


SOUND ADVICE

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We Americans are a litigious people, or at least our lawyers are, which explains the arrival in my mail of a "Notice of Pendency and Proposed Settlement of Class Action." Some *Sound Advice* subscribers got the same piece of mail, since our portfolio included Pan Pacific (PNP), which by the time PNP was acquired last fall had more than sextupled our money. The plaintiffs claimed that the management of Pan Pacific and its acquirer, Kimco Realty, short-changed PNP shareholders because the merger price did not reflect PNP's real value. Now, nine months later, though the defendants still "deny all allegations of wrongdoing, fault, liability or damage," they have agreed to pay Pan Pacific shareholders approximately \$9.6 million, and will compensate the plaintiffs' counsel to the tune of \$1.25 million. Shareholders get about \$23.24 for every hundred shares owned, an amount equal to one quarterly dividend payment or less than 0.3% of the \$70 per share acquisition price. It works out to quite a bit more for the law firms involved in the litigation. It's hard to know whether PNP got a sweetheart deal with Kimco. As for the claim that the deal price did not include a premium to where PNP traded on the eve of its announcement, we see that PNP shares rose 7% in the days leading up to that announcement. Now I wonder how that happened? Is there a lawyer in the house?

—Gray Emerson Cardiff

The Wisdom of Crowds?

James Surowiecki's *The Wisdom of Crowds* (2004) is popular on Wall Street because it explains and reinforces an influential theme widely held by investment professionals: the Efficient Market: "under the right circumstances," writes Surowiecki, "groups are remarkably intelligent, and are often smarter than the smartest people in them...Even if most of the people within a group are not especially well-informed or rational, it can still reach a collectively wise decision." Hence, stock prices reflect the pooled wisdom of all investors, which is not merely consensus but a valid measure of stocks present value.

Of course, the mob-driven idiocy of bubbles challenges such wisdom, since the same crowd that supposedly is capable of divining truth also is able to latch onto lunacy and ride it over the cliff. Do you remember how "It's different this time" supposedly validated triple-digit P/Es?

Surowiecki acknowledges that in bubbles collective intelligence fails because individuals cease acting individually. There is not just a bubble in prices. There is also a bubble inside of which unified euphoria rather than different views rules. But, Surowiecki is convinced, outside of such extremes, investors as a crowd are mostly rational and can ascertain prices with some precision. Certainly he is correct about collective madness during a bubble, and mostly he is right about the day-to-day pricing of stocks. However, he is wrong, I believe, about how the market outside of bubbles prices shares of companies that are experiencing extraordinarily good or bad fortune.

VOX POPULI

The book asserts that the stock market is an ideal arena for aggregation of opinions because buyers for a range of reasons and sellers for a different range of reasons can meet and determine a fair price.

Consider the account that opens this book: at an English country fair a contest is held: guess the weight of an ox. 787 guesses were submitted, and when the results were arranged from lowest to highest, it turned out that the median guess was within a pound of the ox's 1198 lbs.

The modern stock market, however, is a very different affair. The ox

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The Wisdom of Crowds?

we seek to estimate cannot be examined closely, and is much more mysterious. Our evidence is also much more abstract, and the measurements more difficult. Most of all, when we buy a stock, we are concerned not just with its "weight" at that moment but even more with what the stock will "weigh" in the future. I wonder how the country-fair guessers would have fared if asked to guess what the ox would weigh five years hence?

The most important difference between the country-fair contest and Wall Street is that the fair-goers just jotted down what seemed reasonable to each of them, while opinions of individuals on Wall Street are not formed independently. On Wall Street and Main Street, there are bellwethers: for the retail investor, opinion-makers such as CNBC, the *Wall Street Journal* and *Barron's*, *Investors Business Daily*, *Business Week*, *Fortune* and *Forbes*, and that troop of personal investment magazines with their endless diet of "The Ten Best Whatever's." For professional investors there are pricier, more sophisticated oracles.

Surowiecki acknowledges that "news reports tend, by their nature, to overplay the importance of any particular piece of information." Does it surprise you that when an analyst at Morgan Stanley or Merrill Lynch speaks, stock prices in response rise or fall? Surowiecki acknowledges that "The temptation to trade stocks on the basis of what other people are doing is nearly irresistible. Other people's expectations are constantly impinging on your own." Yet he believes that the market can establish true prices in all cases except in a bubble.

CONSENSUS AND DISTORTION

Efficient market theory holds that prices incorporate all available information, and that no one can anticipate what the market will do next. The best a prudent player can do is own the entire market through an index fund that lets you hold a proportionate bit of everything, which guarantees you will do no worse (or better) than the overall market.

However, what if you could know something before the rest of the market learns about it? Barton Biggs in

his entertaining book, *Hedgehogging*, claims he knew a mediocre Wall Street broker who chanced upon a news vendor who each morning would sell him the next day's *Wall Street Journal*, which turned the broker into a genius. We can dream.

Technology appears ready to provide, if not tomorrow's *WSJ*, just that chance to be a step ahead of the crowd. Last week, Reuters announced it intends to market software for stock traders that would immediately aggregate and score all news about individual stocks so that traders could access a real-time, quantitative measure of everything the media knows, and thus gain an information advantage in order to front run the rest of the crowd.

The problem, of course, is that what the media reports—especially the financial media—when tabulated is almost never the result of independent thought. Instead, the market tends to reinforce certain narratives that can distort the share price. There can be a bubble mentality about any stock at any time simply because individual opinions give way to group-think.

At *Sound Advice* such consensus draws our attention. We seek to capitalize on the likelihood of distortion. We're not saying consensus is invariably wrong. Instead, we are saying that consensus forces prices lower (or higher) than they otherwise would be. In the August 2003 issue, we reported on two portfolios we had tracked over the previous 12 months: one, the Glory Portfolio, contained stocks that analysts were uniformly most enthusiastic about, the other, the Doofus Portfolio, consisted of stocks with the most pessimistic ratings. At the end of the year, the Glory Portfolio had grown by 6.8%, slightly less than did the S&P, while the Doofus stocks averaged a 36.3% return. The crowd, when it seeks instructions, is often misled.

The *Sound Advice* portfolio's performance remains solidly ahead of the benchmark indexes so far this year even as the market surges. We continue to look for value, and hope you are profiting along with us. If on the address page you see a red alert that your subscription is expiring, we hope you take advantage of the generous resubscription offers on page 11. [SA](#)

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Waiting for Demand To Meet Need

Two years ago, when we recommended **Tetra Tech**, it was a coin flip, since we were looking at a somewhat similar company, **Insituform Technologies (INSU—Nasdaq)** because it offered exposure to a theme we think was and remains important: infrastructure, especially water infrastructure. However, we went with TTEK primarily because its focus is water reclamation and environmental remediation, and because it had just stumbled badly and its price was too good to pass up. That is working out well—a double in two years. Insituform, however, until this March, was doing even better. Then the bottom dropped out. The primary reason investors are fleeing shares of INSU is a collapse in revenues and earnings that doesn't seem likely to reverse course immediately. The other reason that INSU shares have suffered is a decision to shutter an unprofitable division. TTEK made a similar decision, which helped it recover, all of which make us think again about Insituform, the one that got away.

WHAT INSITUFORM DOES

Insituform, a small-cap outfit (\$542 million), until it announced plans to close down one division had three major businesses: it rehabilitated sewage systems (80.6% of 2006 sales/100 % of operating earnings), relined non-sewage industrial conduits (7.7% of sales/29.8% of operating earnings), and performed tunneling (11.6% of sales/minus 29.8% of operating earnings). Sewage conduits roughly speaking have a useful life of 50 years, and since the average age of sewage systems in place in the United States is around 60 years, restoring them should be almost an annuity business. The traditional pick-and-shovel approach, excavating the conduits, removing the old pipes and laying new ones, is expensive, not just because streets once torn up need to be resurfaced but also because major arterial surgery disrupts commerce and daily life for extended periods.

Insituform's patented Cured-In-Place Pipes (CIPP) technology, a trenchless system, relines existing pipes with a resin-permeated fabric that is then cured with heat to form a hard interior wall. Insituform, which pioneered this technology 35 years ago, still dominates its sector, last year performed more than half of the trenchless sewage line rehabilitation projects in the United States. There's plenty of room for further ex-

pansion, since trenchless rehabilitation, despite its advantages, still only accounts for about 50-60% of all sewer pipe remediation.

The rehabilitation of non-sewage conduits is handled by the Tite Liner division, and addresses industrial, energy, and mining pipes. Currently, its biggest jobs are coming from the energy sector.

The last segment, tunneling, has been a drag on profits, and is being shuttered, which management announced in late March, the same day it presented gloomy expectations for the soon-to-close quarter and for the rest of the year. We welcome the decision because tunneling has been extraordinarily difficult to make money from. However, some analysts worried that disposing of the tunnel business would concentrate the company too much on pipe rehabilitation. We're fine with that.

More important than what INSU is exiting is what it is adding. Insituform is making a major commitment to the potable water business, a variation on what INSU does with sewage and industrial conduits using methods transferable to water pipes that are just as old, and just as in need of replacement.

If Insituform is the dominant player in rehab, and if need for what it does is cresting as infrastructure reaches the end of its useful life, you would expect the company would be coining profits. You would be wrong. In fact, the shares two weeks ago took a 10% one-day drubbing after management announced abysmal results for the previous quarter, something that should have come as no surprise to anyone paying attention, since conference calls in both February and March indicated that demand for sewage rehab work in the U.S. rather than booming is shrinking.

NEED AND DEMAND

Neglect of infrastructure is as old as infrastructure. Indeed, precisely because structures are *infra*, that is, below, are out of sight and difficult to access, they can easily be ignored. Though legislators and bureaucrats are instinctively capable of also ignoring roads and bridges in need of repair, the deteriorating condition of above-ground facilities becomes apparent to citizens rather soon, and forces action. Hence, the biggest growth areas currently for public infrastructure spending are public safety (+14.5% year-over-year), health care (+21.6%), and highways and streets (+10.6%).

Sound Advice on Insituform Technologies

Attention to (and spending on) underground sewer, water, and power systems can deteriorate to crisis levels before the public notices. For example, Detroit estimates residents pay \$23 million annually for the 35 billion gallons of fresh water that leaks from its public water system. In the San Francisco Bay area, the major water provider aims to keep leakage below 10%. Our local sewage district seeks a similar limit.

There is a significant disconnect between demand and need for what Insituform does best: sewage pipe rehabilitation. Demand should be hitting the ceiling, since most of America's sewage lines were put in service 60 years or more ago during the post-WW II suburban building boom. At the time, the expected lifespan for these sewage systems was 50 years. In other words, the clock struck midnight a while ago.

In large cities, especially those east of the Rockies, much of the sewage infrastructure was put in place even earlier. For example, Boston recently had to repair sewage pipes constructed more than a century ago. According to a recent study by Booz Allen, a consulting firm, the problem is global: "The critical infrastructure that is taken for granted by both their citizens and their government leaders is technologically outdated, woefully inadequate, increasingly fragile, or all of the above. In some cities, the quality of water, power, and transportation infrastructure is noticeably declining. In others, it was never very good to begin with. And few cities have enough of it to meet future needs." And the price tag to the world's systems up to current demand and allow for modest future growth? Approximately \$40 Trillion.

In a 2005 study, The American Society of Civil Engineers estimated that bringing the geriatric U.S. sewage and water delivery systems up to grade would cost \$390 billion, which probably understates the cost. Given the lack of public interest, the only way government could excite the citizenry to shoulder such a burden would be to declare a war on corrosion.

Municipalities report that sewage and water infrastructure maintenance projects are anywhere from 25% to 40% underfunded, and half expect that over the next four to five years they will be forced to raise rates to businesses and residents, which is another way of saying that unless crises force their hand, public utilities are unable to get public support for something the public does not (or cannot) see as a problem. As Tom Rooney, Insituform's CEO, frequently remarks, revenues for sewage system rehabilitation are "lumpy," that it is difficult to project when customers decide the

need is so great that they have to come up with the funding.

Commercial clients, especially those who might use Tite Liner services, are more proactive in making sure their operations function efficiently. However, when BP's pipeline at Alaska's Prudhoe Bay, which literally carries the company's lifeblood, ruptured, it was obvious that even the biggest private sector companies can be pennywise when it comes to maintaining their most important assets. BP, after making spot repairs, is still trying to decide how to deal with the underlying problem. The BP spill triggered concerns that translated into more calls, and potentially more business for INSU.

THE CONFERENCE CALLS

INSU's stock price since late April 2006 when shares peaked at just under \$30 (the all-time high occurred in 2001 at \$43.20) and then dropped 22% in two days after pessimistic projections by management has been volatile. The share price jolted up between quarterly earnings reports, and then down after each quarterly conference call as bad news accumulated. We think that the recent cluster of three dour conference calls over the last 10 weeks has put an end to expectations of a rapid reversal of fortune.

On February 23, just as management was issuing its 10K for 2006, CEO Tom Rooney explained that revenues for the CIPP rehabilitation division grew by 8.1%, which was less than analysts had expected. Rooney pointed out that in terms of the amount of work done the company had grown its business by more than 20%, which meant that prices had been slashed to win contracts and to keep INSU's crews and equipment working. Furthermore, the backlog of signed and anticipated contracts had shrunk. Rooney did not make any promises things would get better, noting that municipalities continued to defer remedying existing sewer line problems.

On March 29, Rooney again held a conference call to warn that the first quarter's results would be mediocre: revenues for the CIPP division would fall below 2006 numbers, and the backlog continued to shrink as municipalities dragged their feet. Finally, the tunneling division, which had registered significant operating losses, would be terminated, and tunneling equipment sold.

Then on the last Friday in April, Insituform announced results for the first quarter, and they were as bad as expected. Business had slowed even further, and ex-

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expectations were for at best a 3% increase in U.S. CIPP revenues, which for the quarter had dropped 7.5%. Gross margins were shrinking as competition forced prices lower. Rooney described this deterioration in INSU's core business as "unexpected and disappointing." Tite Liner was doing better, though even here revenues had dropped slightly as some contracts were completed. Balancing this was strong growth in the Tite Liner backlog (13.3%).

Exiting the tunneling business triggered \$16.8 million in writeoffs that overwhelmed operating profits from the other divisions with the result that for the quarter Insituform lost 56 cents per share versus an 11-cent per share profit in the first quarter of 2006.

At the same time that income is pinched, Insituform is spending primarily to prime the revenue pump by adding sales people for CIPP, and to expand Insituform Blue, the potable water division. The company also is for the first time spending to lobby federal, state, and local officials about infrastructure issues that despite being out of sight, should not be out of mind. It is a struggle.

After each of these conference calls, the half-dozen analysts who follow INSU—all of them from regional or boutique firms—reduced their numbers, and most ratcheted down their opinions. At this juncture, only a single analyst considers INSU a buy.

WILL IT GET BETTER?

Insituform is going through a tough period, and given the costs associated with shutting down the tunneling division, profits already reduced by lower margins and fewer biddable contracts, will be ugly for the foreseeable future. However, we prefer to look beyond the obvious horizon, and focus on what all the bad news obscures.

Insituform is the dominant company in trenchless rehabilitation, and even as its fundamental patents expire and allow other competitors in, it retains both reputation and reach to effectively compete for business. It is also aggressively applying its basic technology to new uses, especially water pipes, and is successfully finding better demand and better margins outside of the United States. Indeed, Tom Rooney, the CEO, termed

the dropoff in sewage rehabilitation business a "United States phenomenon," since business looks good outside our borders.

We expect domestically that tough times will shake out weaker competitors, and rather than facing more competition over the next couple of years, poorly capitalized competitors will fall by the wayside. Insituform has a robust balance sheet, which enables it to make the necessary investments in equipment and in skilled workers. As Rooney notes, Insituform is built to run best when all its assets are in demand. In that environment, it is a cash machine.

Eventually—and that is the word that terrifies investors—the need for Insituform's services will get that machine in gear. Whether it will be a noticeable upsurge in sewage system failures, a major calamity, or more diligent enforcement of existing standards by the EPA, rising demand is inevitable, and INSU will be a prime beneficiary.

Insituform's biggest market is here in the U.S. (75% of 2006 sales and 32% of operating profits), but elsewhere con-

ditions are much more favorable. In Canada (7.4% of 2006 sales and 30% of operating profits), for example, both demand and margins are at highs, and new business is developing in Eastern Europe, Asia, and Latin America. Demand for industrial services, the Tite Liner division, grew nicely last year (+19.9%), but for the first quarter Tite Liner sales were down by 7% though operating profit rose 28%.

Most important in the future, Insituform has made what seems to us a natural expansion of its technology and crews into drinking water delivery systems. Though Insituform Blue was formally constituted only last year, INSU has been doing water line rehabilitation for a decade. Today, this represents a small portion of sales, and earnings are negligible. Blue complements everything else Insituform does, and within a few years should be contributing to cash flow.

In fact, management believes that Insituform's best opportunities are in this new division, and that some day INSU will be known primarily for its rehabilitation of drinking water pipes. It's easy to see why. In its last report on drinking water infrastructure, the federal EPA estimates that over the next two decades the cost to

Insituform is trading at a Price to Sales ratio of 0.82, INSU's average annual low since 1986 had been a jot under 1. Price to Cash Flow stands at 10.6 compared to the average low for the last 21 years of 10.2, while Price to Book is 1.5 which compares favorably to the historical low of 1.8. Price to Earnings... at around 21 compares favorably to what we see in normal years.

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upgrade our domestic water delivery system will run \$276.8 billion. Global opportunities magnify the potential.

Finally, management expects to have a new capital structure in place by 2008 that should increase value for shareholders. Rooney thinks that Insituform's balance sheet, with only \$65 million in long-term debt, can absorb three to four times that amount. New funds could be used to provide a significant dividend to shareholders or with a stock buyback boost per-share numbers.

VALUATIONS

The first quarter numbers are so distorted by the tunneling write-off that we're going to rely on figures through the end of 2006, and concede that after another couple of quarters we will have to revisit these numbers to see where reality is.

Based on the 10K for 2006, Insituform is trading at a Price to Sales ratio of 0.82, INSU's average annual

low since 1986 had been a jot under 1. Price to Cash Flow stands at 10.6 compared to the average low for the last 21 years of 10.2, while Price to Book is 1.5 which compares favorably to the historical low of 1.8. Price to Earnings, however, is a bit more difficult to benchmark, since what we are seeing now with earnings—cancelled out by write-offs and slow revenues—has happened before and driven the P/E skyhigh. Nonetheless, the present P/E at around 21 compares favorably to what we see in normal years. These metrics suggest we are near a bottom for INSU, and encourage us to start building a position.

The balance sheet is strong, though presuming management follows through on its intention to borrow to fund either a share buyback or a dividend to shareholders that low level of long-term debt will rise. Based on our view that we currently are seeing the worst environment for Insituform and the gloomiest analyst coverage, and that when conditions improve there will be a boost from the new potable water division, we recommend buying INSU up to \$22. [SA](#)

PORTFOLIO UPDATES

Since the last issue closed on 4/5, stocks have been on fire, especially the Dow 30, which jumped 5.6% while setting new highs, it seemed, each day. The S&P 500 is also closing in on its all-time high last seen at the start of 2000, and now hovers just above 1500 after adding 4.3%. The Nasdaq added 4.1%. *Sound Advice* held its own, up 4.4%.

Fastenal, the April recommendation, reported quarterly earnings on the day before the issue went into the mail and was posted for E-Subscribers. The news was excellent, and pushed the stock above our \$39 Buy limit. FAST is up 17.4% since we priced it. For subscribers who bought it on the following Monday, the reward was a 5.9% increase. We are raising our Buy limit to \$44.

Sprint also had a nice pop on the same day as Fastenal when Relational Investors, an investment firm known for sticking its nose into the business of underperforming companies, announced it recently acquired a 1% stake. The *Wall Street Journal* suggests that Relational wants Sprint Nextel to sell off its national wireline business and to throttle back on capital expenditures, especially the gargantuan costs of setting up WiMax. Relational and others also might be thinking about changes in the executive suite. S is up 5.6% since the April letter.

We noted in the last letter that Berkshire Hathaway has put more than a billion into three railroads. One,

Burlington Northern, was named, but the other two remain a mystery. Now one of England's biggest hedge funds, TCI, has said it is interested in acquiring \$500 million worth of **CSX** shares. Both the TCI news and the Buffett involvement are stunning, since railroads hardly are depressed. I mean, when we bought CSX six years ago at a split-adjusted basis of \$16.66—that was depressed. As of today, on a total return basis, CSX trading at \$46.01, has returned 190%. With such fellow travelers, perhaps we should stay on board. Since the last letter, CSX is up 12.3%.

We are selling **Safeway**, which has treated us well, especially over the last 12 months. We think the transformation management has accomplished is well-factored into the price.

Expectation that somebody out there lusts or might lust after a publicly traded company is the mother's milk of speculation. Hence, the **New York Times** soared when Rupert Murdoch offered \$60 a share for Dow Jones, parent company of the *Wall Street Journal*, *Barron's*, and *CBS Marketwatch*. Dow Jones, like the NYT, is controlled by the founding family through its ownership of supershares, and founding families resist buyers. Murdoch is no fool, and the stunning price he offers might provide a wedge to pry open the family's resistance. We'll see. But the idea that someone would try to convince one media empire's owners to sell is enough

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to get the shares of other super-shared public companies moving higher. NYT added 6%.

Maxim Integrated, the March recommendation, which had been languishing, rose 9.1% on nothing company specific. Instead, it was good news from competitors, which clued investors into the shocking truth that the semiconductor business is cyclical, and perhaps is bottoming. **Symantec**, which has been up and down, hopped 14.7% in part on better than expected revenues and earnings. Indeed, quarterly reports were generally very positive for our portfolio.

Boston Scientific is up 8% but not on earnings, which were as weak as expected, but on a few positive glimmers: the FDA removed a warning that prevented BSX from operating a defibrillator factory, and management is moving to sell some non-core assets. The best part was

that when management announced those poor quarterly results and the market barely flinched, which suggests that those who wanted to get out have done so, and the stock price has a floor.

Western Digital has gotten banged so far this year by industry-wide bloated inventories. In the last quarter, WDC announced strong results. We find particularly encouraging that the split in revenues between drives for desktop PCs, once Western's focus, and for other electronic devices narrowed from 71% vs. 29% to 53% vs. 47%. This means that new markets have opened to WDC. As consumer electronics continue their fast growth, sales should increase as well along with, we hope, margins. Since the last letter, WDC is up 8.2%.

Johnson & Johnson was also dinged by the same news about stents that hurt Boston Scientific, but the damage was not as deep, since BSX is tightly harnessed to stents, which for JNJ is just one, albeit a significant one, horse in its team. JNJ has a hand in almost every imaginable area of medical equipment and pharmaceuticals, which makes owning JNJ like owning a healthcare mutual fund that can control its own destiny. That perspective underpins the very nice results JNJ announced for the previous quarter, which since the April letter has lifted JNJ 4.8%. We think JNJ remains very attractive for long-term profits.

Our best performer this month is **Schering-Plough**, which reported better than good numbers—profits surged 55%—and shares are up 27.5% since the April

issue. I suspect that many of you own SGP, since we recommended it in August 2003, have included it in a couple of our basket-of-ideas issues, and featured it to new subscribers as our single best idea, not because we expected it to be the next Google, but because it epitomized what we look for in turnarounds: great management, tarnished assets, and extreme investor pessi-

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mism. Since the 2003 recommendation, SGP is up 104% vs. the S&P's 54%.

Perrigo while not a major pharmaceutical company does occupy an interesting niche as the largest manufacturer and distributor of generic over-the-counter non-prescription drugs and food supplements. PRGO lost ground recently when it announced two acquisitions, both of which we considered accretive to earnings. The market thought otherwise, and dropped the share price as low as \$16.24. In the March issue, we encouraged you to buy into that pessimism, and hope that you did. Since those purchases drove the price down to \$16.24, the shares are up 19%, and since the last letter by 6.1%.

Honeywell blew the doors off with its quarterly results, upping earnings by 27% compared to the same quarter last year, and beating estimates by 6%. Cash flow more than doubled, and free cash flow more than tripled. HON is up 18.8%.

Tetra Tech also has come to life over the last few weeks, as investors get interested again in infrastructure. TTEK added a new dimension to its business when it acquired The Delaney Group, a small company with expertise in wind-generated power but that also derives revenues from overseeing base closings for the Department of Defense, an area TTEK serves as well. It looks like a good match. Since the last letter, TTEK is up 9.8%.

So where were the problems this month? **Mitsubishi UFJ Financial** dropped 8.3% as investors are less
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Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
HRPT Properties	HRP	NYSE	\$12.08	6.95%	\$14.00	BUY
Senior Housing Properties	SNH	NYSE	\$24.05	5.65%	\$27.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$37.09	0.30%	\$42.00	BUY
American International	AIG	NYSE	\$70.85	0.71%	\$75.00	BUY
Boston Scientific	BSX	NYSE	\$16.16	0.00%	\$18.50	BUY
Coca-Cola Enterprises	CCE	NYSE	\$22.36	1.07%	\$24.00	BUY
ConAgra	CAG	NYSE	\$24.67	2.92%	\$29.00	BUY
CSX Corporation	CSX	NYSE	\$46.01	0.87%	\$51.00	BUY
Disney	DIS	NYSE	\$35.85	0.86%	\$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$48.04	1.19%	N/A	BUY
Excelsior Value & Restructuring	UMBIX	800-446-1012	\$58.31	0.82%	N/A	BUY
Fastenal	FAST	NASDAQ	\$41.80	1.00%	\$44.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$17.52	0.00%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$24.96	0.56%	N/A	BUY
Getty Images	GYI	GYI	\$50.69	0.00%	\$56.00	BUY
Honeywell	HON	NYSE	\$56.12	1.62%	\$59.00	BUY
Insituform Technologies	INSU	NASDAQ	\$19.93	0.00%	\$22.00	BUY
Johnson & Johnson	JNJ	NYSE	\$64.48	2.33%	\$69.00	BUY
Liberty Capital	LCAPA	NASDAQ	\$117.67	0.00%	\$118.00	BUY
Mattel	MAT	NYSE	\$29.13	2.23%	\$32.00	BUY
McDonald's	MCD	NYSE	\$49.92	0.46%	\$53.00	BUY
Molson Coors Brewing	TAP	NYSE	\$96.74	0.85%	\$100.00	BUY
Newell Rubbermaid	NWL	NYSE	\$30.82	2.73%	\$32.00	BUY
New York Times Co.	NYT	NYSE	\$25.91	2.70%	\$27.00	BUY
Perrigo	PRGO	NASDAQ	\$19.33	0.93%	\$23.00	BUY
Safeway	SWY	NYSE	\$35.86	0.65%	N/A	SELL
Sara Lee	SLE	NYSE	\$16.70	2.40%	\$18.00	BUY
Schering-Plough	SGP	NYSE	\$32.96	0.67%	\$37.00	BUY
Sony	SNE	NYSE	\$53.95	0.40%	\$55.00	BUY
Sprint Nextel	S	NYSE	\$20.70	0.48%	\$24.00	BUY
Superior Industries	SUP	NYSE	\$23.13	2.77%	\$24.00	BUY
Tetra Tech	TTEK	NASDAQ	\$20.54	0.00%	\$23.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$64.87	5.15%	N/A	BUY
United Parcel	UPS	NYSE	\$71.09	2.14%	\$82.00	BUY
Wal-Mart Stores	WMT	NYSE	\$48.27	1.39%	\$52.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$62.49	3.16%	N/A	BUY
Xerox	XRX	NYSE	\$18.09	0.00%	\$21.00	BUY
Energy/Natural Resources						
American Cent. Gold Fund	BGEIX	800-826-8323	\$19.70	0.25%	N/A	BUY
Anglo American PLC	AAUK	NASDAQ	\$28.72	1.81%	\$32.00	BUY
Coeur d'Alene	CDE	NYSE	\$3.83	0.00%	\$4.00	BUY
EnCana	ECA	NYSE/TSE	\$56.55	1.06%	\$60.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$36.45	9.22%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$40.40	3.96%	\$41.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$72.22	3.39%	\$74.00	BUY
Transocean	RIG	NYSE	\$90.31	0.00%	\$95.00	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	\$26.89	0.00%	\$30.00	BUY
Crescent Real Estate	CEI	NYSE	\$20.55	7.30%	\$22.50	BUY
Discovery Holdings	DISCA	Nasdaq	\$21.97	0.00%	\$24.00	BUY
Electronic Data Systems	EDS	NYSE	\$27.49	0.73%	\$30.00	BUY
Liberty Global	LBTYA	NASDAQ	\$36.82	0.00%	\$40.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$32.39	1.89%	\$35.00	BUY
Mitsubishi UFJ Financial	MTU	NYSE	\$10.60	0.90%	\$16.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$5.72	1.75%	N/A	BUY
Symantec	SYMC	NASDAQ	\$19.40	0.52%	\$22.00	BUY
Time Warner	TWX	NYSE	\$21.29	1.03%	\$24.00	BUY
Western Digital	WDC	NYSE	\$18.15	0.00%	\$20.00	BUY

*Prices as of the market close on Friday, May 4, 2007

**Yield represents all distributions during current calendar year divided by share price.

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

Sound Advice Market Indicators

confident interest rates will rise in Japan. **Agrium** after a torrid several months dropped 5.9% after announcing better than expected results, though that translated into a loss for the quarter due to bad weather and a rail strike by one of AGU's primary carriers. We still like the prospects for fertilizers.

Senior Housing Properties, a REIT focused on care facilities, declined by 2.8% as REITs in general seem to be leveling off after seven years of rapid price increases and fat dividends. We still like SNH as an income proposition (5.6%), but we don't think it is particularly cheap these days. **HRP** fell 3.2%. HRP showed a slight drop in Funds From Operations, while SNH showed a significant increase. Again, HRP is a good income vehicle (5.7%) and, we believe, the value of its

properties makes the shares worth at least 50% more than the current price of the stock.

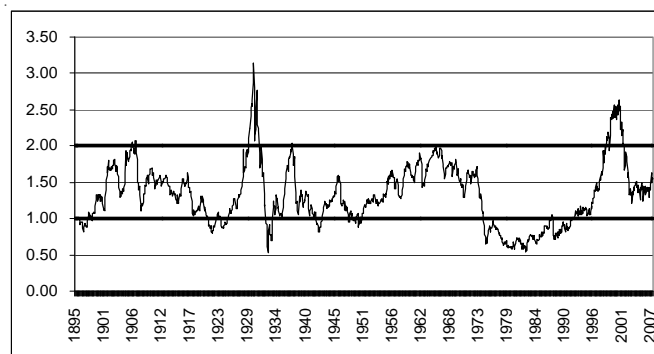
Finally, natural resources had a good month with the exception of **Coeur d'Alene**, which announced it was acquiring two silver mining companies, which will make it the world's largest silver miner. CDE dropped 10.5%. The costs boost debt, but we're all for anything that raises Coeur's profile. Silver miners have not had the attention gold and platinum have enjoyed—yet. **American Century Global Gold** was down 1.4%. Other positions outperformed: **Anglo American** is up 6.3%, while energy stocks did even better. **Transocean** added 10%, **EnCana** 8.6%, **Royal Dutch** 7.7%, and **Icon Energy Fund** 6.9%. **Plum Creek** was the caboose at +2.3%. **SA**

The Sound Advice Market Indicators:

The Risk Indicator (shown to the right) tracks supercycles in stocks by comparing prices of stocks to real estate (house prices). A reading above 2.0 indicates times when stocks are extremely high relative to real estate. These are times when the risk is high and a supercycle is approaching a zenith. Conversely, a reading below 1.0 indicates stock prices are extremely low relative to real estate. At these times, the upward phase of a new supercycle is beginning. The current reading stands at 1.54, down from last month's reading of 1.56.

We recently updated the adjusting factors to make this indicator more useful. The new adjusting factors are explained in the 2007 edition of *A Millionaire's Guide to Panic-Proof Investing in the Stock Market*. We send this book with renewals on a complimentary basis. If you have a red alert above your address, this book will be included with your renewal. If your subscription is not up for renewal for several months, please call our office to receive a complimentary copy.

Within the span of a supercycle, there are usually several business cycles that cause the smaller up and down markets we refer to as bull and bear markets. When the Risk Indicator is moving higher from 1.0, we are in the upward phase of a Supercycle. During the upward phase of a supercycle, bull markets will be more energetic than bear markets. During this upward phase, bull markets can become so strong that they can carry



the Risk Indicator well above 2.0. This happened in the late 1920s and the late 1990s.

The reverse is true during the downward phase of supercycles. When the Risk Indicator is moving downward from 2.0 toward 1.0, which is the case now, bear markets will be stronger than market prognosticators project, while bull markets fall short of expectations.

The Diffusion Indexes

Because bull and bear markets are governed by business cycles, it IS therefore critical to track business cycles, which is what our Diffusion Indexes are designed to do (explained on the next page). Regardless of how many bull and bear markets may occur in a supercycle, it is also important to take a lesson from history by observing that a supercycle always peaks along with the current business cycle; and it also bottoms along with the current business cycle.

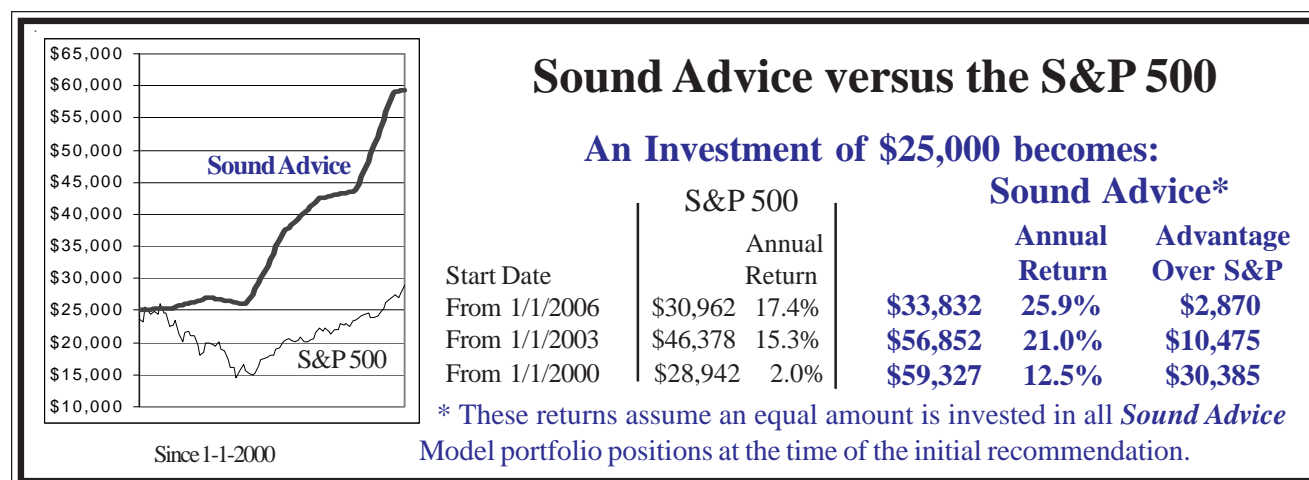
Sound Advice Market Indicators

The Diffusion Index of Leading Indicators gives “buy” signals when all five of its leading economic indicators drop below their respective levels of six months earlier. This reveals a softening economy and a ripe atmosphere for a lasting decline in interest rates. **Currently, 20% of its leading indicators are above their levels of six months earlier.**

The Diffusion Index of Lagging Indicators gives “sell” signals when all five of its lagging economic indicators rise above their respective levels of six months earlier. This reveals a strengthening economy and inflationary pressures ahead. **Currently, 12.5% of its lagging indicators are above their levels of six months earlier.**

While we recommend remaining fully invested in the *Sound Advice* model portfolio at all times, we use the *Sound Advice* Market Indicators to influence our approach and nature of our recommendations. When “sell” signals are in force, our recommendations are defensive in nature. We will be looking for special situations and are likely to recommend taking profits more readily. Conversely, during “buy” signals, our recommendations will be more aggressive.

The latest signal came from the Diffusion Index of Lagging Indicators, a 100% reading in October 2005, which means recommendations will be defensive in nature and limited to special situations. We believe that these proprietary indicators have been important factors in our ability to consistently outperform the market averages. The chart below shows how *Sound Advice* recommendations have performed versus the S&P 500.



History of the Signals

- * 2003 In February, just before the surge in the market, the indicators gave a buy signal. The S&P 500 advanced more than 40%.
- * 2000 In May, close to the peak of the market, the indicators signaled the end of the bull market. The market subsequently dropped 40%.
- * 1995 In March, the indicators gave a sell signal. Then in July, they gave a buy signal. The S&P rose 153% until the next sell signal in May 2000.
- * 1988 The indicators signaled the subsequent bull market that took stock prices up 95% until the next signal.
- * 1987 Six weeks before the 1987 Crash, the indicators gave a sell signal.
- * 1984 A sell signal in January and then a buy signal in September for the bull ride to the 1987 peak.
- * 1979 A buy signal occurs at the beginning of the new bull market.
- * 1977 A sell signal marked a back and fill market for the next two years.
- * 1974 With the Dow Jones trading below 700, the indicators issued a buy signal, announcing a 6-year bull market.
- * 1973 They signaled a “sell” just prior to the bear market that cut stock prices in half by October 1974.
- * 1970 The indicators signaled the beginning of the new bull market.
- * 1968 At the zenith of the huge bull market of the 1960s, the indicators gave a sell signal.

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