

SOUND ADVICE

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Mr. Market's Moods



Our managing editor just got a glimpse of how panics start, and got it in the comfort of his kitchen. At dinner last week, his wife told him that she'd just emailed their two sons with dire news: "I just heard that deposits in Citibank are not FDIC insured because they are mostly held overseas. I hope you are out— if not, get out. MOM"

This was nonsense. Their sons' deposits are federally insured. Where did she get that idea? While driving, she had been half listening to Marketplace on National Public Radio. A piece on the travails at Citibank included the fact that most of Citibank's deposits are in foreign accounts. The NPR show then dropped in the voice of a financial blogger from Portfolio.com: "That means they're not insured by the FDIC and that means that the people who have money on deposit with Citibank have good reason to want to move that money somewhere safer." The problem was sloppy cut-and-paste syntax. The "they" refers not to U.S. deposits but to foreign deposits, and only this "they" "have good reason to want to move that money somewhere safer."

Did this obscure moment start a panic. No. Nonetheless, the NPR story contributes to a lack of confidence in Citi, the same uneasiness that contributed to the downfall of Bear Stearns and of Lehman. What this story most of all signifies is how unhinged we have all become, that a poorly constructed sentence could convince someone that the world was coming to an end and that action must be taken immediately. At times like this, most savers and investors are vulnerable. Take a deep breath.

- Gray Emerson Cardiff

One of Benjamin Graham's investing tales involves Mr. Market, who charitably could be considered unstable. Imagine you and Mr. Market are partners. On some days, he is so euphoric about your company that he wants to buy you out at any price, but on other days he is so despondent that he begs to sell his share at any price. Graham suggests you accommodate him, which is to say sell high and buy low when the market goes crazy in either direction.

Right now I'm wondering about my own sanity. One definition of insanity is doing the same thing over and over and expecting different results. As I sat down to weave this annual basket of five stocks we think can outperform the market over the next 12 months, I have to wonder whether value investing (some might wonder whether any investing) in this sort of market is sane? Lately, most value-oriented funds have underperformed because as financial services shares fell out of favor in 2007, value investors bulked up on them. **Dodge & Cox Stock Fund**, for instance, expanded holdings in **American International Group**, Wachovia and Fannie Mae, and reaped ashes.

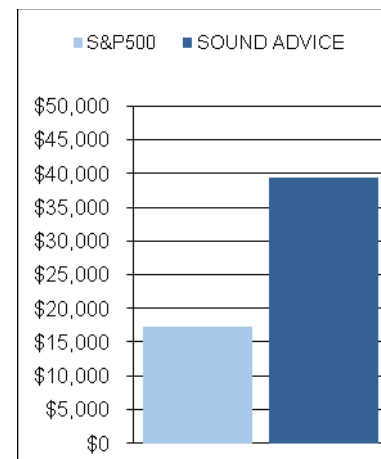
Few (count us as among them) imagined how deeply complicated the rot was in these financial stocks and how abruptly they could collapse. Though *Sound Advice* has done better than DODGX over this period, that's scant comfort.

Over the years, our November baskets have handily outperformed. The 2006-2007 quintet returned 18%, more than double the S&P's 12-month results and nearly triple the Dow's. But not this year.

Only one stock turned in a positive return, **Electronic Data Systems** (26.2%), which Hewlett Packard acquired. The next "best" performer was **Boston Scientific**, which is down 30.7%, followed by **Time Warner** at 37.9%, **Maxim Integrated** at 40.7%. Finally there was **American International Group**, which has nearly vanished.

We always look for stocks that were serious laggards. Stocks without blemishes or investor concerns do not become cheap, hence each had a defect we believed

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could and would be fixed. Each had a seductively low set of price ratios near the bottom of their historical ranges. But a severe bear market has ambushed us.

We still are willing to buy what others are selling. We still are willing to use historical performance as a guide. We still are willing to do the same thing over and over and we still expect different results, because one failure does not negate our much longer history of market-beating results—but it sure does induce some humility about those successes.

As we try to peer over the horizon to glimpse what 2009 will bring, we find ourselves standing firmly in a recessionary environment that cloaks the entire globe. Stock prices are dictated now not by fundamentals but mostly by fear that the global economy is on the precipice of something worse than a garden-variety recession. Even the few shreds of bullish news such as corporate insiders making huge buys of their shares are being spun to fit the market's fatalism. Shares are being priced as if there is no tomorrow, which makes it extremely difficult to imagine otherwise. However, we do think the remorselessly bleak economic landscape will return to more normal conditions.

Why? We expect the massive series of credit infusions onto the balance sheets of financial services companies (and in some cases, the outright nationalization of the companies themselves) along with stimulus measures directed at entire economies (it's a global problem demanding a global solution) will wrench them back to life. Though U.S. authorities, through timidity and ideological reluctance, were slow and piecemeal in confronting the credit market crises, the aftermath of the absurd decision to let Lehman fail marked the end of federal dithering.

Frankly, there now seems nothing the Federal Reserve and Treasury are not prepared to consider to avoid deepening this undeclared recession. Effectively the real Federal Funds Rate now is below zero (Subtract the current core rate of inflation, 4.9%, from the nominal Fed Funds Rate, 1%, and you have free money). Fed officials say they are prepared to force down rates on two and three-year Treasury securities, which would be highly stimulative. Bailouts for non-financial companies, starting with the auto industry, are likely. We also expect hundreds of billions of dollars to pour into

infrastructure projects to get workers working and capital goods sold.

Economists and journalists worry that we might be facing more than the shallow recession of 2002, and point ominously to the 1929 Crash and the ensuing Depression. Fortunately we have learned something during the intervening 80 years, and more fortunately Ben Bernanke, Chairman of the Federal Reserve, devoted his academic career to understanding how to and how not to deal with severe economic slowdowns.

In fact, the 2008 recession is not Bernanke's first real-world experience with recessions. In 2002 as a newly minted Governor of the Federal Reserve, Bernanke drew national attention and gained the nickname "Helicopter Ben" with remarks about what he perceived to be the gravest potential threat to the U.S. economy: deflation, a broad and persistent drop in prices, and how he advised the Fed to deal with such a challenge.

Bernanke figuratively promised, were he confronted by deflation to have helicopters drop cash on the citizenry. We took this as a sure sign that the Fed already was doing just that, and that in addition to blunting deflation would have the unintended consequence of inciting inflation. We packed the portfolio with hard assets because we believed that between the Bush tax cuts, the unfunded war on terror and the Federal Reserve's loose credit policies, we were about to experience a massive inflationary bulge. We got it in housing, in energy and other commodities.

Today inflation is the last thing on Bernanke's agenda. Instead every imaginable stimulus is being applied to reverse deflation that threatens to cripple the U.S. and its trading partners. And just as after Bernanke's 2002 speech, we expect that deflation will be checked, but the remedy will kick off another round of price inflation.

We are using that road map for this year's basket of ideas. If we are right, we expect the dollar again will come under pressure, that hard assets will regain much of their glitter, that interest rates will rise, and that the U.S. economy will climb out of recession during 2009. If the market anticipates such events, expect to see stocks respond in late winter. Is this outlook evidence of our insanity? Check back in 12 months. **SA**

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This year's basket of ideas as usual homes in on beaten up investments, which at the moment means pretty much everything on Wall Street. Frankly, you could buy the most broad-based index fund, and have reason to expect that when the market recovers, you will make money. However, we believe the market's recovery will have much to do with government stimulus, which is why we like infrastructure. We also think that as the economy regains equilibrium, commercial real estate has a solid future, though we are not gullible enough to think that this turn is just around the corner. For the short-term, we are comfortable with the yields REITs offer even as we anticipate reductions in payouts.

Why do we think the market will recover? Well, it always has, though I can appreciate that traumatized investors after falling into a vicious bear market that is 44% below its October 2007 high have given up hope. We are in the midst of a severe recession, whose end is nowhere in sight. Given the massive stimulus programs begun and yet to be begun not just here in the U.S. but around the world, we expect that economies will be jolted back to activity, which should broadly benefit shares. However, we also expect that these emergency programs and the extraordinary infusions of credit into the global banking system ultimately will be highly inflationary and will weaken currencies, which makes us partial to precious metals. Finally, we include two broad investments. The first is the best value fund we know, which has taken its lumps in this market, but which if past is prologue should roar in any recovery. Also we are adding a stock for all seasons, one we consider to be the bluest of blue chips among American corporations, which thanks to the punishing market is extraordinarily cheap.

PowerShares Water Resources ETF (PHO—AMEX) has tumbled this year along with other infrastructure investments as investors decided that constrained federal, state and local budgets would be unable to fund the heavy backlog of deferred maintenance and ambitious new projects which were expected to fuel growth for this sector. Also, the anticipated boom in infrastructure projects had melded in investors' minds into the great natural resources bull market, perhaps

because infrastructure projects demand massive amounts of material. Now that investors have abandoned natural resources and commodities—we think too quickly—so too has their fascination with infrastructure cooled. This year the ETF has lost 40% of its market price. Losses are painful, but we think PHO is an outstanding bargain at this point. Let's take a look at its portfolio.

Most investors in water resources have bulked up on water utilities, the owners and/or suppliers of water, which makes some sense, but when we reviewed possible investments, we preferred concentrating on purification, remediation and the hardware necessary to deliver water, areas we already have cultivated with **Tetra Tech** and **Insituform**. This fund has taken the same tack. Barely 10% of its assets are invested in traditional water companies.

The portfolio contains 32 companies, each deriving some portion of its revenues from water, though in the case of General Electric, for instance, that portion is tiny. **Tetra Tech**, which specializes in water resource remediation and environmental cleanups accounts for 5% of the fund. The second largest position (4.4%), Valmont Industries, fabricates metal conduits and pipes used in irrigation systems and by water utilities. The third largest component, Danaher (4.2%) designs and manufactures professional electronic test tools and calibration equipment, water quality instrumentation and consumables, and ultraviolet disinfection systems as well as industrial water treatment solutions.

But if water resources are a good investment idea, at the moment the sector is, well, under water. Wall Street excitement about the sector has turned to gloom, which might be premature for two reasons. First, the essential demand for clean, potable water is an issue not just in third-world economies where polluted water is a major source of disease and also an obstacle to development but even in the most advanced economies. Take our home state, California, where some of the purest water in the world flows out of the Sierra Nevada snow pack into reservoirs that serve San Francisco and much of the bay area. Urban

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growth, agriculture and fishing are all suffering due to insufficient water supplies.

Almost instinctually, government ignores infrastructure unless a bridge collapses or a dam fails. Now money is tight. But precisely because global economies are simultaneously slipping into a deep recession compounded by a credit crisis, the very tightness of money might turn out to be the reason for a surge in infrastructure projects.

This month, China announced it would undertake a \$586 billion stimulus program to kick start its domestic economy. Prominent in Beijing's priorities are water resources and sewage treatment. Here at home, the President Elect and the new Congress promise to do more to stimulate the economy. On the agenda will be billions in infrastructure projects, some portion of which will involve water and sewage development.

How cheap is PHO today? Its market price is about 20% below where it first traded in December 2005, but more importantly, its underlying shares are also scraping bottom. **Tetra Tech** is trading at price ratios lower than at any point in the last decade. Ditto for this ETF as well.

HRPT Property Trust (HRP—NYSE) has been clobbered this year as Real Estate Investment Trusts (REITs) have been abandoned by both their traditional income-oriented audience as concerns over distribution reductions have mounted and by a more recent audience of performance-oriented investors who wanted to own one of the most dynamic sectors between 2000 and 2007. The result has been the worst period for REIT investors ever. We think that the market has it wrong about REITs in general and HRP in particular. The shares this year are down by more than half on a total return basis. Yet as a business the REIT is doing well. The share price, we believe, cannot be justified by the facts.

HRP owns a large and diversified real estate portfolio with properties spread across 31 states and the District of Columbia. Management has crafted a portfolio that emphasizes long-term lease obligations (six-year average), creditworthy tenants (53% are investment grade rated, 34% are private companies, mostly professional firms, with strong credit ratings). Its properties mostly are situated in central business districts, which presents a significant barrier to new

construction, though management has avoided hot markets such as New York City, since the emphasis has always been on steady income rather than trophy properties and high-rent tenants.

The bulk of HRP's office buildings house government and medical offices, which management believes not only are more creditworthy but also are more stable. Cash flow from such tenants tends to be less exposed to the business cycle. HRPT avoids turnarounds or other speculative acquisitions. The company also avoids off-balance sheet arrangements.

But management can look beyond office cubicles. Three years ago, HRP acquired a large property located between the harbor and airport for Honolulu. Currently occupied by light industry and small businesses, the property generates reasonable current income. Subsequently, HRP added to its Hawaii holdings. We expect that HRP will make improvements to this strategically positioned property, and as the Hawaiian economy picks up in tandem with its real engine, Asia, that this will become a much more valuable asset.

In that recent conference all, management noted that in most markets it was getting higher rates for new leases, though capital expenses for renewing leases and signing new tenants were rising. Still, as we examine HRP's balance sheet and income statement, we find strength that contradicts market pessimism. Based on the portfolio's net operating income, we believe HRP's market capitalization is substantially lower than company's net worth. Indeed, we project that company's equity translates to more than \$15 a share based on a 9% cap rate.

So what has rocked this REIT? There is general anxiety about how office properties will fare during a severe recession, and specific concerns about whether HRP should continue to support the current dividend.

At the third quarter conference call after results were announced, one analyst noted that HRP last year had been able to sell properties, the proceeds from which supported the dividend. But this year such sales were unattractive, since property prices were depressed. He suggested that HRP consider reducing its dividend not only to help defray currently higher capital expenses needed to keep old and attract new tenants but also to fund purchases of depressed properties. Management was noncommittal, though it did admit

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that the sky-high current yield (31%) signaled that the market expected a cut.

We think he has a point. Given the chaotic REIT market, the current yield certainly is not sustainable. Even though we believe management can cover this distribution for the next few quarters, the market is predicting that it will cut it. We have done some calculations based on cuts ranging from 25% to 50%, or from 84 cents a share to 63 cents or 42 cents a share. In that scenario, presuming the share price would rise were a dividend cut announced, we can project HRP selling at about \$4 to \$5 a share and yielding between 10% and 12% during this extremely pessimistic period. Once REITs climb out of this depression, we would expect that distribution to return to current or even higher levels and the share price to move robustly.

USAA Precious Metals & Minerals Fund (USAGX) came undone along with energy and other commodities as the dollar began to strengthen. The dollar had been in retreat since 2002. All commodities are priced in dollars, and when the dollar weakens, as it did from 2002 till this July, the dollar price for commodities rises. This was a simple adjustment to reflect a cheaper dollar. Add in rising demand for most commodities, and the explosion in prices was stunning.

Now the dollar has surged, while demand for commodities has dropped in a recessionary environment. Oil, for instance, peaked at \$147 a barrel. Now it is under \$60. Gold peaked breaking \$1000 per ounce in early spring as did gold mining stocks. As we close this issue, gold is selling around \$740 an ounce, down 27% from that high, while USAGX is down 62%. As you know, gold mining shares always amplify moves in the underlying commodity, both on the up and the downside. USAGX does not own bullion, instead it holds mining shares.

Most presume that not only is the bull market in commodities done but it is especially final for gold, an asset class that many investors reject as primitive and unsuitable to the 21st century economy. Perhaps. But nightmarish drops in gold and gold mining stocks are hardly unusual. At least once in each of the last two decades, USAGX's share price has been cut in half: in 1987, falling 53% in six weeks, and in 1998 over five months dropping 48%. Precious metals compared to other sectors remain relatively small, and share prices demonstrate great volatility.

And then there are psychological tides. Precious metals are seen as a hedge against inflation and in general against economic and political instability. While inflation was a market preoccupation with oil at \$147, that no longer is true. The Federal Reserve, for example, has ceased worrying publicly about inflation. Investors have decided that the U.S. and global economies were slipping into recession, perhaps a deep and prolonged recession. Instead, worries about inflation were replaced by anxieties over deflation, a persistent drop in prices.

USAGX has been in business for 25 years, and its manager, Mark Johnson, has been in charge for 15 of them, regularly outperforming the competition. Only twice during his tenure has Johnson trailed the average precious metals fund's performance. His method is simple: he looks for mining companies with low production costs, strong reserves and low price ratios. He can also temper the pure precious metals profile with industrial metals. Among the 20 largest positions, presently only Freeport McMoRan (4.9% of the portfolio) is primarily involved in industrial metals. Turnover is low (28%), fees modest (0.78%). We expect over the next 12 months that the market will have reason to reconsider its preference for the dollar as well as its disdain for inflation. If we are right, USAGX will vault back.

Dodge & Cox Stock Fund (DODGX) is suffering through its worst year this decade, and in terms of relative performance its worst year since 1998. Despite that, the fund over the past 20 years has outperformed the S&P 500 by roughly 3% annually or 20% overall.

Dodge & Cox has been in business since January 1965, so we think it is safe to say that the method DODGX follows is well-tested. The average tenure of its manager team is 14 years, roughly triple the duration at peer funds. In fact, the only thing that would make us reconsider our respect for Dodge & Cox funds would be if management were to abdicate the conservative, value-oriented, patient approach that has worked so well over more than 40 years.

That approach, as Dodge & Cox writes, "consists of a three-to-five year investment horizon, an analysis of each company's long-term earnings prospects relative to its current stock price, and an understanding of the importance of diversification." Turnover in the fund last year was 27%, remarkably low even for a

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value-oriented large cap fund (the average last year was 61%), but for DODGX high (over the previous six years it averaged 9.7%). The fund's positions are inexpensive on the basis of price to book, sales and cash flow, and yield is more than triple what portfolios of comparable funds return. Finally, the expense ratio is a strikingly cheap 0.52%.

But sometimes the managers get it wrong. As we note on page one, the fund has been humbled lately by significant investments made in financial services stocks that after eroding during most of this year, collapsed in late summer and early fall. Management in its letter to shareholders dated October 9th explains: "While in each of these cases we believe that our assessment of the strength of the company's business franchise and its long-term prospects was on the mark, in the end the regulators crafted arrangements to address broader systemic concerns at the expense of each company's shareholders. (For instance, Wachovia possessed capital levels well above regulatory requirements, significant liquidity and, as of September 25, a growing deposit base. Despite this, the U.S. government seizure that day of Washington Mutual led to a concern about Wachovia's liquidity, and the government facilitated a quick sale which, if completed, would result in large losses to Wachovia shareholders.)"

The portfolio, which numbers 80 positions, currently is skewed toward healthcare (24% of the portfolio), 21% in consumer discretionary, 18% in information technology, 12% in media stocks, 11% in energy and material stocks, 6% in industrials and, not giving up on what has killed the fund this year, 16% remains in financial service companies. In our experience, there are very few investments that once bought should be kept regardless of market conditions. Dodge & Cox Stock Fund is among that elite few. When Mr. Market wants to give shares in DODGX away to you for cheap, it would be foolish to say no.

Johnson & Johnson (JNJ—NYSE) has weathered the bear market better than most, and is down 9.4% from the October 2007 market high while the S&P has tumbled 44%. In fact, before the market fell apart entirely last month, JNJ was 10% above where it stood when the S&P peaked in 2007. Of our healthcare-related stocks, JNJ has always been the least speculative, which is why now we think it's the best

choice to continue retaining value as the economy goes forward. This year's basket of ideas leans toward diversified investments, and though JNJ is just one company, it fits that profile. JNJ's diverse businesses make it look more like a closed-end healthcare fund than just a single stock. Were we to own a single stock that would let us sleep at night, we would choose JNJ, no small comfort in a world in turmoil.

Revenues flow from almost every segment of the healthcare products industry: consumer products ranging from baby care to over-the-counter medications, pharmaceuticals and medical devices. In its quarterly report to the SEC filed earlier this month, Johnson & Johnson shows growing revenues across the board (13.1% for consumer sales, 0.2% for pharmaceuticals and 8.8% for medical devices). Thanks to the strong dollar that prevailed through most of the quarter, foreign sales account for much of the growth. Indeed, foreign revenues countered a 6% decline in U.S. pharmaceutical sales. Now the Greenback is rising, but as argued elsewhere in this issue, we expect that is not going to last. Indeed, the exchange rate factor, though significant, is really not the overarching story for Johnson & Johnson.

The clincher is how cheap these shares are in relation to where they have traded during previous recessions. In the 2002 slowdown, JNJ traded at price ratios double their current levels. JNJ trades at a Price/Earnings ratio of 13.6, a Price/Sales ratio of 2.7, a Price/Cash Flow ratio of 11.2 and a Price/Book ratio of 3.6., well under their historical averages. Current yield is 3.1%, another value flag.

Why so cheap? Aside from the weak market, investors worry that healthcare expenditures will fall should Medicare and Medicaid have to tighten. But national health insurance is coming. We think healthcare—and Johnson & Johnson—have a very positive future. **SA**

Portfolio Updates

The October issue noted the S&P had lost 11.5% since the previous issue. This month was even worse. Between 10/3, when we closed the last issue through this month's close on 11/14, the S&P dropped 20.6%, "better" than the Nasdaq's 22.1% but more than the Dow's 17.7%. Of the 30 trading days, 13 had moves up or down of 4% or more, among them two double-digit days. The intraday swings were even more unnerving. Some of this can be explained by extraordinary news such as GM's stagger toward bankruptcy and startling statistics for unemployment numbers, collapse in consumer activity and the Treasury's abandonment of its plan to purchase toxic mortgage derivatives. After being preoccupied by the dysfunctional credit markets and Washington's bailouts of banks, insurance companies and other financial giants, investors are now focusing on something that is more familiar: recession. No, the National Bureau of Economic Research, the designated arbiter for recessions and expansions, has not spoken, but it will. If investors are familiar with recessions, they are hardly comfortable with them.

The question is whether panicked investors are exaggerating what we can expect, but if what you expect is a replay of 1929-1932 when the Dow dropped 89%, then panic makes sense, which explains some of the sharp price drops. If you are a trader, and can get it right, this must be heaven. If you trade, and get it wrong, hell. We are not traders, but the extraordinary volatility destroys any pretense that the market is efficient. Right now, it is schizoid. Amid the rubble, we hope there is opportunity.

The *Sound Advice* portfolio fell 26%, and not surprisingly the best performer was the **Prudent Bear Fund**, which added 17.8%. The worst performers were REITs, which are being sold, it seems to us, without any regard to what we see as real value. Yes, some recklessly leveraged REITs like General Growth Properties could end up at zero. Others like Diversified

Developers with exposure to Circuit City, which went into Chapter 11 reorganization this month, were clubbed down out of all proportion to even worst-case consequences of their tenant's predicament. For our REITs, frantic sellers seemed even less rational. **HRPT Properties Trust** was cut in half as shareholders bailed

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out because it's likely to cut its distribution to divert cash to operations, but is at no risk. In fact, we're highlighting it this month in Five for 2008 (see page 3), if you need any proof that the market expects a cut, the current yield based on the existing 21-cent a quarter distribution works out to 31.3%. Management, which in its Q3 conference call last week acknowledged that the yield did signal what the market thinks will happen, also reported that though this is a difficult market for its stock, as a business it was doing fine. HRP's rent rolls are dominated by long-term, high-credit government and private firms, and these properties tend to be in quieter markets. We've been constructive about HRP throughout, and lest you think that we are blindly stubborn about its prospects, we suggest you take a look at *Morningstar*, which generally doesn't get caught up in herd thinking. It suggests fair value for the shares is \$8, and thinks it could under better market conditions rise to \$16. On November 14th, the shares were dumped as the lone analyst with a buy rating moved it to a hold. Our other REIT position, **DWS RREEF Real Estate Fund II** was caught up in the same panic, dropping to \$1.90, which also makes no sense to us.

Sound Advice: Portfolio Updates for November 2008

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
DWS RREEF Real Estate Fund II	SRO	AMEX	\$1.90	80.21%	\$5.00	BUY
HRPT Properties	HRP	NYSE	\$2.68	31.34%	\$6.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$32.64	0.34%	\$38.00	BUY
Boston Scientific	BSX	NYSE	\$7.39	0.00%	\$10.00	BUY
Cintas	CTAS	NASDAQ	\$21.01	2.19%	N/A	SELL
Disney	DIS	NYSE	\$21.00	1.48%	N/A	SELL
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$22.55	12.24%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$70.67	25.35%	N/A	BUY
Fastenal	FAST	NASDAQ	\$33.32	1.38%	\$40.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$8.32	0.48%	N/A	SELL
Gabelli Global Telecom	GABTX	800-422-3554	\$14.17	1.64%	N/A	BUY
Honeywell	HON	NYSE	\$27.35	3.66%	\$34.00	BUY
Insituform Technologies	INSU	NASDAQ	\$13.79	0.00%	N/A	SELL
Johnson & Johnson	JNJ	NYSE	\$60.05	3.06%	\$68.00	BUY
CarMax	KMX	NYSE	\$8.36	0.00%	\$12.00	BUY
Liberty Capital****	LCAPA	NASDAQ	\$3.78	0.00%	N/A	SELL
Mattel	MAT	NYSE	\$13.91	5.39%	\$16.00	BUY
Microsoft	MSFT	NASDAQ	\$20.06	2.19%	\$26.00	BUY
Molson Coors Brewing	TAP	NYSE	\$42.55	1.93%	\$50.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$9.43	0.00%	\$11.50	BUY
Sara Lee	SLE	NYSE	\$9.47	4.44%	N/A	SELL
Schering-Plough	SGP	NYSE	\$15.76	1.40%	\$21.00	BUY
Sony	SNE	NYSE	\$21.12	1.04%	N/A	SELL
Sprint Nextel	S	NYSE	\$2.30	4.35%	\$5.00	BUY
Superior Industries	SUP	NYSE	\$10.81	5.92%	\$15.00	BUY
Tetra Tech	TTEK	NASDAQ	\$16.98	0.00%	\$21.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$31.21	6.70%	N/A	BUY
United Parcel	UPS	NYSE	\$53.14	3.16%	\$60.00	BUY
UnitedHealth Group	UNH	NYSE	\$20.02	0.15%	\$27.00	BUY
Wal-Mart Stores	WMT	NYSE	\$52.71	1.27%	\$60.00	BUY
Whole Foods Markets	WFMI	NASDAQ	\$9.38	0.00%	N/A	SELL
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$34.12	5.99%	N/A	BUY
Xerox	XRX	NYSE	\$6.36	2.52%	\$9.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	\$9.53	11.86%	\$15.00	BUY
EnCana	ECA	NYSE/TSE	\$44.46	3.60%	N/A	SELL
Icon Energy Fund	ICENX	800-764-0442	\$13.68	0.85%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$33.88	4.96%	\$41.00	BUY
PowerShares Water Resources ETF	PHO	NYSE	\$12.32	0.55%	\$16.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$49.84	5.78%	N/A	SELL
Transocean	RIG	NYSE	\$70.89	24.45%	\$85.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$15.27	17.35%	N/A	BUY
Aggressive Growth						
American International	AIG	NYSE	\$2.08	38.46%	N/A	SELL
Comcast	CMCSA	NASDAQ	\$15.53	1.60%	\$18.00	BUY
Discovery Holdings	DISCA	Nasdaq	\$13.92	0.00%	N/A	SELL
Ford Motor Convertible Pfrd.	F.PRS	NYSE	\$6.00	54.17%	\$10.00	BUY
Icon Financial Fund	ICFSX	800-764-0442	\$5.69	1.70%	N/A	BUY
Liberty Entertainment****	LMDIA	NASDAQ	\$12.80	0.00%	N/A	SELL
Liberty Global	LBTYA	NASDAQ	\$14.13	0.00%	\$20.00	BUY
Maxim Integrated	MXIM.PK	NASDAQ	\$13.30	1.89%	\$21.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$8.48	2.36%	N/A	BUY
Symantec	SYMC	NASDAQ	\$12.21	0.00%	\$17.00	BUY
Time Warner	TWX	NYSE	\$9.15	2.40%	\$13.00	BUY
Western Digital	WDC	NYSE	\$13.45	0.00%	\$18.00	BUY

* Prices as of the market close on Friday November 14, 2008

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

BUY, HOLD, SELL or LIMIT in **BOLD** signals change in action or limit

Sound Advice: Portfolio Updates for November 2008

Ford Cumulative Preferred tumbled with consumer stocks, and especially auto makers as General Motors is now widely thought likely to go into bankruptcy. On-again, off-again attempts to merge GM with Chrysler seem to be going nowhere. However, though Ford also has its share of problems, no one is saying Ford is that close to the precipice. Should you be confident Ford will survive? We think it will, but this has become a higher risk proposition than when we put it in our Aggressive Portfolio.

When the market is in freefall and investment decisions are made out of fear, it becomes hard to imagine that the companies underlying these ticker symbols might be making progress. Sure, most firms are cutting their estimates for sales and revenues, but improvements even if not acknowledged by investors deserve notice. **Schering Plough's** Vytorin franchise is stabilizing after being lambasted by the medical equivalent of a kangaroo court. As further evidence emerges, the dire interpretations that sent investors fleeing are being reversed. SGP's current price implies that Vytorin sales are going to go to zero. In fact, they are stabilizing, albeit at a lower rate. Since the last letter, SGP was off 3.7%—something of a success. **Odyssey Healthcare**, which continues to expand its hospice business is finding ways to cut costs to keep billing to Medicare within federal limits. ODSY is absorbing a significant acquisition in Texas, cutting operating costs for these facilities by folding them into their IT system as well as implementing the same cost efficiencies it has applied to its own operations. Earnings per share were up. ODSY dropped since the last letter 3.6%. Though consumers have gone into hiding, they do come out to shop and they are doing it at **Wal-Mart**, which unlike other retailers continues to report improving comp sales. You'll recall that WMT during flush times was seen as falling behind competitors such as Target, which were perceived as more stylish both in what they sold and how their stores looked. WMT is trying to close that gap, but in this weak economy everyday low prices trump anything else. WMT still dropped 11.4%.

This month we are going to make wide cuts in our portfolio, not because we have given up on most of these positions but because we think the portfolio has become unwieldy, and frankly in so depressed a market, less might be more efficient. Accordingly we are selling

the following investments, most for efficiency and a few for cause.

First the few positions that are being cut either because they failed in even good times to reach their potential or have given up their gains and now seem less likely to bounce back once the economy and market regain traction, or because we have other, more diversified positions in the same or overlapping sectors. **Whole Foods** got off to a fine start, but in a recessionary economy pricey organic and natural foods are a hard sell. In a recovering economy, these stores won't regain their old traffic and business for a prolonged period. **Sara Lee** has been under reconstruction for a decade. We give up.

For efficiency sake, we will rely on **Dodge & Cox International Fund** for all of our international exposure. We are selling **Fidelity Japan Fund** and **Sony**. We also want to reduce some of our energy positions, not because we think that the recent retreat of energy and natural resource prices marks the end of a commodities bull market but because we can get the same performance from our funds. We are selling both **EnCana**, the Canadian energy company, and **Royal Dutch**, the Anglo-Dutch giant. We are selling **Insituform**, which should benefit from what we expect to be a strong market for infrastructure companies. However, we already own **Tetra Tech**, which is even better positioned, and through the **PowerShares Water Resources ETF** (see page 3), we own shares in both TTEK and INSU. We are also selling **Cintas**, which we see as overlapping with **Fastenal**. We think Fastenal has more upside, having held up better during the bear market.

We are also parting way with the several spinoffs and tracking stocks (except for **Liberty Global**) that accumulated from **Liberty Media**. That means we are selling **Discovery Holdings**, **Liberty Capital** and **Liberty Entertainment**. Among our other media and entertainment stocks, we are also selling **Disney**, which we think has less promise than our other positions. The paradox is that Disney, though there is much to respect in its stable of businesses, seems to us to have less potential than **Time Warner**. Finally, we are selling **American International Group**, and will rely on **Icon Financial Fund** for profits when financial services shares climb out of their deep hole. AIG even after all the bailout funds it has gotten, frankly, might still not survive. **SA**

Sound Advice Market Indicators for November 2008

The Diffusion Index of Lagging Indicators gives “Caution” signals when all of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. We have removed the prime rate as one of the four lagging indicators from this Diffusion Index. We believe that this interest rate has been influenced in a strange way due to the mounting credit crunch and therefore distorting the signals.

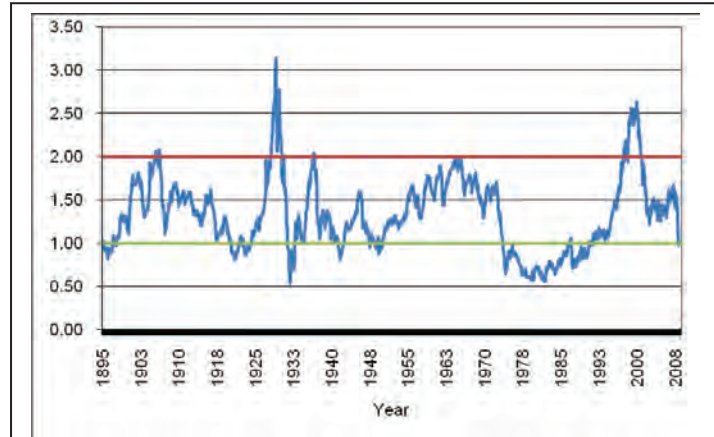
The Diffusion Index of Leading Indicators gives “Aggressive” signals when its individual leading economic indicators drop below their respective levels of six months earlier, providing a zero percent reading. This reveals a soft economy and a ripe atmosphere for a lasting decline in interest rates.

We have also modified the selection of the individual leading indicators that make up this Diffusion Index. Two of the individual leading indicators have been revised substantially each month recently, which reveals to us that the initial data reports are not reliable. Accordingly, we have replaced those indicators (Average Weekly Hours and Manufacturer’s New Orders) with 3 other, more reliable leading indicators: Average Weekly Unemployment Claims, Building Permits, and Index of Vender Performance.

These modifications should make our Diffusion Indexes more reliable because they no longer contain individual indicators that are being revised regularly.

These changes improve the historical results which should make them more beneficial going forward.

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each “Aggressive” signal, the S&P 500 produces an annual return of 17.5. During “Caution” signals, the market was all over the place — sometimes



The Risk Indicator is approaching historically low territory. At the S&P 500 low on November 13, 2008, the Risk Indicator dropped below to 1.0 to 0.97. A reading this low reveals that stocks are historically low relative to house prices. This came at a time when both stock and house prices fell to new lows: The S&P to a low of 818.69, and median price of a new home a low of \$218,400. It is just that stock prices fell faster than house prices.

crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 declined at an annual rate of 0.3 percent. With the removal of the Prime Rate as one of the lagging indicators, the Diffusion Index of Lagging indicators would have produced a “Caution” signal in March 2008. Of course we can’t turn the clock back and take advantage of that signal. However, both Diffusion Indexes should work considerably better in the future. The next signal we should be looking for is an “Aggressive” signal from the Diffusion Index of Leading Indicators.

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

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