion during the first 3 years. Carl Icahn, who holds 82 million shares, believes XRX is undervalued and believes the split will improve management's efficiency and focus.

At the end of October, XRX reported third quarter earnings of 27 cents per share, in line with expectations, and estimated 2016 earnings will come in between $1.11 and $1.14 per share. This puts the stock price under 10 times earnings. We continue to emphasize that XRX is very cheap relative to the rest of the market.

ETFs for Rising Interest Rates

We have been recommending three ETFs designed to benefit from the normalization of interest rates and long-term bond yields. These ETFs differ in the amount of leverage used, and 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 bonds, as measured by benchmark bond indexes. Both TBF and TBT are based on the Barclays US 20+ Year Treasury Bond Index, TMV is based on the Intercontinental Exchange (ICE) US Treasury 20+ Year Bond Index. (We have compared these benchmark indexes with others, including BlackRock's iShares 20+ Year Treasury Bond ETF (symbol TLT) which was previously used as a benchmark, and found that using any of these benchmarks produces negligible differences in our projections.) The prices of these ETFs fluctuate in accordance with the daily fluctuations of their benchmark 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 benchmarks will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in their respective benchmarks will cause these ETFs to drop in the same fashion.

At this writing, long-term Treasury bond yields are currently 2.59 percent, up from 2.34 percent at the end of last month. The current prices of these ETFs are historically low and present compelling long-term investments, even if we may need to wait a couple of years.

The string of 100 percent readings from the **SoundAdvice Diffusion Index of LAGGING Indicators** (page 11) is telling us that a rise in interest rates is on the horizon. In addition, as we have been pointing out recently, for the first time in recent history, synchronized massive monetary expansions are in force among the world's largest countries.

After the 2008-09 meltdown, Europe maintained a relatively tight monetary policy while our Federal Reserve was launching a series of Quantitative Easing (QE) programs. Japan was also hesitant to take action, as was China. Now, all of these countries have launched aggressive monetary expansion policies revealed by stunningly low and negative interest rates.

Japan's Prime Minister Shinzo Abe recently announced a hefty new set of stimulation policies, totaling $275 billion, which is similar in relative GDP scale to the stimulus applied to the US economy since the 2008-09 meltdown. The Bank of Japan says it will continue to buy bonds at the rate of $800 billion a year until inflation rises above 2 percent in Japan and stays there for a while.

The Eurozone's QE stimulus package is expanding the amount bond-buying from $60 billion to $80 billion. The People's Bank of China adopted a new policy aimed at keeping the seven-day repo rate confined to a low and narrow range, and has doubled government spending. Energy-based economies, including Canada and Australia, are strengthening with the stabilization and upturn in commodity prices.

In the immediate months ahead, the global synchronization of strong expansionary monetary policies around the world is bound to translate into higher economic growth rates both here and abroad. This will ultimately lead to increases in inflation and long-term interest rates.

We can project the movements of these ETFs based on any given scenario, and the Federal Reserve's prediction is as good as any. As part of the Federal Reserve's quarterly Federal Open Market Committee (FOMC) meetings, each of the 17 committee members makes a prediction regarding the future path of interest rates. Those predictions are plotted in the so-called "Dot Plot".

The most recent Dot Plot was taken at the September meeting. There was a sharp difference in the predictions among this group of informed experts. The lowest prediction was that the Federal funds rate would end 2016 at 0.375 percent. The highest was 1.0 percent.

In the spirit of being conservative, we can use the average of the lowest half of the predictions of the September Dot Plots (8 of the 17). These averages predict that the Federal funds rate will be 0.625% by the end of 2016, 1.125% by the end of 2017, and 1.875% by the end of 2018. Assuming long-term Treasury bond yields move in accordance with these target points (to preserve the same as today's real return), long-term Treasury bond yields would be yielding 2.965% by the end of 2016, 3.465% by the end of 2017 and 4.165% by the end of 2018.

Here is what would happen to each ETF:

TMV would rise from $18.82 to $23 by the end of 2016, to $30 by the end of 2017, and to $42 by the end of 2018.

TBT would rise from $34.44 to $39.40 by the end of 2016, to $47 by the end of 2017, and to $59 by the end of 2018.

TBF would rise from $21.98 to $23.5 by the end of 2016, to $25.7 by the end of 2017, and to $28.8 by the end of 2018.

The Erosion Factor

As point out regularly, 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, 0.04 percent (4 basis points) every day, and thus go nowhere for the next two years. Here is what would happen to each ETF:

TMV would decline to $18.6 by the end of 2016 (1.2%), and to $17.3 by the end of 2017 (8%).

TBT would decline to $34.2 by the end of 2016 (0.6%), and to $33.1 by the end of 2017 (3.9%).

TBF would decline to $21.9 by the end of 2016 (0.2%), and to $21.7 by the end of 2017 (1.9%).

While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

Hedging the Portfolio

Adding to our overall caution, we are also recommending a reverse ETF that essentially short-sells the market and will benefit from down-drafts in the S&P 500.

The **ProShares UltraShort S&P 500 (SDS)** 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 performs as it should, with daily premiums and discounts within 0.5 percent. It is also very liquid.

Energy/Natural Resources	Symbol	Price / NAV	Yield	Action	Limit
Chesapeake Energy Corp	CHK	$5.51	0.00%	BUY	$7.00
Chevron	CVX	$104.75	4.12%	BUY	$110.00
Fidelity Select Nat. Gas Fund	FSNGX	$25.85	0.00%	BUY	$29.00
Freeport-McMoRan	FCX	$11.18	0.00%	BUY	$12.50
ICON Energy Fund Class S	ICENX	$12.06	0.00%	BUY	$13.00
Transocean	RIG	$9.61	0.00%	BUY	$11.00
Valero	VLO	$59.24	4.05%	BUY	$63.00
Real Estate					
Hersha Hospitality Trust	HT	$17.82	6.29%	BUY	$21.00
Retail Opportunity Investment Corp	ROIC	$20.11	3.58%	BUY	$24.00
RLJ Lodging Trust	RLJ	$19.72	6.69%	BUY	$25.00
Third Avenue Real Estate Value Investor	TVRVX	$29.51	1.49%	BUY	$32.00
Medically Related					
Boston Scientific	BSX	$22.00	0.00%	BUY	$25.00
Pfizer	**PFE**	**$31.71**	**3.78%**	**SELL**	**$30.00**
Stryker Corp.	SYK	$115.35	1.32%	BUY	$122.00
Small Caps					
Third Avenue Small-Cap Value Investor Fund	TVSVX	$20.77	0.00%	BUY	$22.00
Special Situations					
Agrium	AGU	$91.82	3.81%	BUY	$105.00
Alcoa	AA	$21.44	0.56%	BUY	$33.00
Apple	**AAPL**	**$113.54**	**2.01%**	**BUY**	**$120.00**
Ford Motor Company	F	$11.74	5.96%	BUY	$15.00
NCR Corp	NCR	$35.05	0.00%	BUY	$36.00
Symantec	SYMC	$25.03	1.28%	BUY	$28.00
Tekla Life Sciences Fund	HQL	$16.75	0.00%	BUY	$20.00
Tetra Tech	TTEK	$38.45	0.94%	BUY	$40.00
Xerox	XRX	$9.77	2.87%	BUY	$11.00
ETFs for Rising Interest Rates					
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	$18.82	0.00%	BUY	$21.00
ETF - ProShares Short 20+ Year Trsry	TBF	$21.98	0.00%	BUY	$23.00
ETF - ProShares UltraShort 20+ Year Trsry	TBT	$34.44	0.00%	BUY	$37.00
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	$16.99	0.00%	BUY	$18.00

This table has live prices, charts & buy limits on our website: http://www.soundadvice-newsletter.com/members

Notes to the table:
Prices are as of 10/31/2016. See our website for live pricing and buy limits:
http://www.soundadvice-newsletter.com/members
The right hand column is the highest recommended price limit for purchases.

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. The table above divides the portfolio into four sectors; Income with Growth, Diversified Growth, Energy and Natural Resources, and Aggressive Growth.

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 100+ years, we can see this titanic struggle between the stock market and its foremost competitor for investment dollars: real estate.

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

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

We can, therefore, label this new tool the SoundAdvice "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 SoundAdvice 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 SoundAdvice Risk Indicator has oscillated back and forth, revealing the ongoing struggle between Stocks and houses for investment capital. We have labeled these long vacillations Supercycles.

The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a $25,000 investment would have grown to $12.6 million in stocks and to $1.6 million in houses.

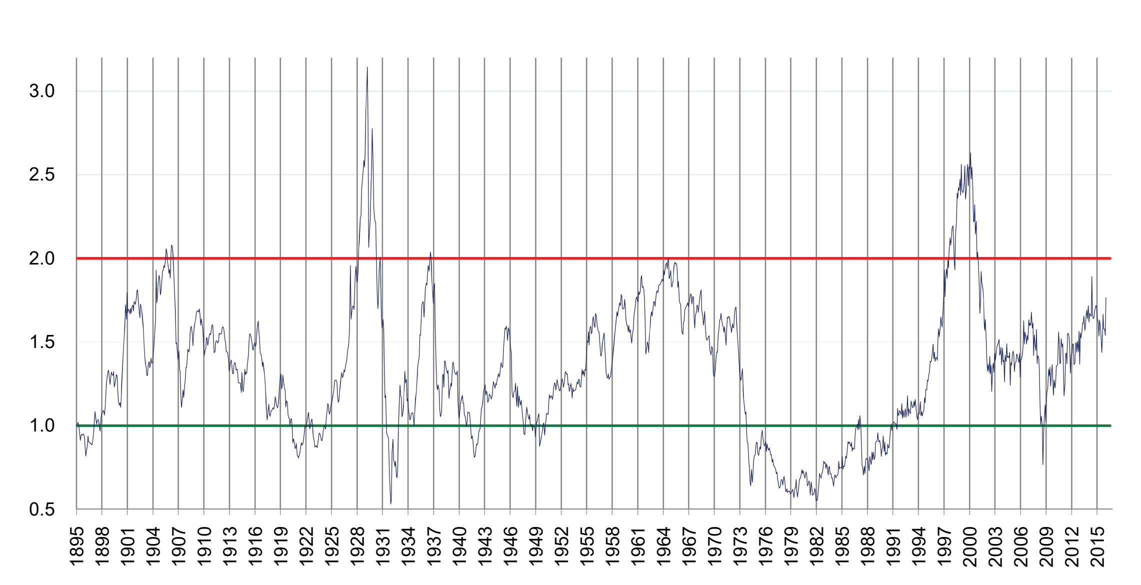
But though an investment beginning with $25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the SoundAdvice Risk Indicator he would have made $500 million, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the SoundAdvice Risk Indicator would have provided.

These figures illustrate why it is so important to remain aware of the Supercycles that are at work within markets.

The latest reading for the SoundAdvice Risk Indicator is 1.70. This reading reveals that stock prices are above average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

See ***The Science of Making Money in the Stock Market*** for a complete explanation of the SoundAdvice Risk Indicator and its track record.

The SoundAdvice Risk Indicator



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

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

When the SoundAdvice **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 **SoundAdvice 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.

We have been operating under a "Caution" signal since the June 2015 release of the May lagging economic indicators. This was just after the S&P 500 peaked at 2,130.82 on May 27, 2015.

It is worth noting that the SoundAdvice Diffusion Index of LAGGING Indicators hit 100 percent again in September (the most recent data). This is the fifth consecutive string of 100 percent readings, which is confirming our caution signal.

Track Record of the SoundAdvice 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 climbed an average of 32.1 percent. During "Caution" signals, the S&P 500 increased an average of 2.6 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
Ave +/-	32.1%		2.6%

See ***The Science of Making Money in the Stock Market*** for a complete explanation of the **SoundAdvice** Diffusion Indexes and their track records.

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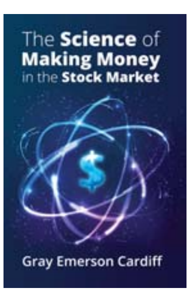

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