

SOUND ADVICE

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Buying in Bad Times



It's always instructive to see how people deal with getting caught. During the Enron scandal, for instance, Ken Lay, PhD in economics, friend of presidents, experienced CEO, tried the moron defense, claiming the tricks others at Enron used were too sophisticated for him. The reality was that Enron insiders relied on outsiders, analysts, rating services and investors honestly not being able to understand what was in those black box deals or cynically choosing not to probe too deeply.

Two weeks ago, the SEC accused Angelo Mozilo, Countrywide Mortgage's now ex-CEO, of securities fraud. It all seems so familiar. In some ways, the debacle that destroyed the credit markets and played a crucial role in triggering and deepening the global recession, should be familiar. Assume that some CEOs and their henchmen on occasion will put their own interests ahead of those of the rest of us. Analysts, the financial media and many investors willingly suspended their skepticism before and did it again by buying into the illusion that financial hocus pocus could turn lead into gold. There's plenty of blame to be shared by rating agencies, regulators and legislators, but ultimately, as Pogo reminded us: "We have met the enemy and he is us." The real lesson is that if we don't understand an investment—and who really understood the mischief structured finance could cause—it's wise not to buy into it. Which isn't to say we won't take satisfaction as this season's Ken Lays do their perp walks. It's just that you'd think we would have learned something from seven years ago.

—Gray Emerson Cardiff

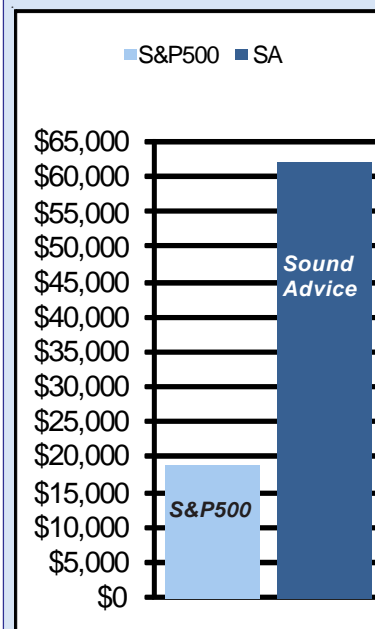
Sound Advice is at its core contrarian. It's not just that we buy shares in companies when they are out of favor. Our entire approach to the market in general is to be an aggressive buyer when the economy is weak and a defensive investor when it is strong. Though none of our cyclical indicators depends on stock market conditions, each taps into how poor and pessimistic or rich and optimistic the economy is making companies and consumers act and feel. Our track record evidences how effective this approach has been. However, during deep bear markets merely staying in the market—forget about being a buyer—can be excruciating.

Here is one example. On March 8th, a Sunday, a subscriber wrote a letter of surrender that reached us two days later. After seeing his portfolio get nearly cut in half, he said he had liquidated every share he owned regardless of sector. As events unfolded, he was right for one day: March 9th.

The next day, the media was filled with the most dire predictions. Investors were sending the same message to their brokers: "Get us out, get us out now regardless of the price. This is not going to get better anytime soon." *Sound Advice*, which went to the printer that morning and would be posted ominously on a Friday the 13th, had a different tone.

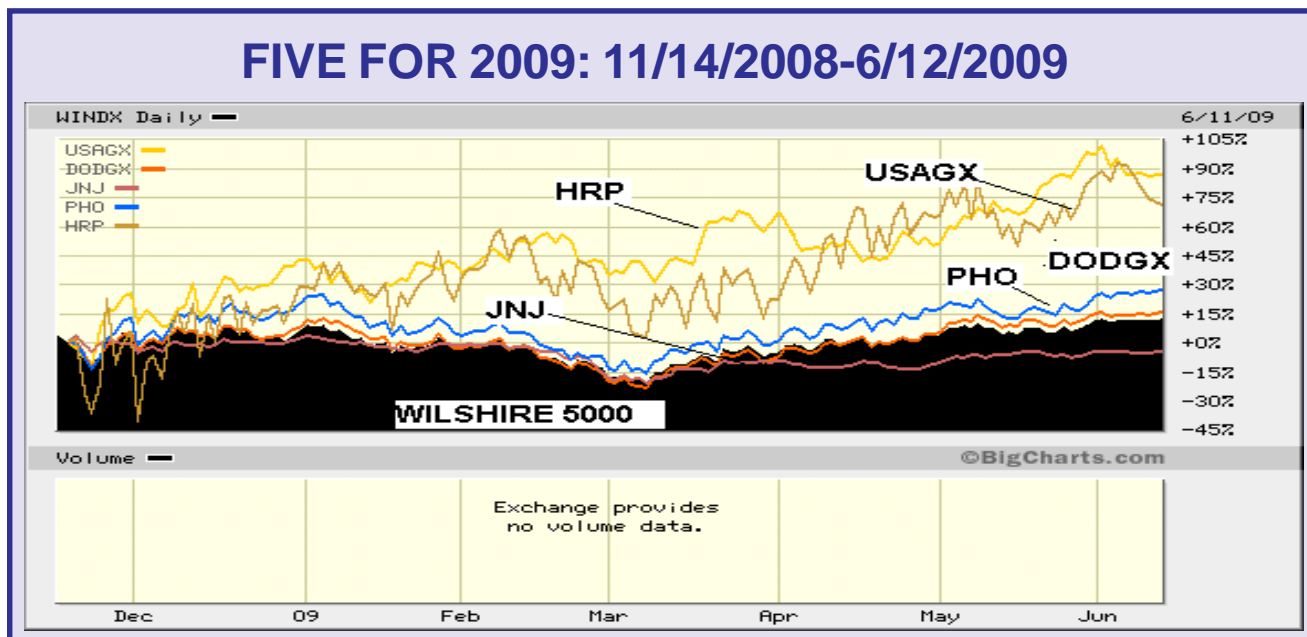
Our cover essay was intended to keep our subscribers from capitulating: "[I]t is difficult, even painful, to be a buyer, since after being knocked around for 22 months, we sometimes feel that the only encouraging evidence for a market recovery—and I know that only the most battle-hardened contrarian would agree—is the very lack of apparent evidence." This

Sound Advice Versus the S&P 500



Since 1-1-2000, an Investment of \$25,000 becomes: \$18,987 with the S&P 500, for a loss of \$6,022, or \$62,296 with *Sound Advice*, for a gain of \$37,296, a difference of \$43,318 (173 percent of the investment)

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was not “whistling past the graveyard.” We had our reasons.

“Approaching A Buy Signal,” that essay’s title,” after noting a few positive sparks amid the growing gloom, outlined how we invest both in individual firms and in the market: we always look for the least comfortable economic conditions to turn cyclically bullish, something that had occurred 11 times since 1974, the last time what we call a “Supercycle” began. Indeed, short of declaring we had confirmation of the start of the new Supercycle (that came in the next few days), we encouraged subscribers to get deeper into the market. We even quoted that great market observer, Bob Dylan’s *Subterranean Homesick Blues* “You don’t need a weather man to know which way the wind blows.”

As we know, since then, the market has levitated, erasing all of the losses suffered year to date, which still does not restore losses since autumn 2007. *Sound Advice* as we price the portfolio for this issue on June 12th stands for the year 22.2% to the good, which brings us to a belated mid-year review of our Five for 2009 basket of recommendations pulled from our existing portfolio last November, something we do every autumn. We’ve had good luck with them over the years. With seven months gone, this year’s crop is growing nicely.

How these five positions have fared so far provides a window into how the market itself has progressed. We recommended **USAA Precious Metals & Minerals Fund** (76.9%), **HRPT Properties Trust**

(78.9%), **PowerShares Water Fund**(22.7%), **Dodge & Cox Stock Fund** (14.2%), and **Johnson & Johnson** (minus 5.7%).

With the exception of JNJ, each has outperformed the broadest market index, the Wilshire 5000, which since November 14th is up 11.2%. **USAGX** is skewed heavily to gold and silver, though it does have exposure to industrial metal miners, and benefited initially as a safe harbor during the worst of the market turmoil and more recently had gained on concerns that inflation was building somewhere over the horizon. **HRP** boomed as investors began to realize that REITs, especially those without imminent need to refinance their debt, were not going to collapse. **PowerShares Water Resources Fund** is rising not only because investors think that water infrastructure will expand but also because nearly all the companies in its portfolio are involved in general infrastructure and industrial businesses. **DODGX** held on to many of those financial positions such as Wells Fargo and Capital One that ruined it last year, and has benefited as they have rebounded. Only **JNJ**, perceived by investors as defensive, has not prospered. We’re not worried about JNJ’s future. It will reward us in the long-run even if in a recovering market, it lacks pizzazz.

We’re too experienced to go into a home-run trot before the ball goes over the wall. Nonetheless, the Five for 2009 with five months to run its course, is doing remarkably well. More importantly, our positive view of where the market is headed remains intact and profitable. So far, so good. **SA**

Stealth Products

As we've observed during the rally that began after March 9th, investors are demonstrating a growing appetite for risk, which is the precise opposite of what prevailed during 2008 and in the weeks leading up to March 9th. For example, shares in **Wal-Mart**, where consumers go when they need to squeeze every penny, fared better than those of other retailers as investors fretted over whether they were experiencing merely the worst recession of their lifetimes or the dawn of a real Depression. Healthcare stocks, even though Wall Street worried about what universal healthcare and more stringent Medicare and Medicaid payment schedules could do to the bottom line, did relatively well. Safe harbors like precious metals and Treasuries were favorites. As investors' mindset shifts, **Wal-Mart** has lagged the broad averages as did most other defensive stocks.

With our usual zig when the market zags approach, we're recommending a defensive stock with a kicker, **Perrigo (PRGO—Nasdaq)**, which through the first three quarters of the current fiscal year derives 82% of its revenues from over-the-counter (OTC) store-branded medications and food supplements. The balance comes from generic prescription drugs (7.7%) and formulation of drug ingredients (6.5%).

For long-time subscribers, Perrigo is no stranger. It's been in our portfolio twice (February 1999-August 2001 and June 2002-November 2007) returning 96.3% and 113%. However, for most consumers Perrigo, despite its products sitting in every medicine chest in America, is invisible unless you like reading the ultra-small print on the packaging of store-branded generic Tylenol and similar products. As an investment, Perrigo owns the OTC market, and as it begins to develop and sell generic prescription drugs, will emerge as a much more profitable company. Right now, in a depressed market, Perrigo is doing reasonably well, but not nearly as well as it will do once the prescription business kicks in.

DRUG COMPANIES

It's hard to decide whether pharmaceutical companies or HMOs today are more despised by

American consumers. As for Wall Street, the consensus is that unless you control patents for the most lucrative drugs or own the rights to biotech wonder drugs, drug companies are a slow-growth proposition and not worth investor interest. The costs and risks of failure in developing and getting FDA approval for a new drug are daunting. For example, earlier this month Merck announced a drug had failed to meet its goals in its Phase III trial, the final stage before receiving FDA approval. Merck had paid \$366 million to buy the biotech company that developed and patented the drug. Now that investment might be worth nothing. And \$366 million in the big league pharma world is really small change.

Perrigo does not have these problems. One benefit of being invisible to consumers is that Perrigo rarely garners bad press. No member of Congress is going to hold up a pill produced by Perrigo and rail against the company for price gouging. As for the costs of developing new products, Perrigo in its OTC and its generic prescription drug businesses needs only to recreate existing medications that either already are in the public domain as OTC products, are coming off of patent and, as the FDA decides some previously prescription products can be self-prescribed by consumers, move directly to the OTC market or, in the case of prescription drugs, are already approved for use. Because these are me-too products, little of the expense and none of the risk of failure in developing new prescription drugs falls on Perrigo.

LOOK IN YOUR MEDICINE CHEST

Perrigo is the world's largest manufacturer and distributor of store-branded over-the-counter non-prescription drugs, which means that every time you buy a bottle of ibuprofen, cough syrup or antihistamine capsules with the logo of **Wal-Mart**, Safeway, Rite-Aid or any other retailer, you are most likely buying a Perrigo product. Go look in your medicine chest, and read the fine print on your non-prescription drugs.

Consumers like the price breaks, which average about 25% below national brands, and retailers love store-branded OTC products, since the store's profit margin

Sound Advice on Perrigo

for Perrigo's stuff is 57% compared to the 25% national brands bring. In a difficult economy, all of Perrigo's strengths for both consumers and retailers are magnified: cheap prices for functionally equivalent OTC products.

Americans, not just those without medical insurance, traditionally rely on self-medication before resorting to visiting a physician. Even when we take the time and spend the money to see a physician, what gets prescribed might not require a prescription ("Take two aspirin and call me in the morning."). Perrigo has grown to \$2.2 billion in sales from \$878 million a decade earlier.

THE OTC BUSINESS

OTC drugs are a big business. The most visible players are national brand names such as **Johnson & Johnson**, Warner Lambert, and SmithKline. Perrigo is the only publicly traded company to build its business around OTC products, and controls 70% of the store-branded OTC market. The scale of operations is at the root of Perrigo's profitability. More efficient distribution and coordination of its inventory and supply to customers are also crucial.

However, Perrigo's biggest competitive advantage is a version of the anonymity that insulates it from political critics. Manufacturers of national brands spend millions promoting their products. Perrigo's advertising budget is zero. All that Perrigo needs is to make sure retailers place its me-too products next to the national brands, with signage that lets consumers compare prices for products with the same active ingredients.

Each time we've recommended Perrigo, we visit a local super-drugstore. For nearly every nationally branded product, there was a store-brand, which was priced between 23% to 42% less than the nationally branded equivalents (The average for the eight items I priced for this issue was 34%). The price-savings were obvious thanks to placards placed strategically beneath each paired product. If you're skeptical, ask the pharmacist.

THE PIPELINE

If this thumbnail description of how Perrigo and its customers market their cut-price pills and potions suggests that Perrigo needs merely mimic what others promote, it misses Perrigo's competitive need to be first

to bring new products to the OTC market. The most lucrative new products are not copies of existing over-the-counter medications. Instead, they are versions of prescription pharmaceuticals such as Claratin or Zyrtec, whose patent protection has lapsed and which the FDA considers appropriate for over-the-counter use. Over the last 30 years, Perrigo has gotten approval for 61 such products and controls 70% of current sales for these relatively high-margin products. For maximum benefit, Perrigo must be first to request FDA review of its formulation.

For example, Perrigo last year got approval to market Omeprazole, its own version of Pepsid, an antacid medication, which Merck had introduced in 1985 as a prescription drug, and subsequently moved to OTC status. Perrigo's Omeprazole now controls 40% of the OTC market. Perrigo's version of Ceterizine (generic Zyrtec) came to market in 2008 and has jumped to a 45% market share.

Management estimates that over the next five years approximately \$10 billion of sales will come from prescription drugs that will lose their patent protection. And consumers are responding. Twenty years ago, 12% of shoppers bought store-branded medications and accounted for 10% of OTC sales. In 2006, that figure had risen to 41% and last year, in the teeth of a recession, 55% of consumers preferred store-brands, which accounted for 25% of OTC sales. Once consumers realize there is no functional difference between national brands and store brands, there is little reason for them to migrate back to the more expensive national versions. Certainly pinching pennies makes Perrigo's products inviting, and when consumers can't afford even generic prescription drugs, in some cases they can turn to what Perrigo sells. However, these economy-related forces are not the ultimate driver for expanded sales.

Currently Perrigo's sales and profits live and die with the OTC business, but its future success goes beyond its expertise in development, marketing and distribution of these products here in the United States. Perrigo has two developing engines for growth, one market oriented and the other product oriented that can drive price ratios—and share prices—much higher.

GROWTH

Perrigo's dominance in the U.S. OTC store-branded

Sound Advice on Perrigo

market is the company's foundation, but when you control a market as Perrigo does, you can't expect to grow sales any faster than the domestic population expands. If the U.S. market is saturated, looking abroad would seem to be a natural extension. Earlier in the decade, Perrigo did try to muscle into foreign markets, seeking to interest European and Latin American retailers to carry its products. But foreign retailers were resistant, since in their markets store-branded OTC products were not well accepted. Not surprisingly that effort failed. Over the last few years, Perrigo saw the light and is shaping its global expansion by "following the flag," that is by expanding into regional markets into which its existing U.S. clients are growing fastest, something you can see in the strategic acquisitions Perrigo is making.

Consider what Perrigo did last year. The company has had a history of strategic acquisitions, almost all of them complementary to existing businesses, and last year was especially active. No deal was particularly big, but each had a purpose. Perrigo bought Unico for \$49 million in cash (one time sales), the leading U.S. manufacturer of store-branded pediatric electrolytes, enemas and feminine hygiene products, all items new to Perrigo's products. It also purchased J.B. Laboratories, a maker of solid-dose pharmaceutical products for major pharmaceutical companies, for \$44 million. Perrigo expects it to add \$70 million in revenue, and to be immediately accretive to earnings. Three deals, however, reached outside the U.S. PRGO paid \$25 million (1.7 times sales) for Laboratorios Diba, a Mexican manufacturer of store-branded OTC and prescription pharmaceuticals and also bought for \$55 million Galpharm Healthcare, a British OTC drug manufacturer, which will be accretive during the first year. Finally, Perrigo swapped its British vitamins, minerals and supplements businesses for Brunel Healthcare's OTC medication lines. When combined with the Galpharm acquisition and its existing pharmaceuticals businesses in the UK, this deal pushes Perrigo closer to matching the dominance it enjoys in the North American OTC business. Each of these foreign acquisitions added to earlier deals Perrigo had made in each country.

Why Mexico and the United Kingdom? **Wal-Mart** represents 20% of Perrigo's total sales, so naturally

management wants to make sure it's well positioned to grow along with its customers. Last year, Wal-Mart saw international sales rise 9.1% versus a 6.8% increase domestically. Wal-Mart de Mexico, for example, has 1239 stores ranging from Superstores to Sam's Clubs to small retail outlets and has seen revenues increase more than five fold over the last decade. Wal-Mart also is active throughout Central and South America, and Mexico is an anchor for that region. The United Kingdom runs a distant second to Mexico when it comes to Wal-Mart stores with 358 (Brazil is third with 345 followed by Canada with 318), but has seen a 32% jump in Wal-Mart retail space over the last five years. Other major Perrigo customers like Costco are also targeting both Latin America and the UK. Perrigo, after having saturated the U.S. OTC store-branded market, is looking to international sales to its best customers for growth. At the start of this decade, Perrigo got 5% of its net sales outside the U.S. Today that figure is 33%.

The second strategy that will change Perrigo even more than its international growth is movement into generic prescription drugs, something we had been waiting for management to accomplish ever since we first recommended the company. Our reasoning was simple: Perrigo already had a superb distribution system that put its OTC products in every major retail outlet for prescription pharmaceuticals in America. It also sold to the major drug wholesalers like Cardinal, which in turn sell to institutions and government. Its reputation and relationships with customers were excellent.

Generic medications were growing at a 15% annual rate while OTC medications were growing at 4% rate. However, Perrigo took its time. One deal in 2004 fell through, but in 2005 Perrigo acquired Agis Pharmaceuticals, an Israeli maker of generic prescription ointments, gels and shampoos, admittedly a subsector of the prescription drug business, but it provides an entry point. Ownership of Agis, we should add, also gave Perrigo expertise in manufacturing non-prescription topicals, which are already paying dividends as Perrigo now is the second biggest provider

PRGO's price ratios today stand where they did in 2005, which was the last time the shares bottomed. In fact, they look similar to where they stood when we recommended the shares twice in the past. Last time round, before peaking, the shares tripled from our buy-in point.

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of topical ointments and shampoos. The company has 14 new topical drug applications in the pipeline.

Management is also adding non-topical prescription drugs to its inventory. For example, Perrigo produces and distributes citalopram, a generic version of the antidepressant Celexa as well as several other tablet and capsule generics. There is also a rich potential in partnerships with other drug companies that tap into Perrigo's development, manufacturing and distribution expertise. Thus, starting in 2006 Perrigo joined with Cephalon (CEPH—Nasdaq) to develop topical ointments using a drug Cephalon had patented. As part of the deal, Perrigo owns the generic rights to this product.

It's not just that generic prescription drugs are growing faster than OTC medications. The margins are superior. For instance, in the most recent quarter, Perrigo's operational profits from its OTC business ran at 14.9% while the generics business ran at 19.1%.

Is Perrigo's success guaranteed? Hardly. There are bigger and better established generic drug manufacturers in the U.S. and abroad. If the foreign expansion strategy stalls, the best prospect for growth in its OTC products stalls as well. The generic drug business requires sharp elbows as companies like Perrigo seek to gain generic status for OTC and patented drugs. Suits and countersuits are common. Just last week, a Belgian drug company complained that Perrigo was seeking to market a generic version of its patented Androgel, which raises low testosterone levels. Perrigo claims the Belgian company had colluded with other firms to prevent marketing of a generic version. Perrigo, unlike its breadth in OTC products, is still a small player in the generic prescription drug market, and if it can leverage its existing strengths, will have considerable potential.

THIRD QUARTER SURPRISE

PRGO shares had ignored the bear market, peaking in the low \$40s in April of last year, but then started falling as quarterly results failed to meet exaggerated expectations. PRGO bottomed in the high teens while glum investors awaited Q3 results.

Happily for Perrigo shares, those results were a pleasant surprise. Despite consumers cutting back on

nationally branded OTC drug purchases, Perrigo enjoyed growth in each category with gastrointestinal products enjoying double-digit growth. Sales for the quarter were up 5.3% compared to 2008, operating income 19.8% thanks to cost-controls and the absence of costs incurred in launching new products. Diluted earnings per share rose 17.7%. Only gross profit was negative, slipping 0.5%.

Much of the third-quarter sales growth resulted directly from new products introduced over the previous 18 months as well as inclusion of revenue from acquired companies mentioned earlier. These strong results occurred in the face of unfavorable exchange rates that reduced sales by \$12 million. But results for the prescription drug division slid.

Materials costs were higher, something management believes it can control through better sourcing. There was also the failure of a partner to make a multimillion dollar payment. That too is something that is not expected to repeat. Management was upbeat about the remainder of the year and beyond, anticipating that new products and the growth in consumer acceptance of store-brands would be the primary engines for growth.

On the strength of the conference call, PRGO got a nice bump to \$28 but along with other healthcare stocks has been drifting lower. At this level, the standard price ratios are attractive both in comparison to the overall market but especially in relation to Perrigo's own historical levels.

Perrigo trades at a current P/E of 17.8, roughly in line with the S&P 500, though over the last six years it has traded at a premium to the S&P. Price/Sales stands at 1.2, distinctly lower than the S&P's 1.9 and lower than it has been since 2005. Price to Cash at 11.2 is higher than the S&P's 9.7, and last was at this level in 2005.

You'll notice that PRGO's price ratios today stand where they did in 2005, which was the last time the shares bottomed. In fact, they look similar to where they stood when we recommended the shares twice in the past. Last time round, before peaking, the shares tripled from our buy-in point. No, we are not predicting a triple over the next 36 months. We are just saying the market seems to be putting PRGO on sale, ignoring some attractive engines for future growth. We recommend buying Perrigo up to \$29. **SA**

Portfolio Updates

Since we priced the May portfolio on May 8th, we are up 2.6% versus the Dow's 2.6%, the S&P's 1.8% and the techcentric Nasdaq's 6.9%. Technology shares, which had led the market earlier in this rally but then slacked off, are again moving higher, which fits nicely with our emphasis in last month's issue on five tech stocks in our portfolio. Since then as a group this quintet is up 12.4%. None qualifies as one of the sexy Nasdaq names that get endless coverage in the financial media. Indeed, they are generally considered old tech. They were led by **Maxim Integrated** (+19.2%), **Microsoft** (+20.8%) and **Western Digital** (+7.3%) with **Symantec** (+10.8%) and **Xerox** (+4.3%) rounding out the quintet.

Maxim, which designs and manufactures analog and digital semiconductors, despite lower results for the quarter, experienced slightly higher demand that ignited investor interest in it and other semiconductor manufacturers. For Microsoft, the only solid news is the rollout of Windows 7, which really is a debugged version of Vista, the most recent Windows operating system. Microsoft has the habit of introducing new software and operating systems without working out all the kinks. Vista was no exception. Also, MSFT is replacing its Live Search with Bing, which it hopes will begin to peel users away from Google's ubiquitous search engine. It's also possible that renewed discussions with Yahoo! make investors think that a deal might be worked out. However, none of these specifics is as important as the emerging sense among investors that an economic recovery, if not underway, is not too far in the future.

We did not include **Sprint Nextel** among last month's tech quintet, even if its prospects are bound up with technology stocks. This year S has been torrid, among the best performers in the S&P 500, up 189% from its 12/31/08 close. Sprint barely budged since the last letter, up less than 1%, though there was some good

news. Most prominent was the roll out of the Pre, which seems to be the best challenger to Apple's iPhone so far. Produced by Palm and marketed by Sprint, the Pre got very positive reviews and sold out

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As for the rest of the portfolio, a glance at what else did well and what did worse suggests something about how the market in general is working. After technology investments, natural resources and infrastructure had the best blended performance since the last letter. These eight positions were able to push their average return to 7.9%. The natural resource segment alone turned in a 7.6% performance. **Tetra Tech**, which makes its money from engineering primarily water remediation projects, is up 14.4% since the last letter. We wonder whether its nascent involvement in windpower engineering has something to do with its recent strength. If you overlay its chart with that of the SPDR Energy ETF (XLE), there are some resemblances.

The best natural resource performer this month has been **Anglo American** (+13.7%), which has a diverse portfolio of mining businesses and had jettisoned its exposure to gold when it sold off its remaining shares in AngloGold Ashanti earlier this year.

In addition to arguing that natural resource shares would be early leaders in any market recovery, we also argued that the deflation fear was overdone. We were (and are) more concerned with inflation and a weak dollar, and recommend retaining precious metals in your portfolio.

Sound Advice Portfolio for June 2009

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
Duke Realty Cumulative Preferred	DRE.PRO	NYSE	\$18.91	11.07%	\$20.00	BUY
HRPT Properties	HRP	NYSE	\$4.64	10.34%	\$5.25	BUY
Public Storage Cumulative Preferred	PSA.PRM	NYSE	\$20.73	7.99%	\$21.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$50.14	0.22%	\$55.00	BUY
Boston Scientific	BSX	NYSE	\$9.37	0.00%	\$11.00	BUY
CarMax	KMX	NYSE	\$13.85	0.00%	\$15.00	BUY
CGM Realty Fund	CGMRX	800-343-5678	\$15.57	3.92%	N/A	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$26.49	8.50%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$78.92	2.33%	N/A	BUY
Fastenal	FAST	NASDAQ	\$34.93	2.00%	\$41.00	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$16.01	2.06%	N/A	BUY
Honeywell	HON	NYSE	\$35.41	3.42%	\$38.00	BUY
Johnson & Johnson	JNJ	NYSE	\$56.06	3.50%	\$68.00	BUY
Leucadia National Corp.	LUK	NYSE	\$23.73	0.00%	\$32.00	BUY
Mattel	MAT	NYSE	\$16.28	4.61%	\$18.00	BUY
Microsoft	MSFT	NASDAQ	\$23.33	2.23%	\$26.00	BUY
Molson Coors Brewing	TAP	NYSE	44.93	2.14%	\$48.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$9.71	0.00%	\$12.75	BUY
Perrigo	PRGO	NASDAQ	\$26.46	0.83%	\$29.00	BUY
Sprint Nextel	S	NYSE	\$5.29	0.00%	\$6.00	BUY
Stryker Corp.	SYK	NYSE	\$40.80	0.98%	\$45.00	BUY
Superior Industries	SUP	NYSE	\$13.25	4.83%	\$18.00	BUY
Tetra Tech	TTEK	NASDAQ	\$28.50	0.00%	\$31.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$39.91	0.46%	N/A	BUY
United Parcel	UPS	NYSE	\$50.53	3.56%	\$60.00	BUY
UnitedHealth Group	UNH	NYSE	\$24.21	0.12%	\$32.00	BUY
Wal-Mart Stores	WMT	NYSE	\$49.84	2.19%	\$60.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$34.05	4.56%	N/A	BUY
Xerox	XRX	NYSE	\$6.98	2.46%	\$8.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	\$14.21	0.00%	\$17.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$16.41	0.71%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$34.11	4.93%	\$40.00	BUY
PowerShares Water Resources ETF	PHO	NYSE	\$15.20	0.53%	\$17.00	BUY
Transocean	RIG	NYSE	\$82.58	0.00%	\$89.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$27.00	0.04%	N/A	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	\$14.35	1.90%	\$19.00	BUY
Ford Motor Convertible Pfd	F.PRS	NYSE	\$22.45	15.41%***	\$25.00	BUY
Icon Financial Fund	ICFSX	800-764-0442	\$4.76	0.00%	N/A	BUY
Liberty Global	LBTYA	NASDAQ	\$15.13	0.00%	\$19.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$16.51	4.85%	\$16.00	BUY
Federated Prudent Bear Fund	BEARX	800-711-1848	\$6.31	0.00%	N/A	BUY
Symantec	SYMC	NASDAQ	\$16.49	0.00%	\$19.00	BUY
Time Warner	TWX	NYSE	\$26.00	2.92%	\$28.00	BUY
Western Digital	WDC	NYSE	\$25.14	0.00%	\$28.00	BUY

*Prices as of the market close on Friday, June 12, 2009

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

Note that all fund distributions fluctuate annually.

***Dividend Deferred

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

Sound Advice: Portfolio Updates for June 2009

Gold, after looking like it would make another run at \$1000, faltered instead. Still, **USAA Precious Metals & Minerals Fund** is up 7.2% since the last letter, stands in marked contrast to what had been the other safe-harbor investment, Treasuries, into which money cascaded during the darkest days for the market. Had you latched onto the 10-Year Treasury Note when it yielded 2.07% in mid-December 2008, you would be looking at a market price loss of 29%. That 2.07% yield doesn't do much to soothe the pain from the drop in price for Treasuries all along the yield curve. One other very important note on USAGX. When we originally presented it to subscribers, we noted that USAA management was trying to discourage non-USAA members from buying their funds. More recently, management has changed its tune (could it have had something to do with how much money was flooding out of all funds and management's need to get dollars anywhere they could?). If you were stymied in buying USAGX before, it's much easier now. Check with your broker, and if that doesn't work, just call USAA at the number listed on the portfolio page.

So what lost or lagged since the May letter? **Liberty Global**, the foreign cable company, dropped 12.7% in the wake of quarterly results below expectations. Most of the problem resulted from foreign exchange issues. We'd use the drop to establish or expand a position, since the future of what LBTYA sells (cable TV, Internet connectivity and telephone services) is bright and lucrative. Another loser, **Superior Industries**, whose major customers are Chrysler, GM and Ford, also had a horrific quarter, and its problems are more open-ended than those of Liberty Global. Still, we think that Ford is a survivor, Chrysler with its absorption into Fiat and GM once it exits its choreographed bankruptcy will be good customers provided demand for cars and trucks recovers here at home. SUP dropped 11.7%. On the other hand, the **Ford Preferred** keeps moving higher. Since the last letter, it's up another 6.5% and 149% for the year, and that does not take into account the deferred dividends, which as Ford continues to improve is becoming more and more likely to be paid in full.

If you want a broad sector that has dropped recently, try healthcare, which once again has come under suspicion as investors fret that reform of healthcare insurance will decimate the industry. The biggest loser

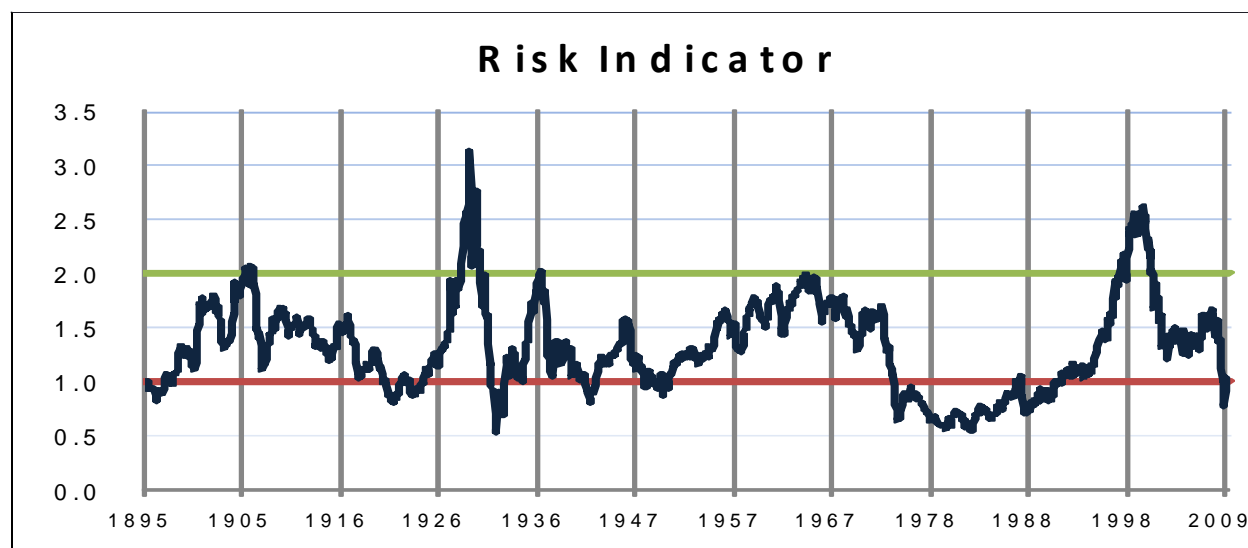
has been **UnitedHealth**, which dropped 16.1% since the last letter. **Odyssey Healthcare**, the hospice provider, lost 9.4%, **Stryker**, the orthopedic replacement and hospital supply company, dropped 1.8%. **Boston Scientific** was flat, though we continue to think that it has the greatest potential among depressed medical device stocks.

Given weakness in healthcare, we're not surprisingly recommending a healthcare stock this month, and suggest value-oriented investors consider the entire sector while Wall Street projects extraordinarily negative expectations into future earnings. We believe that after all the noise coming out of Washington there will be a national health insurance program and that it will neither destroy the HMOs nor beggar drug and medical device companies.

This retreat in healthcare stocks fit in with a larger theme this past month as investors got more confident: anything that had been good earlier in the year when defensive investments were all the rage mostly backpedaled this month. **Wal-Mart** was flat even after it announced it was expanding its share buyback program, which over the last five years had retired \$21 billion in shares. The new program, announced at the annual meeting early in June, authorizes the repurchase of \$15 billion of outstanding shares.

Financial stocks, which had the biggest bounce as the March rally gained speed (why not, since they had had the biggest fall during the bear market), were down. The SPDR Financial ETF (XLF) dropped 4.1%, while the **Icon Financial Fund** slipped 2.6%. Real Estate Investment Trusts, after going ballistic since March, cooled off a bit this month. **HRPT Properties Trust** gave back 2.7% and the **CGM Real Estate Fund** was essentially flat. However, REIT Preferreds continue to climb as investors recognize that most REITs are not going to implode, and will be covering their preferred distributions. If this modest expectation strikes you as reasonable, just recall that in late February, both Wall Street analysts and institutional holders were furiously trying to get as far away as possible from REITs. Since the last issue, the **PSA Series M Cumulative Preferred** has added 8.8% while the **Duke Realty Series O Cumulative Preferred** 9.3%. Both went ex-dividend on 6/12. Their performance includes the quarterly distributions. **SA**

Sound Advice Market Indicators for June 2009



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

The Risk Indicator was 1.19 in May. A reading this low reveals that stocks are historically low relative to house prices, and present an extraordinary value. February's reading of 0.79 will likely mark the low for this cycle.

The Diffusion Index of Lagging Indicators gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. This Diffusion Index currently stands at 33 percent.

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

The March 2009 data caused this Diffusion Index to drop to zero, officially giving us an "Aggressive" signal.

An "Aggressive" signal coming at a time when the Risk Indicator is close to 1.0 reveals that

Supercycle 5 has come to an end, and that Supercycle 6 is born. See *The Science of Making Money in Turbulent Markets* for a history of Supercycles (which you received with your subscription). You will also receive an updated copy when you renew your subscription.

Track Record of the Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 produces an annual return of 20.6. During "Caution" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased at an annual rate of only 1.62 percent.

Aggressive S&P	Caution	S&P
Sep-74	Apr-76	101.90
Nov-79	Oct-83	167.65
Dec-84	Jun-85	188.89
Jul-86	Aug-87	329.36
Mar-88	Jun-88	270.68
Mar-89	May-89	313.93
Oct-89	Mar-93	449.74
Feb-97	Dec-98	1,141.00
Oct-00	Dec-00	1,320.28
Jun-03	May-05	1,191.50
Jul-06	Mar-08	1,325.43
Apr-09		

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