

Caution: Bad Breadth



The *Sound Advice* Portfolio is up 1.3 percent this year, compared to a 4.2 percent decline for the S&P 500. We have an average profit of 60 percent in the *Sound Advice* portfolio, based on the prices that each position was recommended. Best regards,

-- Gray Emerson Cardiff, Editor

Last month we pointed out the deteriorating market breadth of the stock market. We noted it was a harbinger of a vulnerable market, and indeed, the final days of August introduced some breath-taking down-drafts; the largest since the days of the 2008-09 melt-down.

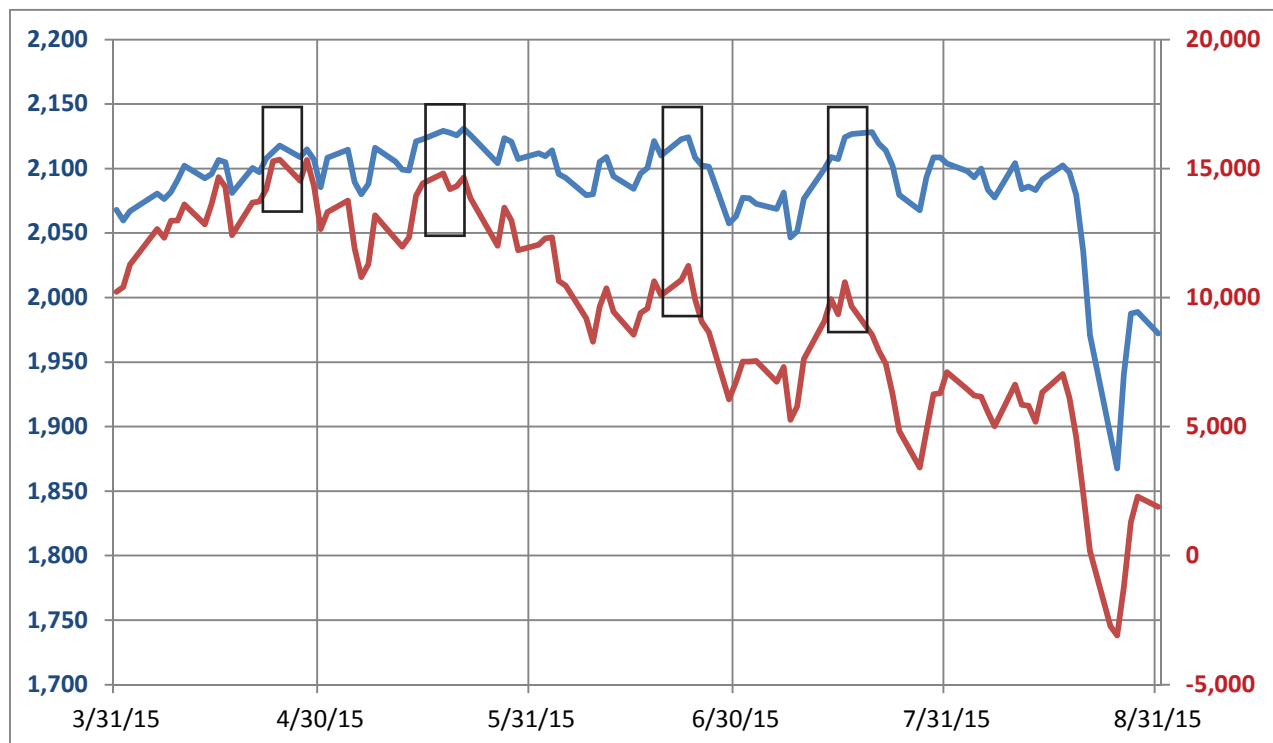
A healthy bull market will have broad participation among a wide range of stocks, but participation will narrow as it runs out of gas. Near major tops, the largest capitalized stocks continue rising because they are the easiest places for money managers and mutual funds to put incoming cash. This causes the popular market averages to continue rising because they are heavily weighted by the stocks of the largest companies. However, the overall breadth of the market will be deteriorating. As we graphically illustrated last month, the phenomenon has preceded major market declines, including the crashes of 2000-02 and 2008-09.

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

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

We also pointed out last month that this deterioration was appearing at a time

Stock Market Breadth Since March, 2015



when our Diffusion Index of Lagging Indicators (Page 10) had been hitting 100 percent, reversing our prior green light into a caution signal.

We also pointed out that bad breadth was coming at a time when the market was historically high, based on the ratio of the overall market capitalization to GDP (the ratio of the total capitalization of the stock market -- stock prices of all publically traded companies multiplied by their respective amounts of shares outstanding -- to the gross domestic product of the US). This ratio was above 1.2 in the late 1990s prior to the 2000-02 bear market that took stocks down nearly 50 percent. It also rose above 1.1 just prior to the 2008-09 melt-down which took stocks down nearly 50 percent again. Last month, this ratio was back in the stratosphere again, close to 1.3.

It was with this perspective that we introduced an ETF that will benefit from a declining stock market, The **ProShares UltraShort S&P 500 (SDS)**, a reverse ETF that is designed to produce two times the daily fluctuations of the S&P 500 index. For example, a decline of say, 1.0 percent in the S&P 500 will cause SDS to increase by 2.0 percent. Conversely, an increase in the S&P 500 will cause SDS to decline in the same fashion. We have been tracking SDS and confirmed that it performs as it should, with daily premiums and discounts within a narrow range of 0.5 percent. It is also very liquid.

As with any reverse ETF, SDS will erode slightly over a long period of time because it will decline slightly more than it will increase with an equal movement in the S&P 500. The erosion factor is nominal in comparison to normal market movements, but it can add up over an extended period. The 2:1 leverage amplifies this erosion factor as well.

Accordingly, SDS is not a long-term holding proposition. However, for the near term, it will serve as a counter-balance to the rest of our portfolio in a general market correction. The 2:1 leverage factor means that it will better serve this purpose without making a large investment.

What's Next?

Although we went to great lengths to point out the vulnerability of the market, and have been advising caution, we have not been calling for a full-fledged crash or extended bear market. This is because the interest rate environment has remained low, and thus friendly to stocks. However, we must keep our eyes on the horizon for this friendly atmosphere to change.

Last week, the second quarter GDP growth rate was

revised substantially upward, from 2.2 percent to a 3.7 percent annual growth rate. This revision alone changes the character of the US economy from lackluster to vibrant. While that may be good news for the economy, it is not for the stock and bond markets. A vibrant economy is not consistent with the Federal Reserve's current monetary stance of near-zero interest rates, which was established after the 2008-09 meltdown as an emergency measure to bail out the economy.

Whether or not the members of the Federal Reserve's federal open market committee (FOMC) decide to begin raising interest rates in September is almost moot. As the US economy continues to strengthen, market interest rates and bond yields will rise anyway.

We are recommending three ETFs designed to benefit from the inevitable rise in long-term Treasury bond yields. We have dubbed these ETFs as "No-Brainers" because interest rates and bond yields always rise during an economic recovery, especially as a recovery evolves into a vibrant economy. These ETFs differ in the amount of leverage used, and you can choose among them depending on your investment objectives and risk tolerance.

The **Direxion Daily 20 Plus Year Bear 3 Shares (TMV)** uses 3:1 leverage.

The **ProShares UltraShort Lehman 20 Plus Year Treasury (TBT)** uses 2:1 leverage.

The **ProShares Short 20 Plus Year Treasury (TBF)** uses no leverage.

The price action of these ETFs is based on the changes in long-term treasury bonds, specifically BlackRock's iShares 20+ Year Treasury Bond ETF (symbol TLT) which holds a portfolio exclusively of long-term Treasury bonds. The prices of our No-Brainer ETFs fluctuate in accordance with the daily fluctuations of TLT, only in the opposite direction, multiplied by the leverage each uses. For example, a decline of say, 1.0 percent in TLT will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in TLT will cause these ETFs to drop in the same fashion. We can project the movements of these ETFs based on any given scenario.

As part of the Federal Reserve's economic projections, each member of the FOMC makes a prediction regarding the future path of interest rates. Those predictions are plotted in the so-called "Dot Plot", and medians are taken to formulate the Federal Reserve's official prediction. Although the most recent Dot Plot was taken before the substantial upward revision in second quarter GDP, it serves as a baseline forecast.

Sound Advice is published monthly by S.A. Newsletters, LLC. ©2015 S.A. Newsletters, LLC. Editor: Gray Emerson Cardiff. Executive Editor: Linda Cardiff. Subscription rate: \$99 per year. Send subscription requests to: Sound Advice, 140 Town & Country Drive, Suite E, Danville, CA 94526. Phone: (925) 838-6710. Fax: (925) 838-0522. Information presented in Sound Advice may be used provided the newsletter—its name, address, and website—is mentioned as the source. The information contained herein has been carefully compiled from sources believed to be reliable, but accuracy cannot be guaranteed. When securities are initially recommended herein, the editors, affiliates, and associates of the editors do not have positions in such securities and are required to wait at least 2 business days from the date *Sound Advice* is posted before placing orders for them. After the initial recommendation, editors and staff members may own stock of any or all of the securities discussed herein. Gray Emerson Cardiff owns all of the stocks mentioned herein.

The most recent Dot Plot predicts that the Federal funds rate will be 0.625% at the end of 2015, up from zero currently. The Federal funds rate is predicted to be 1.625 percent at the end of 2016, and 2.875% by the end of 2017. Over the longer run, the consensus ranges between 3.25% and 4.25%, with the median of 3.75%.

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

TMV would rise to \$41 by the end of 2015, to \$66 by the end of 2016, and to \$115 by the end of 2017.

TBT would rise to \$56 by the end of 2015, to \$78 by the end of 2016, and to \$112 by the end of 2017.

TBF would rise to \$28 by the end of 2015, to \$33 by the end of 2016, and to \$39 by the end of 2017.

China's Devaluation

In August, China's devalued its currency, shocking world the markets. It was alarming because it brought the health of the world's second largest economy into question. The recent slide in China stocks also undermined confidence, stoking fears of a more significant slowdown. Although US exports to China are negligible, China's demand for the world's goods and services has a significant impact on world prices.

As we pointed out in our email update the day following the devaluation, China does not allow its currency to float freely in the currency exchange markets. Instead, every day, China's central bank sets the value of its currency against other major currencies. Changes are usually in very small adjustments, normally a fraction of one percent. However, over the years, these adjustments have been adding up, resulting in an increase of 25 percent in the value of the yuan versus the dollar since 2005. Since the beginning of this year, until the devaluation, the adjustments have been tandem with the 8.7 percent increase in the dollar index.

Aligning the yuan to the dollar has made China's exports substantially more expensive to the rest of the world, especially this year as the dollar has soared. August's sudden devaluation followed the announcement that China's exports fell substantially in July, by a whopping 8.3 percent.

The recent devaluation against the dollar has brought the yuan more in line with other major currencies. At one point in August, China's central bank actually stepped in to stem the slide of the yuan, which had evidently gone too far.

China is growing from an emerging country into a large, self-fueling economy with its own base of consumers. Its services sector became the largest growth factor in the first half of the year, growing by 8.4 percent and becoming half of China's GDP. Retail sales were also strong.

The devaluation of the yuan will strengthen the Chinese economy. As evidence, we have only to look at the boost that the weak dollar gave the US economy as it recovered from the 2008-09 melt-down. We are seeing the same beneficial effect that a weak euro is having on Europe's economy now.

Portfolio Updates

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

Energy Selections

As one of the few deeply discounted values in the market, carefully chosen energy stocks are bound to enhance the long-term performance of our portfolio. China's devaluation, and the raised concern over its demand for basic commodities, coincided with a drop in the price of oil below \$40 a barrel for West Texas Intermediate (WTI) crude. The subsequent announcement of the upward revision in the second quarter US GDP growth brought a rebound above \$45. Although our energy selections recovered from their low-points, they still offer compelling buying opportunities.

As of the week ending 8/21/15 (the latest week reported) there were currently 450 million barrels of oil in US storage tanks, which is 61 million barrels more than when there was no glut. This is a significant improvement from the 101 million barrel glut that existed in April 2015, a reduction of 40 million barrels. Today's 61 million glut is less than 9 days of our imported oil needs of 7 million barrels a day. Even every drop of the entire 450 million barrels in all US storage tanks equates to only 64 days of imported oil.

The increase in US oil production in recent years has come largely from fracking shale. However, production falls off sharply from fracked wells, typically down by 70 percent during the first year. New wells need to be constantly added to maintain overall production levels. We know that is not happening because of the 50 percent plunge in the domestic drilling rig count since last October.

US Production has been tapering off since the peak in early June, down by 273 thousand barrels per day. As production continues to decline and becomes more pronounced, draws from storage tanks are certain to be substantial, and the oil glut will fade into memory.

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

Chevron (CVX) is a vertically integrated oil company which means it has operations in all phases: from exploring and drilling, to transporting and refining, and even to retail sales at its gas stations. Profits from these various stages of production will change with the price of oil. When oil prices are high, margins are high from drilling, while margins are low from refining. However, the reverse is also true when oil prices are low. The annual dividend is \$4.28 per share which the company pronounces sacrosanct.

Chesapeake Energy (CHK) reported earnings in August, and fell below into new low territory. We did an extensive update in our August 19 email update. By way of review, we noted a significant statement by CEO Doug Lawler:

"We understand that our debt structure and gathering commitments add to the challenges of the commodity price

environment, and there are several questions out there in the market, such as: can Chesapeake generate sufficient cash flow to weather this storm? And can the portfolio and operational strengths overcome these significant obstacles?

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

We also noted the incredibly low price CHK received for its Ohio Utica Shale natural gas in the second quarter, which accounted for close to one-fourth of the company’s natural gas production. Due to the glut in the immediate vicinity and lack of pipelines, CHK only received \$1.01 per million cubic feet (Mcf), and 75 cents before hedges. This compared to the national market price of approximately \$2.75, and \$2.45 received by CHK in the same quarter last year. However, this situation is about to change.

In November, the Ohio Pipeline Energy Network (OPEN) is scheduled for completion which will **connect to the** 9000-mile network of the Texas Eastern Transmission pipeline that crosses through southern Ohio and runs down to the Gulf Coast. This will enable CHK to receive Gulf Coast pricing for about 85 percent of its Utica gas, and well worth the transmission cost of 38 cents per Mcf. The opening of OPEN is bound to enhance CHK’s revenue beginning in 2016. Receiving anything close to today’s national market price would be a game-changer.

Valuation

Morningstar (<http://www.morningstar.com>) currently values CHK at \$25 per share, close to 3 times the current price. As a credible company, it is astonishing to see Morningstar’s valuation this far from the market price of the stock. So we recently performed our own independent valuation of the company, based on the company’s most recent second quarter financials.

In our evaluation, we assume that production would stay flat in 2015 because CHK is paring back Utica production until the new Ohio pipeline (OPEN) can transport the gas to the Gulf Coast for higher prices. Based on the projected production growth in the Utica and Haynesville shales, we project that the company’s overall production will increase by 2.4 percent in 2016 and 4.8 percent in 2017.

Because future prices of oil and natural gas are wildcards, conservative projections are in order. Our evaluation assumes that the price of oil will climb to \$52 per barrel by 2017, which is close to the price CHK received in the latest quarter. For natural gas we assumed CHK would net \$2.25, which is below the current market, and below what CHK received one year ago.

We also assumed that CHK’s marketing and gathering arm breaks even in the years ahead (although it turned a \$209 million profit in the second quarter).

In a similar method to that of Morningstar’s, we calculated Chesapeake’s enterprise value at 11 times EBITDAX (earnings before interest, taxes, depreciation, amortization,

and exploration costs). After subtracting long-term debt of \$11.55 billion, which we assume will grow by \$2.5 billion, and reducing equity further by the outstanding preferred stock, we get a value for CHK of \$33.70 in 2017. If we discount that price back by 10 percent annually, we get a present value of \$26.47 for CHK today.

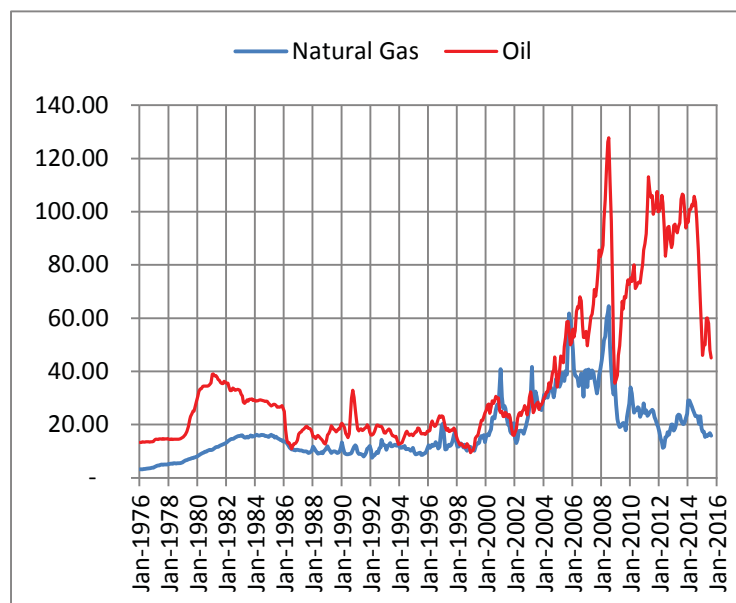
CHK has high-quality producing assets in prolific areas, and it has the ability to survive the current downdraft in oil and gas prices. It takes more than a 60 percent annual discount rate to bring the 2017 value of \$33.70 to today’s price.

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

The drop in the price of oil brought the energy-equivalent costs of oil and natural gas closer, but a substantial disparity still exists. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. At \$45 a barrel, that is the cost of 5.8 million BTUs. However, with the current market price for natural gas close to \$2.72 for one million BTUs, 5.8 million BTUs will cost \$15.78 (5.8x\$2.72). So the same amount of energy is available for 35 cents on the dollar, if it is in the form of natural gas rather than oil.

The following chart below shows the historic relationship between the costs of these two forms of energy. The red line shows the price of a barrel of oil since the mid-1970s. The blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. Most of the time, the costs of the two forms of energy have been closely aligned. They have moved closer together, but remain substantially apart. This difference still translates into an expanding natural gas industry.

The Cost of Energy Equivalents of Oil and Natural Gas



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

Transocean (RIG) reported its second quarter financial results in August of \$1.11, which were a pleasant surprise, more than double expectations. CEO and President, Jeremy Thigpen, said:

"Despite the challenging market conditions, Transocean delivered strong operating results and underlying cash flow in the period due to exceptional revenue efficiency and a relentless emphasis on cost management ... I remind all of our stakeholders of our commitment to the continuous improvement of our business, which includes taking the necessary steps to ensure that we have the right rig fleet to compete effectively in all market conditions."

It is important to keep in mind that the US still imports 7 million barrels per day. Deep water drilling is still a necessary source for the US and the world's oil needs. Long-term profits from RIG should be stellar from here.

Valero Energy (VLO) is the largest oil refiner in the US. It owns 15 refineries with a capacity for 2.9 million barrels per day. The company also has 7,400 retail outlets in the US, Canada, UK, and Ireland, under the brands Valero, Beacon, Ultramar, Shamrock, and Texaco.

Valero Energy is one of the few energy companies that can benefit from lower oil prices because margins expand during such times. However, high demand for gasoline during times when oil prices are rising provide good margins too. This is evidenced by VLO's second quarter earnings of \$2.66 per share, more than double the \$1.22 per share one year ago. Low oil prices and high demand for refined products propelled a profit margin of \$13.71 per barrel, which is wider by \$3.87 per barrel larger than one year ago.

Most US refineries are not set up to handle the light, sweet, crude oil that is coming from fracking US shale, which is a primary cause of the US oil glut. Valero's refineries are notable exceptions because they are the most flexible refineries, allowing Valero to capture the highest margins among its competitors. Valero's refineries are also well positioned geographically, even for accessing the low-cost Maya crude from Mexico, a heavy sour oil that Valero bought in 2014 for an average \$13 per barrel discount, an even larger discount than from glutted US oil.

VLO remains an astonishing value, especially after the late-August drop. After rising close to \$70 in August, VLO

dropped below \$60 as panic hit the stock market and oil dropped below \$40 a barrel. In searching for causes for the drop, and to make sure we are not missing anything, we can find only one potentially harmful scenario.

The drop in VLO came when oil dropped below \$40, giving the appearance that low oil prices would hurt VLO. However, lower oil prices would be a benefit because oil is the "feedstock" to refining, and thus an expense. VLO's margins could only be hurt by an extended change in US gasoline prices that would be disproportionate to the change in oil prices, thus narrowing profit margins. That scenario could occur if significant weakness in the US economy drove gasoline prices down, but only if oil prices did not drop proportionately. In view of the strength in the US economy, this is not a likely scenario.

Even if margins were pressured, VLO is so under-valued that the stock is likely to rebound with anything short of a calamity in US gas prices. Earnings are expected to be in the vicinity of \$8.00 per share in the year ahead. This puts VLO's forward price/earnings ratio (P/E) close to 7.5, which is a low P/E for any stock and a deep discount from the overall market.

Real Estate Selections

As in the case with bond yields, low interest rates for so many years have pushed down real estate capitalization (cap) rates (the yield before debt payments are considered) to historically low levels. As a result, commercial real estate prices are historically high. With an uptrend in interest rates on the horizon, commercial real estate in general does not present a particularly good value.

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

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

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

Retail Opportunities Investment Corp (ROIC) began as an IPO in October 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains. ROIC buys distressed retail properties with high-quality demographics, refurbishes them, and then leases them

at a premium. As new properties are added, along with tenant upgrades, funds from operations (FFO) is bound to continue to rise.

We saw this trend continue in the most recent second quarter with a strong 9.5 percent increase in FFO and occupancy of 97.3 percent. ROIC also pays an attractive dividend which lowers its risk profile.

In August, ROIC completed its public offering of 5,520,000 shares of common stock. The offering will not be dilutive because the net proceeds of \$87.3 million will be used to reduce debt.

Third Avenue Real Estate Value Investor Fund (TVRVX) is replete with stellar values substantially below NAV with strong growth prospects.

Management has a similar approach to ours because it is very price conscious, especially in relation to net asset value, in making decisions on whether to buy, hold, or sell a particular company. The managers expend great effort analyzing financial statements, visiting companies and their properties, and assessing management teams to come up with their estimates of intrinsic value. An additional similarity to *Sound Advice* is that members of management eat their own cooking – they invest a substantial amount of their personal assets into their recommendations by investing into the funds they manage.

TVRVX has a number of distinguishing characteristics. This is a global real estate fund. Management looks for growth more than current income by focusing on real estate operating companies which, unlike REITs, can reinvest profits back into the business. Management also looks for opportunities in different points of a real estate company's capital structure by investing in senior debt in addition to a company's equity. Also unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities in distressed times.

Medically-Related Selections

Generally this sector is defensive, even though price/earnings ratios may be higher than average. Medical needs persist regardless of financial conditions, and the world's inexorable demographic aging trends and the commensurate increase in medical care needs translates into strong growth prospects for this industry.

Boston Scientific (BSX) has medical products that are well suited for an aging population. The company's mission is to transform lives through innovative medical solutions that improve the health of patients around the world. BSX has been a global medical technology leader for three decades by providing a range of high performance solutions aimed at addressing medical needs and reducing healthcare costs. BSX has more than 900 US patents.

In August, BSX received FDA approval for its Innova Vascular Stent System. It is a self-expanding stent system for the arms and legs. Normal anatomical changes of the

limbs, along with normal regular movement, cause failures in standard (non-flexible) stents. Approximately 8 million in the US suffer from peripheral artery disease.

Innova Stents have been available in Europe since 2012 and are the basis for BSX's newest stent system, the Eluvia Drug-Eluting Vascular Stent, designed specifically for blockages in the superficial femoral artery. Eluvia stents have yet to be available in any global market but are now going through the European approval process. The company believes the global market for its Innova and Eluvia stent systems are 200 million patients.

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

The most recent to receive approval earlier this year, *Palbociclib*, trade-named "Ibrance", treats one of the deadliest forms of breast cancer. It is expected to be a blockbuster for PFE, producing \$4 billion in sales by 2020. PFE rose 3.5 percent on the day in late August when PFE announced a new collaborative study to determine whether *Ibrance* improves disease-free survival rate and prevents the disease from recurring in patients.

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

Stryker's cash-rich balance sheet and strong cash flow gives SYK avenues for continued diversified growth through acquisitions. In August, one of its acquisitions, MAKO Surgical, received market clearance by the FDA for its knee and hip applications which enhances SYK's robotic reconstructive solutions. Other recent acquisitions include Small Bone Innovations, Pivot Medical, Berchtold Holding, as well as Trauson Products, China's largest manufacturer of orthopedic implants.

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

Tekla Life Sciences Investors (formerly Hambrecht & Quist Life Sciences Fund - the symbol is still HQL) is in our portfolio because the most explosive profits in the entire healthcare industry can be found in biotech companies. Over the last 10 years, biotechnology has become a major industry which now provides the world's top drugs. This sector has outperformed the broad market during the last one, five, and ten year periods.

Biotech companies tend to be high risk and high reward investments which makes diversification essential. This

fund is an excellent way to invest in this sector.

Small Caps

Numerous studies show that small caps perform better over the long run than the market as a whole. This is especially true during a recovering economy. Small-cap stocks perform better than large-cap stocks because they are pure plays on the early stages of new industries and inventions. They have more dynamic and entrepreneurial management, and they are much more likely to be the target of an acquisition or merger which is usually quite profitable. They also tend to be domestic companies without substantial overseas exposure, and therefore are not buffeted by the currency fluctuations that are currently haunting larger companies. Here more than ever, attention to value is paramount.

Third Avenue Small-Cap Value Investor Fund (TVSVX) invests in companies with small capitalizations using the same value-oriented approach as it does with its real estate value fund. TVSVX management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value (NAV), and the ability to consistently grow NAV, with an initial targeted holding period of three to five years. A patient and price conscious acquisition is a critical first step in both protecting capital and in realizing an attractive investment return.

Special Situations

The rest of our portfolio falls into other market sectors, with companies that are presenting extraordinary values within their respective industries. Here they are in alphabetical order.

Agrium (AGU) is a Canadian company offering a broad mix of agricultural products, from wholesale fertilizers to retail farm products, aimed at increasing the efficiency of food production. AGU products will be in growing demand as arable land continues to disappear around the world while population and per-capita income increases. This translates into a need for greater crop output per acre through the use of the AGU's products.

In August, AGU reported second quarter earnings per share of \$4.90, beating estimates, and the company tightened up its full year estimate to \$7.00-\$7.50. At the current price, AGU is a good value with a growing dividend.

Disney (DIS) was added to the portfolio in our August 6th email update after a disappointing earnings report caused the stock to drop. We noted that half of Disney's earnings come from its cable networks -- the Disney Channel, ABC, the ABC Family Network, and the largest by far, ESPN and its sister networks.

The decline in ESPN revenues stoked fears of the fragmentation trends in the media landscape, with younger audiences watching television in different ways than on the traditional multichannel cable and satellite platforms. However, Disney management is well aware of these

trends, and is prepared to change with the times. All of the new alternative platforms want Disney's programming, especially ESPN. CEO Bob Iger noted that not one new platform has talked about launching without coming to Disney first for its programming content.

ESPN and its growing sister networks collect the highest affiliate fees per subscriber of any cable channel. As the premiere sports network, it has a targeted audience and demographics for advertisers. In addition, live sporting events are substantially more valuable to advertisers because 96% of all sports events are watched live, which means commercials cannot be fast-forwarded and channel flipping is minimal. Iger noted that in the first calendar quarter of this year alone, 83% of all multichannel households turned to ESPN at some point.

The other half of Disney's earnings come from its well-loved characters, movies, videos, theme parks, and Disney's ability to monetize these franchises.

Parks and Resorts had their highest quarter ever in the most recent quarter. A new China Disneyland park is scheduled to open this spring in Shanghai, with 6 theme lands featuring Disney's best along with original new attractions distinctly designed for the world's most populous market.

Disney has quietly purchased 15 acres of land for \$60 million near its California Adventure theme park which may be for a new park possibly featuring Star Wars or Marvel themes.

Successful movie productions bring in revenue from both big and small screens. *Frozen* grossed \$1.27 billion in box offices and so far has generated \$300 million on DVD and Blu-ray sales. A sequel is also coming up.

Productions from the Marvel and Pixar acquisitions are paying off, including *Avengers - Age of Ultron*, grossing \$1.4 billion, and *Inside Out*, which has grossed \$600 million so far with more overseas markets yet to open. The new Pixar film, *Good Dinosaur*, is opening this Thanksgiving.

The recent Lucasfilm acquisition brings the Star Wars franchise to Disney. In December, the next Star Wars movie will be launched, *Star Wars: Episode VII - The Force Awakens*, and is expected to gross over \$2 billion, surpassing *Jurassic World's* \$1.5 billion and second only to *Avatar's* \$2.8 billion.

Another array of new Star Wars products will be offered by retailers beginning September 4. This new attention and anticipation of the movie is bound to be positive for the price of DIS.

Evidently management agrees, as evidenced by the buyback of 9.4 million shares (\$1 billion) of DIS during the last quarter, bringing the total to 32.4 million shares (\$3.2 billion) during the last 9 months.

Ford (F) declined with concerns over China's growth rate because Ford is expanding in China. The dip provides an opportunity to buy this already depressed stock at an

excellent value.

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

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

Ford is selling at close to 10 times earnings, a deep discount to the rest of the market, with good growth prospects.

Freeport-McMoRan Copper & Gold (FCX) is the world's largest copper producer, and has suffered from a decline in copper prices and more recently the concern over China's growth because China is the largest consumer of the world's copper.

In the final days of August, activist investor Carl Icahn reported a stake of 88 million shares of FCX, making him its largest shareholder. The stock jumped substantially on the announcement but is still down for the year.

Management announced it will be targeting significant additional reductions in capital spending and operating and administrative costs in response to weak market conditions and to reduce costs to preserve its most valuable resources for anticipated improved market conditions in the future.

FCX plans to spin off its oil and gas properties through a public offering with the ticker symbol FMOG. We will be evaluating the spin-off when it occurs, and advise whether to hold it or not.

After the spin-off, FCX will become a pure copper company again. Copper is woven into the fabric of the world's developed economies, and its price moves dramatically in tandem with expansions and contractions. We made a 643 percent gain during the last expansion, from March 2003 until December 2006, on Phelps Dodge, the largest copper producer back then and subsequently purchased by FCX.

Expanding economies during this cycle around the world are bound to be exerting increasing demand for copper. Evidently Carl Icahn agrees.

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

At the end of August, NCR announced that the Industrial and Commercial Bank of China (in Zhongshan) will expand its use of NCR's cloud-based OptiCash software throughout its entire network of 600 ATMs. China still operates for the most part on a manual cash management system, and

NCR's pilot system demonstrated a significant cost savings. This is the first bank to use the system which means there is promising growth potential in China.

NCR expects 2015 earnings in the range of \$2.70 to \$3.00 per share. At less than 10 times earnings which is a steep discount to the market, NCR is a value play. Several activists have been rumored to be in pursuit, including the Blackstone Group, the Carlyle Group, Marcato Capital, and Jana Partners. NCR continues declining to comment regarding potential suiters for the company. Jana recently sold half of its stake but still holds 7.7 million shares.

Symantec (SYMC) is the dominant supplier of software for computer security and protection against viruses and other nuisances through its leading flagship brand, Norton. Nearly all of the Fortune 500 companies are Symantec customers.

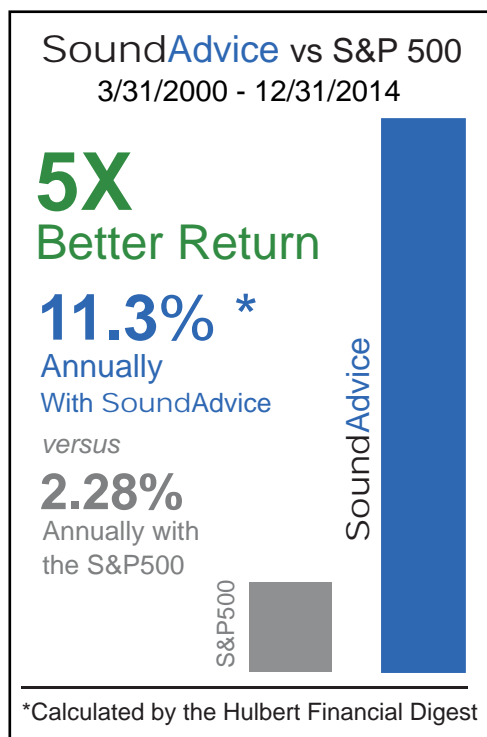
According to Symantec's latest annual Internet Security Threat Report, cyber-attacks against large corporations have jumped by 40% this year. If there ever was a more certain growth industry, protection from cyber espionage is it.

In late August, the company announced that it had agreed to sell its Veritas data-storage and recovery business for \$8 billion to a private-equity firm led by the Carlyle Group. Symantec will be using part of the sale proceeds to add \$1.5 billion to its share-buyback program.

The sale allows SYMC to focus on developing security tools that will better compete with rivals Cylance, CrowdStrike, and FireEye.

The sale replaces previous plans to spin off Veritas as a separate company. Without Veritas, SYMC is a more attractive acquisition to large information technology (IT) companies, with its strong balance sheet, along with its good cash flow and margins.

Tetra Tech (TTEK) is a leading company in water technologies and environmental remediation with a healthy



Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Hersha Hospitality Trust	HT	NYSE	\$ 24.44	4.58%	\$ 31.20	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 15.93	3.77%	\$ 18.00	BUY
Third Avenue Real Estate Value Investor	TVRVX	800-443-1021	\$ 30.24	1.46%	\$ 34.00	BUY
Diversified Growth						
Agrium	AGU	NYSE	\$ 103.87	3.00%	\$ 110.00	BUY
Disney	DIS	NYSE	\$ 101.88	1.30%	\$ 110.00	BUY
Ford Motor Company	F	NYSE	\$ 13.87	3.60%	\$ 17.00	BUY
Freeport-McMoRan	FCX	NYSE	\$ 10.64	1.88%	\$ 14.00	BUY
NCR Corp	NCR	NYSE	\$ 25.09	0.00%	\$ 33.00	BUY
Pfizer	PFE	NYSE	\$ 32.22	3.23%	\$ 37.00	BUY
Stryker Corp.	SYK	NYSE	\$ 98.65	1.07%	\$ 105.00	BUY
Tetra Tech	TTEK	NASDAQ	\$ 25.98	1.23%	\$ 27.00	BUY
Third Avenue Small-Cap Value Investor Fund	TVSVX	800-443-1021	\$ 22.16	0.00%	\$ 27.00	BUY
Xerox	XRX	NYSE	\$ 10.17	2.46%	\$ 12.50	BUY
Energy/Natural Resources						
Chesapeake Energy Corp	CHK	NYSE	\$ 7.81	0.00%	\$ 10.00	BUY
Chevron	CVX	NYSE	\$ 80.99	5.28%	\$ 90.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 25.54	1.29%	\$ 28.00	BUY
ICON Energy Fund Class S	ICENX	800-828-4881	\$ 12.21	0.74%	\$ 16.00	BUY
Transocean	RIG	NYSE	\$ 14.23	4.22%	\$ 19.00	BUY
Valero	VLO	NYSE	\$ 59.34	2.70%	\$ 65.00	BUY
Aggressive Growth						
Boston Scientific	BSX	NYSE	\$ 16.74	0.00%	\$ 19.00	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 29.65	0.00%	\$ 38.00	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 25.11	0.00%	\$ 30.00	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 45.51	0.00%	\$ 55.00	BUY
S&P 500 ProShares Ultra Short ETF	SDS	NYSE	\$ 22.41	0.00%	\$ 27.00	BUY
Symantec	SYMC	NASDAQ	\$ 20.49	2.93%	\$ 24.00	BUY
Tekla Life Sciences Fund	HQL	NYSE	\$ 26.74	0.00%	\$ 28.00	BUY

Notes to the table:

Prices are as of 8/31/2015. See our website for live pricing and buy limits:

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

Yields on funds may include capital gain distributions.

balance sheet including \$500 million of capital for growth in strategic markets.

Growth areas for TTEK include helping utilities respond to new coal ash regulations as well as pipeline studies and designs for the transformation of energy use and delivery in North America. Its smart water management technology adapts emerging technologies to meet critical water supply needs.

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

Xerox (XRX) is transforming from a seller of printers and copiers to a company providing business services

in the form of business process outsourcing, information technology (IT) services, and document outsourcing (printing as a service). Toward that end, XRX announced in late August the acquisition of RSA Medical which will expand Xerox's portfolio of healthcare service offerings to its existing clients, which include 12 of the largest Blue Cross Blue Shield plans and the top pharmacy benefit managers, as well as to the 16 million Americans entering the health insurance system under the Affordable Care Act.

The company expects to earn from \$0.95 to \$1.01 per share, which puts the stock price close to 11 times earnings, very cheap relative to the rest of the market.

Capital Competition: Real Estate versus Stocks: The SoundAdvice Risk Indicator

There are few forces that are more important to a market's destiny than the amount of capital that is available to it. In a normal situation, capital will flow easily between markets as their underlying conditions change. But if a market becomes dangerously superheated, it will absorb a larger proportion of available investment capital than economic conditions and market demand can justify. This change will be reflected not only in the rising market's prices but also in the prices of competing markets, which will be lower than their underlying fundamentals would indicate they should be. Over the last 100+ years, we can see this titanic struggle between the stock market and its foremost competitor for investment dollars: real estate.

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

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

We can, therefore, label this new tool the SoundAdvice "Risk Indicator," since it will allow us to locate the point at which prices are so high when

compared to competing markets that they have come loose from their moorings and are on the verge of declining or underperforming the other market.

What is too high? When stock prices are very high relative to house prices, the SoundAdvice Risk Indicator will rise over the line marked 2.0, revealing a high-risk time for stocks. In contrast, when the indicator drops below the line marked 1.0, it means that it is a very low-risk time to buy stocks. Notice from the chart how the SoundAdvice Risk Indicator has oscillated back and forth, revealing the ongoing struggle between Stocks and houses for investment capital. We have labeled these long vacillations Supercycles.

The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$11.6 million in stocks and to \$1.51 million in houses.

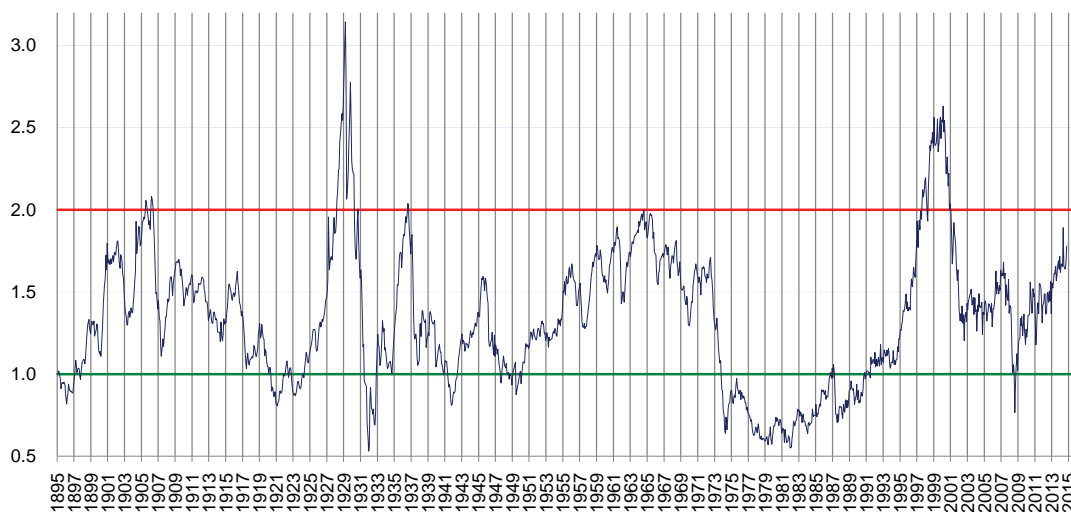
But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the SoundAdvice Risk Indicator he would have made \$465 million, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the SoundAdvice Risk Indicator would have provided.

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

The SoundAdvice Risk Indicator

The latest reading for the SoundAdvice Risk Indicator is 1.66. This reading reveals that stock prices are above average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

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



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

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

When the SoundAdvice Diffusion Index of Leading Indicators drops to zero, it is time to buy stocks aggressively, regardless of how negative the atmosphere may be. This is not just an empirical coincidence. It is also logical. In order for all of the leading economic indicators to be giving off a zero value compared to six months before, it is nearly certain that the soft economy is providing an atmosphere for stable or declining interest rates.

This Diffusion Index gave us a zero reading in March, 2015.

The previous zero reading was in April, 2009, close to the bottom, officially giving us an "Aggressive" signal. That signal came at a time when the Risk Indicator was below 1.0, which revealed that Supercycle 5 came to an end, and that Supercycle 6 was born.

However, the March 2015 signal was usurped.

The SoundAdvice Diffusion Index of Lagging Indicators gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading which reveals that the economy is about to put upward pressures on interest rates.

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

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

The most recent lagging economic indicators released in June (for May) causes the SoundAdvice Diffusion Index of Lagging indicators to hit 100 percent, giving us a new caution signal.

Track Record of the SoundAdvice Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 climbed an average of 31.7 percent. During "Caution" signals, the S&P 500 increased an average of 2.1 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Mar-15	2,080.0	May-15	2,111.9
Ave +/-	31.7%		2.1%

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

SoundAdvice
140 Town & Country Drive, Suite E
Danville, CA 94526



Address Service Requested

Enclosed: The September 2015 Issue of SoundAdvice

To Renew Your Subscription to SoundAdvice

Renew online: go to www.soundadvice-newsletter.com

or fax or mail in the renewal coupon below.

- * #1 rated by Hulbert for the best track record in both up and down markets since 2000
- * 11.3% annual return with Sound Advice versus 2.3% with the S&P 500

GREAT DEAL: 12 Month Renewal for \$99.

BEST DEAL: 24 Month Renewal for \$169.



With your renewal, you will receive the latest edition of:

The Science of Making Money in Turbulent Markets

This is the book that explains all of the SoundAdvice indicators, including the Diffusion Indexes and the famous Risk Indicator, and exactly how they work so that you can update them yourself.



E-mail: _____

To receive your Printer-Friendly Issues and updates between Issues)

Send me my Issues by regular mail. **Add \$25 (\$50 for two years) to cover printing and postage costs.** (But keep me posted by e-mail between Issues about important events.)

Phone (_____) _____ - _____ (In case we have a question about the order)

Enclosed please find my check payable to: SoundAdvice

Please charge my **Visa** or **MasterCard**: Card #: _____

Expiration Date: _____ Security Code: _____ (the 3 Digit Number on the back of your credit card)

SoundAdvice / 140 Town & Country Drive/ Suite E/ Danville, CA 94526 Fax 925-838-0522, or call 800-866-0026

(cut along dotted line)