

Where is the Divergence?



The *Sound Advice* Portfolio is now down this year, by 5.11 percent, compared to 6.74 percent for the S&P 500. We have an average profit of 42 percent, based on the prices at which each position was recommended.

-- Best regards,

-- **Gray Emerson Cardiff, Editor**

In our June 29, 2015, issue, with the market considerably higher than it is today, our Diffusion Index of Lagging Indicators (page 11) rose to 100 percent, and we issued a caution signal.

We also noted that the stock market was dangerously high, based on the ratio of the total capitalization of the stock market (stock prices of all publicly traded companies multiplied by their respective amounts of shares outstanding) to the gross domestic product (GDP) of the US. At the time, this ratio was close to 1.3. This ratio rose above 1.2 in the late 1990s prior to the 2000-02 bear market that took stocks down nearly 50 percent. It also rose above 1.1 just prior to the 2008-09 bear market which took stocks down nearly 50 percent again.

We felt that was an appropriate time to introduce an ETF that benefits from a declining stock market, the **ProShares UltraShort S&P 500 (SDS)**, a reverse ETF that is designed to produce two times the daily fluctuations of the S&P 500 index. The gain in this ETF has helped hedge our portfolio against the general market decline since the peak.

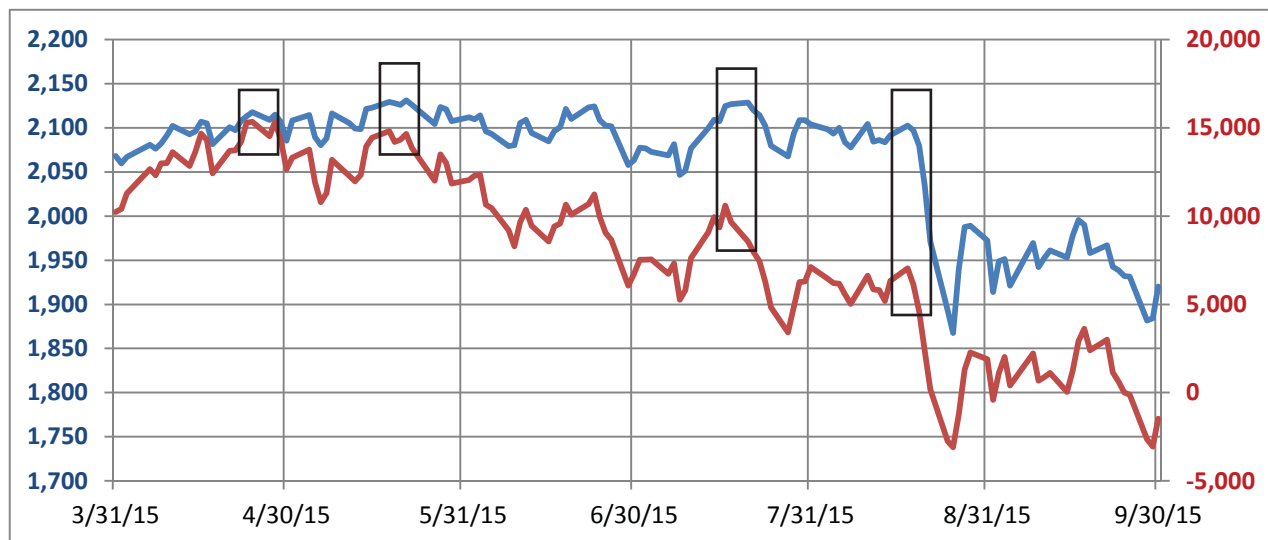
In recent issues, we have also pointed out the deteriorating market breadth of the stock market, and we graphically illustrated how this phenomenon has preceded major market declines, including the crashes of 2000-02 and 2008-09.

A healthy bull market will have broad participation among a wide range of stocks, but participation will narrow as it runs out of gas. Near major tops, the largest capitalized stocks continue to rise because they are the easiest places for money managers and mutual funds to put incoming cash. This causes the popular market averages to continue rising because they are heavily weighted by the stocks of the

largest companies. However, the overall breadth of the market will be deteriorating. The breadth of the market is revealed by tracking the number of stocks that advance on the New York Stock Exchange, and subtracting the number that decline. The cumulative total is the "advance-decline line" or ADL.

We have updated the chart below showing the market breadth since March. The blue line on the chart below shows the S&P 500, and the red line shows the ADL. The boxes highlight the breadth deterioration. Each time the S&P 500 rallied, the peaks of the ADL were consecutively lower, revealing that participation was narrowing and breadth was deteriorating.

Stock Market Breadth Since March, 2015

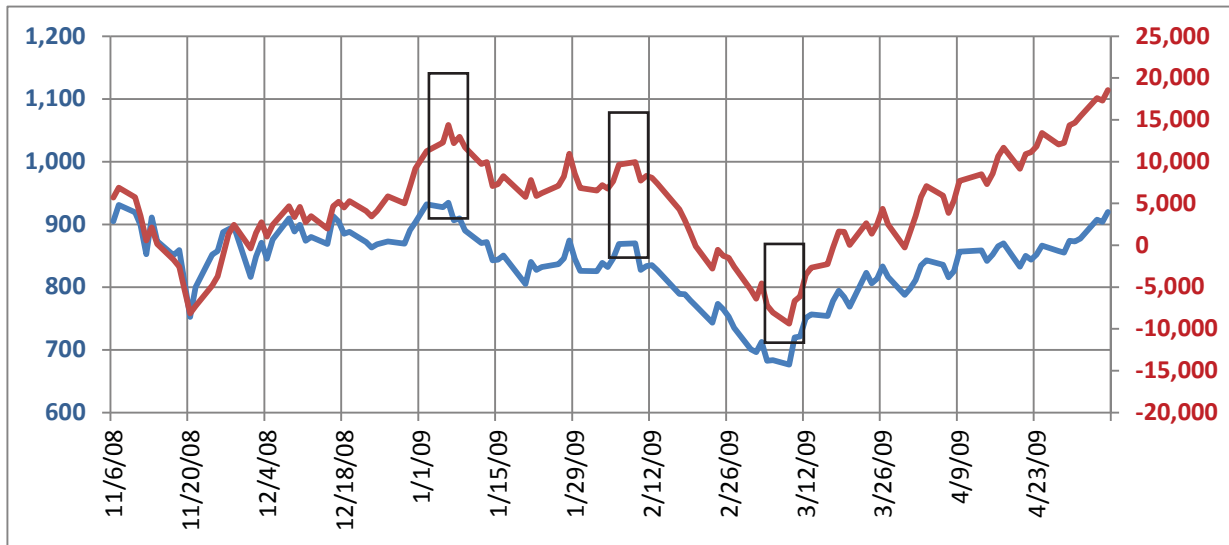


What to Look for Now

Just as negative divergence of the market breadth from the S&P 500 is a reliable bearish prognosticator, positive breadth presages bull runs. The bottom of the last major decline, in 2009, serves as a good example. Take a look at the chart below.

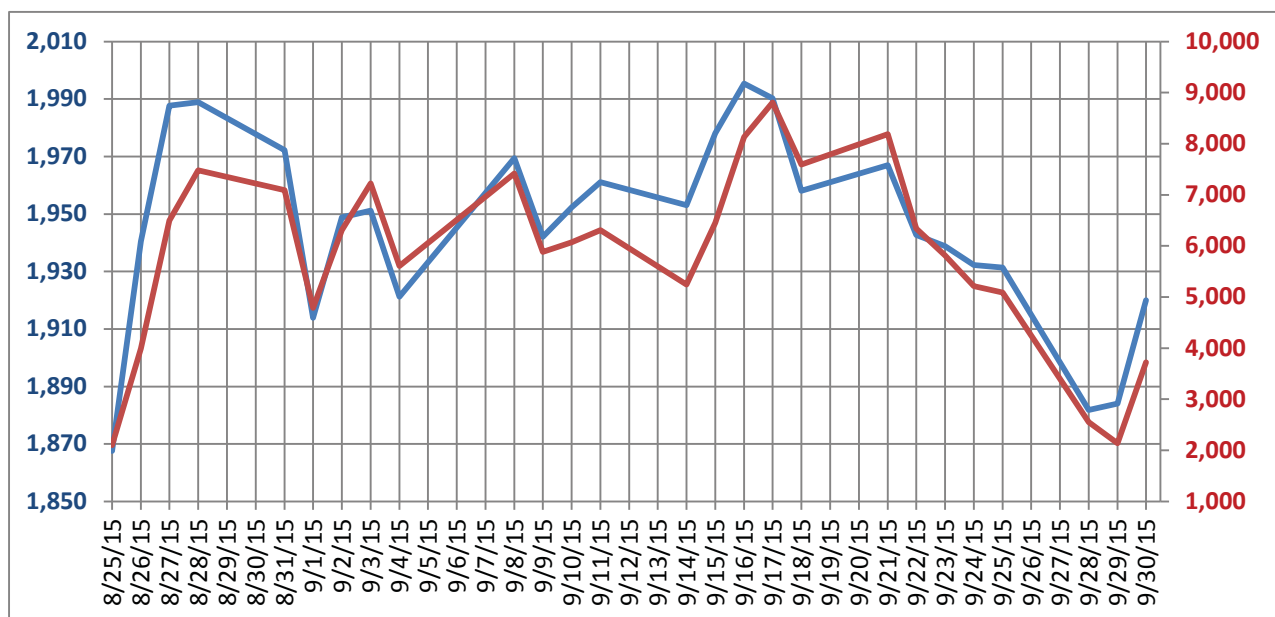
Here again, the blue line on the chart below shows the S&P 500, and the red line shows the ADL. The boxes highlight the positive breadth divergence. Notice how the breadth improves after the bottom in November 2008. Even when the S&P 500 drops to new lows in March 2009, the ADL does not follow the S&P all the way down. Of course, a major long-term bull market followed.

Stock Market Breadth 11/2008 - 4/2009



To be sure, a significant breadth divergence is an important indicator for imminent major movements, in either direction. In the next chart, we start with the last bottom reached on August 25, and put the S&P and ADL together in order to measure any subsequent breadth divergence.

Stock Market Breadth Since 8/25/2015



As you can see, although slightly negative, there has not been conclusive divergence either way. This reveals that there are no major changes likely ahead from the current market conditions, and that there is not a compelling reason to change our cautious approach. We will continue to watch for any divergence, along with the rest of our indicators.

Portfolio Updates

In volatile stock markets, it is exceedingly important to emphasize value. Here are updates on the rest of our portfolio.

Energy Selections

The industry has been decimated by the oil glut, caused primarily by over-production from the US fracking boom. However, as new drilling continues to decline, it is only a matter of time until the glut will disappear.

Under the pressure of brimming oil storage tanks, the price of oil has fallen below the cost to drill. Of course, this makes new drilling impractical. Moreover, low oil prices have a lingering impact on the industry.

According to a mid-September *Wall Street Journal* article, US oil-and-gas producers have written down the value of their drilling fields by more in 2015 than in any full year in history, even more than the previous record set in the 2008 melt-down.

Impairment write-downs must be taken by a company when the value of assets falls below the value on its books. Valuations must be based on the prior 12 month average of oil and gas prices. At the end of the second quarter, those averages were \$71.50 per barrel for oil and \$3.40 per million British thermal units (Mbtu) for natural gas.

Although impairment write-downs are accounting entries, and not real money, they reduce the value of the assets that can be used as collateral for loans to finance drilling. With oil and gas prices continuing to slide, it is certain that there will be more impairment write-downs for the third quarter. That means drilling activity will continue to decline.

We also know that US production will continue falling off because of the nature of fracked oil wells. Production drops 70 percent during the first year from the typical fracked well. The requires a substantial amount of new wells to be added to maintain overall production levels. We know that is not happening because the domestic drilling rig count has plunged 50 percent since last October.

US Production has been tapering off since the peak in early June, down by 273 thousand barrels per day. As of the week ending 9/25/15 (the latest week reported) there were 457 million barrels of oil in US storage tanks, which is 68 million barrels more than before the glut. This is a significant improvement from the 101 million barrel glut that existed in April 2015, a reduction of 40 million barrels. Today's 68 million glut is less than 9 days of our imported oil needs of

7.5 million barrels a day. Even every drop of the entire 458 million barrels in all US storage tanks equates to only 61 days of imported oil.

As production continues to decline and becomes more pronounced, draws from storage tanks are certain to be substantial. That means the oil glut will disappear, the price of oil will recover, and that is bound to translate into stellar profits from carefully chosen oil and gas stocks.

Here are updates to our energy portfolio, in alphabetical order.

Chevron (CVX) is a vertically integrated oil company which means it has operations in all phases, from exploring and drilling, to transporting and refining, and even to retail sales at its gas stations. Profits vary from these various 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, but not nearly enough to offset declines in drilling profits. CVX's earnings are down sharply due to the drop in oil prices, but management has pronounced the annual dividend of \$4.28 per share as "sacrosanct." Accordingly, the current yield of more than 5.5 percent puts a floor under the stock price while we wait for a recovery in oil prices.

Chesapeake Energy (CHK) took an impairment charge for the second quarter of \$5.015 billion. This was in comparison to a book value of \$70 billion in proved oil and gas properties. After subtracting depreciation and depletion for prior years, the book value of CHK's net assets was \$28 billion, \$4.2 of which was cash and other current assets. This was a significant impairment charge, and more are on the way. However, it appears that CHK still has enough assets to survive. **As evidenced by his recent statement, CEO Doug Lawler agrees:**

"We understand that our debt structure and gathering commitments add to the challenges of the commodity price environment, and there are several questions out there in the market, such as: can Chesapeake generate sufficient cash flow to weather this storm? And can the portfolio and operational strengths overcome these significant obstacles?"

The answer is definitively, yes. We have tremendous flexibility and optionality given the breadth and diversity of our portfolio."

In September, Morningstar (<http://www.morningstar.com>) lowered its current valuation of CHK from \$25 per share to \$19 a share, based primarily on lower assumptions for future oil and gas prices. This valuation is still close to 3 times the

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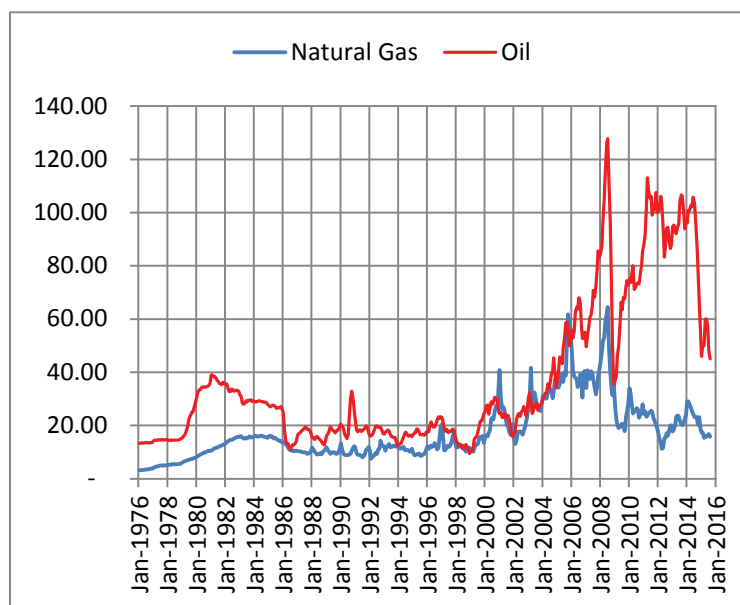
current price of the stock. When the prices of oil and natural gas start to recover, valuations are bound to increase sharply.

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 \$45 a barrel, that is the cost of 5.8 million BTUs. However, with the current market price for natural gas close to \$2.72 for one million BTUs, 5.8 million BTUs will cost \$15.78 (5.8x\$2.72). So the same amount of energy is available for 35 cents on the dollar, if it is in the form of natural gas rather than oil.

The following 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. Most of the time, the costs of the two forms of energy have been closely aligned. They have moved closer together, but remain substantially apart. This difference still translates into an expanding natural gas industry.

The Cost of Energy Equivalents of Oil and Natural Gas



ICON Energy Fund Class S (ICENX) is also a diversified way to participate in the recovery with a basket of substantial companies. In the past, this fund has achieved growth even during periods of declining energy prices. ICON management looks for changes within the energy sectors to capture value, rather than simply depending on rising oil prices. For example, the profit margins expand on pipelines when the price of oil is low, because the cost and price of storage and

transportation have little to do with the price of oil. This fund is a good way to capture today's values and profit from the recovery and changing landscape on a diversified basis.

Transocean (RIG) has been sharply impacted by the drop in oil prices. To survive, management has cut capital spending by 70 percent which has increased free cash flow and made its debt manageable. CEO and President, Jeremy Thigpen, has recently commented on the company's relentless emphasis on cost management as well as making sure that RIG has the right rig fleet to compete effectively in all market conditions.

The US still imports close to 7.5 million barrels per day. Deep water drilling is still a necessary source for the US and the world's oil needs. Long-term profits from RIG should be stellar from here.

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, under the brands Valero, Beacon, Ultramar, Shamrock, and Texaco.

Valero Energy is one of the few energy companies that can benefit from lower oil prices because refining margins generally expand during such times. The most recent quarter saw earnings more than double.

Most US refineries are not set up to handle the light, sweet, crude oil that is coming from fracking US shale. Valero's refineries are notable exceptions because they are the most flexible refineries, allowing Valero 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, a heavy sour oil that Valero buys for an even larger discount than from glutted US oil.

VLO remains an astonishing value. Earnings are expected to be in the vicinity of \$8.00 per share in the year ahead. This puts VLO's forward price/earnings ratio (P/E) close to 7.5, which is a low P/E for any stock and a deep discount from the overall market.

Reverse Bond Yield ETFs

We are recommending three ETFs designed to benefit from the inevitable rise in long-term Treasury bond yields. We have dubbed these ETFs as "No-Brainers" because interest rates and bond yields always rise during an economic recovery, especially as a recovery evolves into a vibrant economy. 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, specifically BlackRock's iShares

20+ Year Treasury Bond ETF (symbol TLT) which holds a portfolio exclusively of long-term Treasury bonds. The prices of these ETFs fluctuate in accordance with the daily fluctuations of TLT, only in the opposite direction, multiplied by the leverage each uses. For example, a decline of say, 1.0 percent in TLT will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in TLT will cause these ETFs to drop in the same fashion. We can project the movements of these ETFs based on any given scenario.

As part of the Federal Reserve's economic projections, each member of the Federal Open Market Committee (FOMC) makes a prediction regarding the future path of interest rates. Those predictions are plotted in the so-called "Dot Plot", and medians are taken to formulate the Federal Reserve's official prediction.

The most recent Dot Plot was taken at the September meeting and had some reductions in expectations from the last Dot Plot taken at the FOMC's June meeting. The September Dot Plot predicts that the Federal funds rate will be 0.375% at the end of 2015, up from zero currently. This was a reduction of 0.25% from the June meeting. By the end of 2016, the Federal funds rate is predicted to be 1.375%, also a reduction of 0.25% from the June meeting. By the end of 2017, the Federal funds rate is predicted to be 2.375%, a reduction of 0.50% from the June meeting.

Assuming long-term Treasury bond yields move in accordance with the latest Dot Plot predictions of the Federal Funds rate, here is what would happen to each ETF:

TMV would rise to \$34 by the end of 2015, to \$55 by the end of 2016, and to \$86 by the end of 2017.

TBT would rise to \$49 by the end of 2015, to \$69 by the end of 2016, and to \$93 by the end of 2017.

TBF would rise to \$26 by the end of 2015, to \$31 by the end of 2016, and to \$36 by the end of 2017.

In September, the second quarter GDP annual growth rate was revised upward to 3.9 percent of 3.7 percent. This verification reveals a vibrant economy. September also saw strong consumer spending reports along with a stunningly high consumer confidence survey. Clearly, the vibrancy of the US economy is not consistent with the Federal Reserve's current monetary stance of near-zero interest rates, which was established after the 2008-09 melt-down as an emergency measure to bail out the economy.

The FOMC's decision not to commence normalizing interest rates was based on the lack of inflation and international turmoil, especially in China, which is undermining demand for oil and other commodities. Chair Janet Yellen calls these conditions "transitory", and indeed they are. Any changes on these fronts will be a game-changer, and will likely make the September Dot Plot too conservative.

An additional factor is the amount of Treasury securities on the Federal Reserve's balance sheet. Purchases during the quantitative easing programs have resulted in an inventory

of \$4.5 trillion of Treasury securities, more than four times normal. Eventually, most of these Treasuries have to come back onto the market, adding upward pressure to bond yields.

At zero interest rates, and a bloated balance sheet, the Federal Reserve does not have the tools to implement an easier monetary policy, or much more in the way of a quantitative easing program, should they become necessary in the future. The current situation has to be corrected to allow for future latitude.

Real Estate Selections

Low interest rates for so many years have pushed down real estate capitalization (cap) rates (the yield before debt payments are considered) to historically low levels. As a result, commercial real estate prices are historically high, and the average real estate investment trust (REIT) does not present a particularly good value.

In the longer run, a rising economy will push up rental rates which will more than compensate for added interest expenses caused by rising interest rates. However, this benefit is most likely to translate into profits only on real estate stocks offering an extraordinary value now.

Hersha Hospitality (HT) is selling at a discount to its hotel assets because most of its major properties have been undergoing renovations and not producing their full income potential. Income is rising from new acquisitions and completed renovations. Second quarter revenue was 13.9 percent higher than one year ago, but there is room for more organic increases ahead.

We estimate the net asset value (NAV) of Hersha's hotel properties is at least \$28.42, based on the net operating income of the most recent four quarters. However, we expect the NAV of HT to increase as renovations are completed and new acquisitions add to revenue.

Retail Opportunities Investment Corp (ROIC) began as an IPO in October 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. As new properties are added, along with tenant upgrades, funds from operations (FFO) is bound to continue to rise.

This trend continued in the most recent second quarter, ending with a strong 9.5 percent increase in FFO and occupancy of 97.3 percent. ROIC also pays an attractive dividend which lowers its risk profile.

Third Avenue Real Estate Value Investor Fund (TVRVX) is replete with stellar 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, in making decisions on whether to buy, hold, or sell a particular company. The managers expend great effort analyzing financial statements, visiting companies and their properties, and assessing management teams to come up

with their estimates of intrinsic value. An additional similarity to *Sound Advice* is that members of management eat their own cooking – they invest a substantial amount of their personal assets into their recommendations by investing into the funds they manage.

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 looks for opportunities in different points of a real estate company's capital structure by investing in senior debt in addition to a company's equity. Also unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities in distressed times.

Specifically, the management team looks for 4 fundamental characteristics before making investments:

- 1) The issuer has an especially strong financial position.
- 2) The common stock is selling at a price that reflects at least a 20% discount from Net Asset Value ("NAV").
- 3) There is comprehensive disclosure including reliable audited financial statements.
- 4) The prospects are that over the next three to seven years, NAV will be increasing by at least 10 percent annually (including dividends).

Medically-Related Selections

This sector is defensive because medical needs persist regardless of financial conditions. The world's inexorable demographic aging trends and the commensurate increase in medical care needs translates into strong growth prospects for this industry.

Boston Scientific (BSX) has medical products that are 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 September, BSX received Europe's CE Mark marketing approval for its *Vercise* Primary Cell Deep Brain Stimulation (DBS) System for Parkinson's disease. DBS therapy involves the placement of a device that stimulates specific areas in the brain using electrical signals.

Pfizer (PFE) has an arsenal of new pharmaceutical products, with 88 in clinical development and 30 in late stage development or registration. PFE has rebuilt its pipeline and transformed its R&D approach. The company is well positioned with several break-through drugs and treatments.

In late September, Pfizer announced that the FDA granted "orphan drug" designation for the investigational cancer immunotherapy *avelumab* for the treatment of Merkel cell skin cancer.

FDA orphan drug designation qualifies the sponsor to receive special incentives, including assistance for clinical trials, prescription fee waivers, tax incentives, and seven years of market exclusivity.

Although the orphan drug designation applies only to *avelumab's* use against Merkel cell skin cancer, *avelumab* is in development programs for melanoma and mesothelioma, along with more than 15 tumor types in the breast, gastric region, ovaries, bladder, and esophagus.

PFE's potential blockbuster, *Palbociclib*, trade-named "Ibrance", for treating one of the deadliest forms of breast cancer, was approved earlier this year. In late September, PFE announced an increase in the quarterly dividend to 28 cents, beginning with the fourth quarter.

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 gives SYK avenues for continued diversified growth through acquisitions. The latest acquisition in September was Muka Metal, which sells hospital beds and other patient-room furniture in Turkey and other countries.

The most significant recent acquisitions was MAKO Surgical, which received FDA clearance in August for its knee and hip applications, enhancing SYK's robotic reconstructive solutions. Other recent acquisitions include Small Bone Innovations, Pivot Medical, Berchtold Holding, as well as Trauson Products, China's largest manufacturer of orthopedic implants.

Stryker is buying back \$2 billion of SYK in 2015, following the purchase of \$100 million in 2014.

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 which now provides the world's top drugs. This sector has outperformed the broad market during the last one, five, and ten year periods.

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. This is especially true during a recovering economy. Small-cap stocks perform better than large-cap stocks because 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. They also tend to be domestic companies without substantial overseas exposure, and therefore are not buffeted by the currency fluctuations that are currently haunting 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 use of AGU's products.

Close to one-half of AGU's earnings come from its retail stores offering farm products, and the other half comes from its wholesale sales of fertilizers, mostly nitrogen-based but also from potash and phosphates. This diversification tends to protect Agrium from swings in the markets and brings steady sources of growing free cash flow which allows it to expand for future growth.

AGU is trading at close to 12 times next year's earnings estimate of \$7.25 per share. This is a good value with a growing dividend.

Evidently the company's CEO, Charles Magro, agrees. In September, he purchased 3,800 shares, after a similar purchase in July.

Disney (DIS) announced in September that the 15 acres of land quietly purchased near its California Adventure theme park will be used for "Star Wars Land". Disney's Lucasfilm acquisition brings the Star Wars franchise to Disney. In December, the next Star Wars movie will be launched, *Star Wars: Episode VII - The Force Awakens*, and is expected to gross over \$2 billion, surpassing *Jurassic World's* \$1.5 billion. It could over take *Avatar's* \$2.8 billion and double last year's Studio Entertainment operating profit.

A sequel of *Frozen* is also coming up, which grossed \$1.27

billion in box offices and so far has generated \$300 million on DVD and Blu-ray sales. The new Pixar film, *Good Dinosaur*, is opening this Thanksgiving.

The company purchased 9.4 million shares of DIS (\$1 billion) during the last quarter, bringing the total to 32.4 million shares (\$3.2 billion) during the last 9 months.

Ford (F) has declined over concerns regarding Ford's growth rate in China, and more recently, in sympathy over VW's diesel emissions scandal. The decline has made the stock dirt cheap. Earnings are expected to be \$1.93 next year, putting the forward price/earnings (P/E) ratio below 7. This P/E ratio is far too low for a stock offering a solid dividend along with growth prospects.

As we have been pointing out in previous issues, earnings have been depressed because of down time and preparation for 24 new or refreshed vehicles, including Ford's new all-aluminum F-150 truck which weighs 700 pounds less than last year's model and gets close to 30 miles to the gallon. The F-150 is Ford's best-selling vehicle in the US and the company's most profitable product, even as volume has been held back by production capacity.

On the cost side, Ford is reducing the number of platforms it uses to produce its models, from 27 in 2007 to 9 by 2016, which will save billions of dollars through economies of scale, and give Ford more agility to adapt to changes in demand.

Freeport-McMoRan Copper & Gold (FCX) is the world's largest copper producer. It has suffered from a decline in copper prices which have been undermined by concern over China's growth because China is the largest consumer of the world's copper.

FCX had some good news in late September. It reported positive drilling results from its 100-percent-owned Horn Mountain Deep Oil and Gas well in the deep waters of the Gulf of Mexico. Initial production is expected to come on stream in 2017 with 30,000 barrels of oil equivalents per day. Drilling logs have also revealed profitable areas deeper than previously known, as well as additional opportunities in the area, including the 100-percent-owned Sugar, Rose, Fiesta, Platinum and Peach prospects.

The good news at Horn Mountain Deep follows other positive results announced in July from three other wells drilled in the vicinity which could produce 27,000 barrels per day of oil equivalent, with initial production commencing in 2016. FCX has other promising holdings which are bound to be a source of growth over the longer term.

We made a 643 percent gain during the last expansion, from March 2003 until December 2006, on Phelps Dodge, the largest copper producer back then and subsequently purchased by FCX. However, this was at a time when China was expanding and exerting high demand for copper and other commodities. Now that China has grown into the world's second largest economy, it is transforming into an economy fueled by its own consumers which has made its growth path less certain. However, recent devaluations of the yuan are bound to stimulate the Chinese economy.

FCX management is targeting significant additional reductions in capital spending and operating and administrative costs in response to weak market conditions in order to reduce costs to preserve its most valuable resources for anticipated improved market conditions in the future.

Expanding economies around the world are bound to be exerting increasing demand for the assets held by FCX. Evidently activist investor Carl Icahn agrees. In the final days of August, he reported a stake of 88 million shares of FCX, making him its largest shareholder. Mr. Ichan is an activist, and not happy with FCX's corporate governance. Any actions he takes can only be positive from here.

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.

The speculation regarding the acquisition of NCR has waned recently. So far, the Blackstone Group has not been able to reach a deal or find a partner for its \$10 billion bid. Discussions with Bain Capital and the Carlyle Group fell apart over disagreements on the price. The private equity firm Thoma Bravo has also held talks to acquire NCR but could not agree on terms. The hedge fund Marcato Capital now holds a seat on its board of directors and has been exploring strategic alternatives since last year.

The acquisition difficulties have undermined the price of NCR to a significant discount to the market. Even with currency headwinds, NCR expects to earn \$2.68 to \$3.00 per share in the year ahead. At less than 10 times earnings, NCR is a value play.

NCR is expanding into the software sector. It recently launched a cloud-based software system for ATMs called Kalpana aimed at lowering costs for users. It also recently launched its cloud-based platform for the ATMs operated by the Industrial and Commercial Bank of China which has demonstrated substantial cost savings, especially in comparison to the bank's manual cash management system.

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. According to Symantec's latest annual Internet Security Threat Report, cyber-attacks against large corporations have jumped by 40% this year. If there ever was a more certain

growth industry, protection from cyber espionage is it.

Through its so-called "Internet of Things" (IoT) division, SYMC's most recent focus is on protecting devices from hackers. Devices needing protection are those controlled by an internal computer that is accessible by the internet. A prime example is a modern automobile, where hackers can literally steer the car and disable or lock the brakes from their remote keyboards. The risk of hackers tracking and hijacking extends to a wide range of devices, from industrial controls and medical devices to ATMs (especially those running on a Windows operating system), along with a plethora of consumer electronics.

Symantec's offering of IoT solutions operates by (1) locking down the device to prevent intrusion, (2) authenticate and encrypt data running throughout the device, and (3) verifying that all code running through the device is authorized and protected by a strong "Root of Trust".

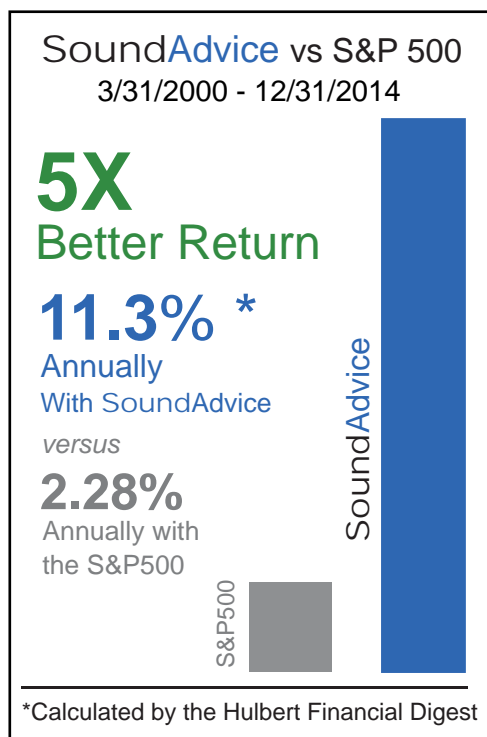
Tetra Tech (TTEK) is a leading company in water technologies and environmental remediation with a healthy balance sheet for growth in strategic markets.

In September, TTEK announced it was awarded a \$47 million contract to conserve forested areas in Indonesia which are among the planet's most biologically diverse and carbon-rich ecosystems and offer the potential to mitigate global climate change through carbon sequestration.

These ecosystems are threatened by deforestation and unsustainable land-use practices that accelerate the release of greenhouse gas emissions while increasing the vulnerability of forest and coastal communities to extreme weather events such as floods and forest fires. In a five-year term, Tetra Tech will work to mitigate the threats of deforestation and unsustainable land-use practices, prepare and implement low emission development policies, and support conservation-oriented decision-making to retain the health of Indonesia's biodiverse ecosystems.

So far this year, the company has purchased about \$75.5 million of TTEK. The quarterly dividend was raised to 8 cents per share.

Xerox (XRX) is continuing to transform from a seller of printers and copiers to a company providing business services in the form of business process outsourcing, information technology (IT) services, and document outsourcing (printing as a service). The services side now amounts to 55 percent of revenue. These outsourcing arrangements are long term in nature and encompass a wide range of profitable services for larger customers and result in contract renewals of close to 90 percent.



Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Hersha Hospitality Trust	HT	NYSE	\$ 22.66	4.94%	\$ 28.42	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 16.54	3.63%	\$ 18.00	BUY
Third Avenue Real Estate Value Investor	TVRVX	800-443-1021	\$ 29.73	1.48%	\$ 34.00	BUY
Diversified Growth						
Agrium	AGU	NYSE	\$ 89.50	3.49%	\$ 110.00	BUY
Disney	DIS	NYSE	\$ 102.20	1.29%	\$ 110.00	BUY
Ford Motor Company	F	NYSE	\$ 13.57	3.68%	\$ 17.00	BUY
Freeport-McMoRan	FCX	NYSE	\$ 9.69	2.06%	\$ 14.00	BUY
NCR Corp	NCR	NYSE	\$ 22.75	0.00%	\$ 30.00	BUY
Pfizer	PFE	NYSE	\$ 31.41	3.57%	\$ 35.00	BUY
Stryker Corp.	SYK	NYSE	\$ 94.10	1.13%	\$ 105.00	BUY
Tetra Tech	TTEK	NASDAQ	\$ 24.31	1.32%	\$ 27.00	BUY
Third Avenue Small-Cap Value Investor Fund	TVSVX	800-443-1021	\$ 21.23	0.00%	\$ 24.00	BUY
Xerox	XRX	NYSE	\$ 9.73	2.57%	\$ 12.00	BUY
Energy/Natural Resources						
Chesapeake Energy Corp	CHK	NYSE	\$ 7.33	0.00%	\$ 10.00	BUY
Chevron	CVX	NYSE	\$ 78.88	5.43%	\$ 90.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 22.76	1.45%	\$ 25.00	BUY
ICON Energy Fund Class S	ICENX	800-828-4881	\$ 11.17	0.81%	\$ 14.00	BUY
Transocean	RIG	NYSE	\$ 12.92	4.64%	\$ 16.00	BUY
Valero	VLO	NYSE	\$ 60.10	2.66%	\$ 65.00	BUY
Aggressive Growth						
Boston Scientific	BSX	NYSE	\$ 16.41	0.00%	\$ 18.00	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 27.50	0.00%	\$ 34.00	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 24.52	0.00%	\$ 26.00	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 43.37	0.00%	\$ 47.00	BUY
S&P 500 ProShares Ultra Short ETF	SDS	NYSE	\$ 23.28	0.00%	\$ 25.00	BUY
Symantec	SYMC	NASDAQ	\$ 19.47	3.08%	\$ 23.00	BUY
Tekla Life Sciences Fund	HQL	NYSE	\$ 22.51	0.00%	\$ 28.00	BUY

Notes to the table:

Prices are as of 9/30/2015. See our website for live pricing and buy limits:

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

Yields on funds may include capital gain distributions.

In September, XRX expanded its pharmacy solutions portfolio by acquiring the inVentiv Health company, a patient access and reimbursement services hub that helps XRX's pharmaceutical company clients expand sales by identifying uninsured and under-insured patients, and working with them to eliminate financial obstacles to obtaining prescribed medications.

Also in September, XRX introduced 2 electronic printed labels that can store data about a product. One can track how a product has been handled during distribution. The other version has an encrypted code that can only be read by authorized personnel using a reader which interfaces with a secure smartphone application. This is one of the most secure solutions for protecting against counterfeiting.

These labels make it possible to ensure the integrity of a product from the time it leaves the factory to the time it gets into the hands of a customer for a range of products, from pharmaceutical products to tax and duty stamps. Unlike other anti-counterfeiting methods, such as invisible ink, holograms, and radio-frequency I.D. tags, which can be copied, they are a cost efficient, highly secure method of authenticating and verifying information about a product as it moves through various distribution channels or as it is used.

XRX is a good value. The company expects to earn from \$0.95 to \$1.01 per share, which puts the stock price close to 10 times earnings, very cheap relative to the rest of the market.

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 underperforming 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 \$11.3 million in stocks and to \$1.46 million in houses.

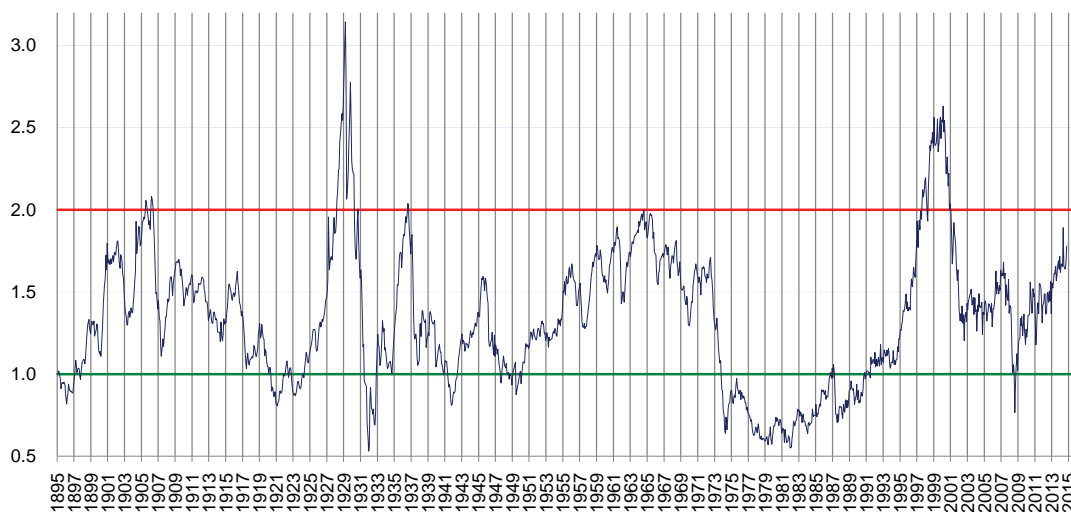
But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the SoundAdvice Risk Indicator he would have made \$448 million, or 39.7 times more money—the 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 SoundAdvice Risk Indicator

The latest reading for the SoundAdvice Risk Indicator is 1.66. 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 Turbulent Markets* for a complete explanation of the SoundAdvice Risk Indicator and its track record. (You received a copy of this book with your subscription, and you will also receive an updated copy when you renew your subscription.)



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

To construct our 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 March, 2015.

The previous zero reading was 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.

However, the March 2015 signal was usurped.

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 which reveals that the economy is about to put upward pressures on interest rates.

This has been a critical indicator in the past and has aided in avoiding severe declines, most notably the crash of 2008-09. However, since then, the Federal Reserve's Quantitative easing program has been holding short-term rates artificially low to stimulate the economy.

This index hit 100% in 2012. Although we operated under the "Caution" signal, we have continued to be bullish about stocks because of the Federal Reserve's expansive monetary policy and its quantitative easing program, which has been distorting the natural business cycle.

The most recent lagging economic indicators released in June (for May) caused the SoundAdvice Diffusion Index of Lagging indicators to hit 100 percent, giving us a new 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 31.7 percent. During "Caution" signals, the S&P 500 increased an average of 1.9 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 +/-	31.7%		1.9%

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

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