

Caution: Storm Warning



Gray Emerson Cardiff, Editor

The *Sound Advice* Portfolio is up 2.5 percent in 2018. The *Sound Advice* investment returns in prior years have been calculated independently by the Hulbert Financial Group. They are as follows:

From 2000-2017
10.54% Annually vs.
2.68% from the S&P 500

Our Sound Advice Risk Indicator (page 10) detects the seasons that roll across the market's landscape. Our Diffusion Indexes (page 11) detect the more visible business cycles that are the storms which we actually perceive as weather -- the bull and bear markets that fluctuate along the path of Supercycles.

In the last week of January, the Commerce Board released the latest of economic indicators. These indicators caused the Sound Advice Diffusion Index of Lagging Indicators to switch into a Caution Signal. This signal reveals that the economy is gaining enough strength to fuel a significant rise in interest rates.

Most of the time, this Diffusion Index has been a timely indicator of oncoming bear markets because a rising interest rate environment is a dangerous time for stocks. The times when this Index has not performed in a timely fashion is when monetary policy has been established and enforced, regardless of fluctuations in economic strength. A prime example is the quantitative easing (QE) programs that were used to bail out the economy from the 2008-09 meltdown. In recent years, the economy has strengthened, sufficiently at times to push the Sound Advice Diffusion Index of Lagging Indicators to 100 percent. However, interest rates were held artificially low by the QE program. That has changed now. What was once quantitative easing has been reversed into quantitative tightening because the Federal Reserve has started reducing its current inventory of \$2.8 trillion of Treasury bonds and \$1.8 trillion of mortgage-backed securities. This is a

titanic reversal. The Fed's assets grew by more than 5 times, from under \$900 million in 2008 to \$4.6 trillion, and now it is being reversed back to more normal levels.

This means that we will no longer have a QE program holding interest rates artificially low. Therefore, the Caution Signal we just received from the Sound Advice Diffusion Index of Lagging Indicators is likely to be timely.

The Risk Indicator

Another reason for caution comes from the Sound Advice Risk Indicator which rose very close to 2.0 in January, revealing a very high-risk time for stocks. There have been only 5 times in the past 100 years that this indicator has risen above 2.0, and it was always prior to major market tops.

Fully Valued

These readings from the Sound Advice indicators are scary, and they come at a time when stock prices are high. One of most the widely accepted metrics for measuring value is the trailing 12 months (TTM) price/earnings (P/E) ratio of the S&P 500 stock index. At the recent price of 2,840 for the S&P 500, and using the operating earnings for the stocks that make up the index, the TTM P/E is 21.7. To put this number into context, we can go back to the end of 2009 to see the range of P/E ratios during the economic recovery. The average has been 17.4, and the range has been from a low of 11.9 to a high of 21.5 which was recorded at the end of last year. So, we are in record high territory in terms of value, and well above average.

Of course, the market looks forward to anticipating the future. Operating earnings for the S&P 500 are projected to end up being \$152.11 by the end of 2018. That makes the forward P/E equal to 18.7. Since the recovery began, the forward P/E of the S&P 500 has averaged 16.1 and ranged from a low of 11.34 to a high of 21.0 reached in the second quarter of 2015. By this measure, market values are well above average and in the high end of the range.

However, we should note that the \$152.11 earnings projection for 2018 represents a 22.5 percent growth rate, which is unusually high. Judging by the fact that the forward P/E is near the high end of its cyclical historical range, we can conclude that the market is banking on this high growth rate.

Price to Sales Ratio

Another standard metric is the ratio of the price of the S&P 500 to the revenue from the sales of the underlying companies. The metric is at a lofty level, as can be seen in the chart.

The fourth quarter sales for the S&P 500 are ending up close to \$1,227.94 per share. That puts the year-end ratio at 2.18, very close to the peak levels achieved at the top of the bull market in the late 1990s, and considerably higher than at the peak of the last bull market in 2006. With the S&P 500 at 2,840, the ratio is 2.31, which is in new high territory.

The Portfolio

Intuitively, we know that stock prices are high, and these metrics confirm it. It is not safe to bet on events that are already anticipated by the market. If the events actually happen, there is usually not much of a positive reaction because they were already anticipated. Of course, if they don't happen, the disappointment will certainly translate into sinking prices.

We must keep in mind that the market delivers returns in waves and not in measured doses. Stock prices have been rising for a long time. This bull market will be 107 months old on February 9, making it one of the longest in post World War II history. Only the bull market that ended in March, 2000, lasted longer, for 113 months, which ended with a bear market that took prices down 50 percent. Past bear markets become a fading memory with time, but we should also keep in mind that a 50 percent loss requires a 100 percent gain to break even.

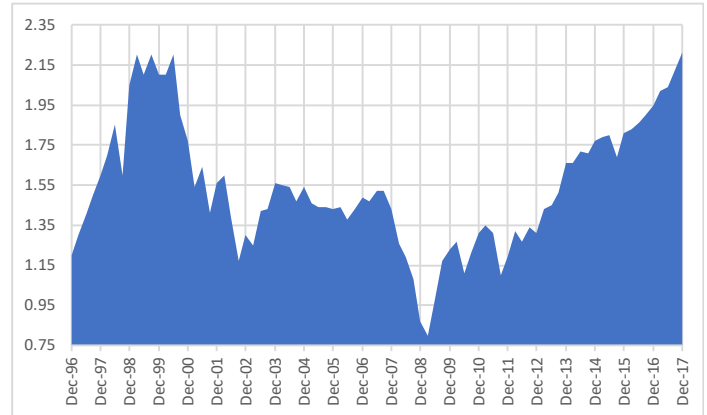
Accordingly, we are continuing to make our portfolio recommendations with caution in mind. Our recommendations are with regard to the money you have in the stock market. It is your personal decision as to how much of your investment capital you have in the market and how much you have in cash or cash equivalents on the sidelines, and cash equivalents should not include bonds. Our recommendation is that you should have a substantial amount on the sidelines, waiting for a substantial correction in the overall market to restore value to individual stocks, ETFs, and mutual funds.

ETFs for Rising Interest Rates

The Fed's swollen bond portfolio has a preponderance of longer term bonds. That means that the reduction of the Federal Reserve's long-term bond holdings will add a disproportionate amount of upward pressure to long-term bond yields. This is important because our recommended ETFs are designed to benefit from an increase in long-term bond yields.

Rising inflation will also push up long-term bond yields in order to furnish investors with a real return in the vicinity of 3 percent. With inflation pushing above 2 percent, yields should be close to 5 percent, giving these ETFs a tremendous upside potential.

S&P 500 Price to Sales Ratio



Our recommended ETFs differ in the amount of leverage used. 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, as measured by benchmark bond indexes, only in the opposite direction, and then multiplied by the leverage each ETF uses. For example, a decline of say, 1.0 percent in their respective benchmarks will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in their respective benchmarks will cause these ETFs to drop in the same fashion.

We can project the movements of these ETFs based on any given scenario. We have been using the Federal Reserve's prediction, which was as good as any. As part of the Federal Reserve's quarterly Federal Open Market Committee (FOMC) meetings, each of the committee members makes a prediction regarding the future path of interest rates. Those predictions are plotted in the so-called "Dot Plot".

The most recent Dot Plot was taken at the December meeting when the Federal Reserve raised the Federal Funds rates another 0.25 percentage point to 1.25 percent. The median prediction was that the Federal funds rate would be 2.125 percent at the end of 2018, and 2.69 percent at the end of 2019. The FOMC is predicting that the Federal funds rate will rise in the months ahead because the Federal Reserve wants to bring short-term interest rates back to more normal levels from the extremely low levels used to stimulate the economy out of the 2008-09 crash.

We are using the Fed's dot plots of Federal funds as a means to predict changes in short-term interest rates, and making the assumption that long-term interest

rates will move in tandem in order to maintain the same long-term real returns that exist today. While this should be a reasonable guide, it will be changes in inflation expectations that will ultimately govern long-term interest rates and the behavior of these ETFs. Recently we have seen a flattening of the yield curve (the difference between short and long-term interest rates) because the Fed has been raising (normalizing) short-term interest rates while a perceived mild inflation rate has kept long-term interest rates low. However, we are predicting that this flat condition will change as inflation heats up, and forces long-term interest rates up from historically low levels. We are starting to see the beginnings of an upward shift in inflation.

The February 2 robust jobs report showed wages increasing 2.9 percent year-over-year in January, the highest increase since 2009. The 100 percent reading from our Diffusion Index of Lagging Indicators confirms that new strength in the economy is appearing which, as it has in the past, is bound to be a natural upward force on bond yields.

However, in the spirit of trying to be conservative, we can assume that the yield curve will remain as flat as it is today, which means that long-term Treasury bond yields move in accordance with the Dot Plot target points. Accordingly, long-term Treasury bonds would be yielding 3.96% by the end of 2018, and 4.52% by the end of 2019.

Here is what would happen to each ETF:

TMV would rise from \$20.83 to \$32.35 by the end of 2018, and to \$41.91 by the end of 2019.

TBT would rise from \$37.84 to \$50.75 by the end of 2018, and to \$60.31 by the end of 2019.

TBF would rise from \$23.19 to \$26.86 by the end of 2018, and to \$29.28 by the end of 2019.

The Erosion Factor

As we point out regularly, these ETFs suffer from erosion because they decline slightly faster than they increase with an equivalent change in bond yields, particularly with higher leverage. To gauge this factor, we can assume that Treasury bond yields simply tread water, rising and falling by an unusually large amount, say, 0.03 percentage points (3 basis points) every day, and thus go nowhere. By the end of 2018, TMV would decline to \$20.06.71 (3.7%), TBT would decline to \$37.15 (1.8%), and TBF would decline to \$23.05 (.5%). While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

Energy & Natural Resource Selections

The table nearby shows the price of oil OPEC countries needed to balance their 2017 budgets. On average, the OPEC countries needed \$77.68 per barrel (weighted by production). With oil prices below the necessary price, OPEC countries will continue to urge for oil production cutbacks wherever they can exert pressure. These cutbacks and resulting price stability are advantageous for US oil and gas companies.

Chesapeake Energy (CHK) is in a favorable position to benefit from the secular shift to clean burning natural gas fuel for power generation globally and in the Asia-Pacific region in particular, led by China's transition away from coal. The company has a portfolio of close to 8 million net acres of oil and gas assets inside the US, in the Powder River Basin, Eagle Ford, the Marcellus and Utica shale, along with the Haynesville/Bossier and Anadarko Basin regions. These large domestic assets make CHK well situated to participate in the resurgence of the US shale drilling.

The consensus is that CHK will earn 96 cents per share in 2018. At \$4.00 per share, CHK's forward P/E ratio is close to 4.2 – ridiculously cheap. A forward P/E ratio of just 10 puts the stock at \$8.60, more than double the current price.

Chevron (CVX) posted fourth quarter operating profits in January of \$9.2 billion, its strongest performance since the oil price crash of 2014. Cash flow from operations rose 60 percent in 2017 to \$20.5 billion, which indicates overall financial health for the company. Chairman and CEO Michael Wirth said, "We achieved our objective of being cash flow positive through deliberate actions to reduce capital expenditures, lower our cost structure, start and ramp-up projects, and conclude planned asset sales." The company raised its quarterly dividend (again) to \$1.12 per

Requisite Oil Prices

Prices Needed to Balance 2017 Budgets

OPEC Country	Balancing Price	2016 Oil Production
Algeria	63.80	1,348,361
Angola *	83.00	1,769,615
Ecuador *	78.00	548,521
Libya	102.00	348,686
Iran	54.70	3,990,956
Iraq	54.10	4,451,516
Kuwait	46.50	2,923,825
Nigeria *	127.00	1,999,885
Qatar	46.80	1,522,902
Saudi Arabia	73.10	10,460,710
United Arab Emirates	68.00	3,106,077
Venezuela *	216.00	2,276,967
Weighted Average	77.68	34,748,021

Competing Country	Balancing Price	2016 Oil Production
Russia	49.90	10,551,497
US	n/a	8,856,809

Source of Oil Production: US Energy Information Administration
Source of Balancing Prices: International Monetary Fund

* Estimated figures provided by RBC Capital Markets

share, up 4 cents from the previous quarter.

Chevron is set to see an increase in production and revenue in 2018, including the two massive Australian projects, the Gorgon and Wheatstone, both of which had required large capital outlays that are no longer needed in CVX's forward-going cap-ex budget. The company is making large investments in its 1.5 million acre position in the prolific Permian Basin to boost its output by 400,000 barrels of oil per day in the next few years. CVX is well-positioned to see earnings growth in the years ahead, along with an attractive dividend.

ICON Energy Fund Class S (ICENX) is a diversified way to participate in the expansion of the energy sector with a basket of substantial companies. The hallmark of this fund has been its ability to look for changes within the energy sector to capture value, rather than simply depending on rising oil prices. This fund is a good way to capture today's values and profit from the recovery and changing landscape on a diversified basis with professional management.

Fidelity Select Natural Gas Fund (FSNGX) is a diversified way to participate in the growth 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. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. At the current price of \$66 a barrel, that is the cost of 5.8 million BTUs. However, with the current market price for natural gas at \$2.90 for one million BTUs, 5.8 million BTUs will cost \$16.82. Thus, the same amount of energy is available for approximately 25 cents on the dollar, if it is in the form of natural gas rather than oil.

The updated chart shows the historic relationship between the costs of these two forms of energy. The red line shows the price of a barrel of oil since the mid-1970s. The blue line shows the price of natural gas multiplied by

5.8 to approximate the same amount of energy contained in a barrel of oil. The fact that natural gas provides energy for pennies on the dollar will translate into an expanding natural gas industry.

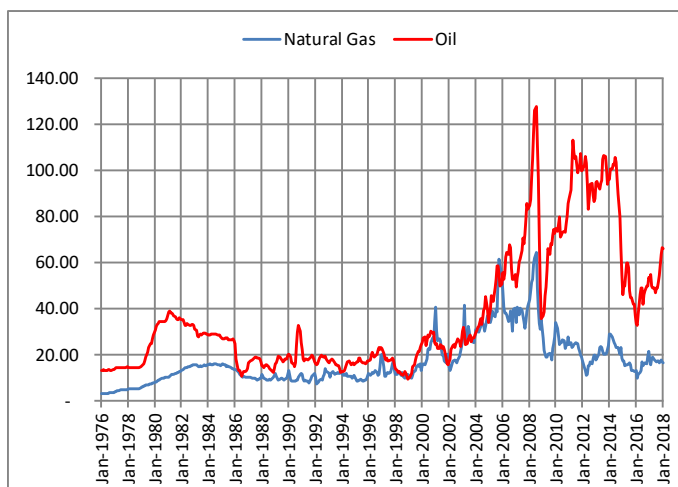
Valero Energy (VLO) reported strong fourth quarter income per share of \$1.16 per share, adding to a string of favorable earnings surprises in all four quarters of 2017.

Refiners are well-positioned to outperform other energy segments in 2018 as they benefit from corporate tax cuts along with robust crude oil supplies, strong demand, and steady global oil prices. Valero's Chief Executive Joe Gorder said, "Looking ahead, we continue to see a favorable fundamental environment, with abundant crude oil supply and strong products demand being supported by global economic growth."

VLO is in our portfolio because it is in a unique position to benefit from a US conundrum. Prior to the US shale revolution, most US refineries were constructed to process imported oil which is a heavy (thick) and sour (high sulfur) grade. The oil from fracking US shale cannot be processed at these refineries because it is light sweet crude. Additionally, refineries on the east and west coast do not have access to the US crude oil pipeline network, so they must rely on imported oil arriving in US ports for their feedstocks. This is evidenced by the fact that we are still importing nearly half of our oil needs, while US storage tanks in Cushing, Oklahoma, are brimming with the light sweet crude fracked from US shale.

Valero is well-positioned to take advantage of this conundrum because it has the flexibility to refine substantial quantities of both US light sweet as well as heavy sour crude. It also has access to the US pipeline network for delivery to its gulf coast locations. This flexibility allows VLO to capture the highest margins among its competitors. It can take advantage of the best discounts for its feedstocks, whether it's low or high-quality crude, or light sweet or heavy sour.

The Cost of Energy Equivalents of Oil and Natural Gas



Real Estate Selections

Commercial real estate prices are historically high because low interest rates have pushed down real estate cap rates to historically low levels (like bond yields). Our posture is still defensive with regard to real estate stocks. The *Sound Advice* portfolio only includes real estate stocks offering an extraordinary value now. Two REITs currently exist in the hospitality industry along with one mutual fund.

Hersha Hospitality (HT) has reported several hotel transactions during the last several years at cap rates ranging from 5.4 to 8 percent. To be on the conservative side, we can establish a "Main Street" cap rate at the high end of this range of 7.5 percent for valuation purposes.

Based on the latest trailing four quarters' financials, including the most recent 2017 third quarter results released at the end of October, and using a 7.5 percent cap rate to evaluate the company's real estate portfolio, we value HT at \$19.19 per share which is higher than the

Hospitality REITs Comparison Table

Company Name	Symbol	Recent Stock Price	Dividend Yield	Stock Market Cap Rate	Portfolio Value @ 7.5% Cap Rate (\$Millions)	Stock Value	Discount (-) Premium (+)
RLJ Lodging	RLJ	22.24	5.9%	10.7%	9413.79	38.21	-42.4%
Hospitality Properties	HPT	27.42	7.4%	10.6%	11,616.3	48.11	-43.0%
Hersha	HT	18.10	6.2%	8.8%	2,257.6	19.19	-5.7%
Host Hotels & Resorts	HST	20.11	4.0%	9.3%	21.6	25.75	-21.9%
Apple Hospitality	APLE	18.73	6.4%	8.5%	6,114.9	21.86	-14.3%

The table above shows the “Stock Market Cap Rate” (what the stock price is paying for the underlying real estate portfolio) for several comparable hospitality stocks. The “Stock Value” column shows the current value of the stock assuming the underlying portfolios are valued using a cap rate of 7.5 percent, which is close to the average cap rate on recent hotel transactions. The last column shows the discount or premium at which the stock is trading based on a 7.5 percent cap rate valuation of each company’s real estate portfolio.

Hospitality Properties (HPT) has the second largest discount. However, this company is externally managed by RMR which charges high fees and suppresses value. As long as RMR continues to externally manage HPT, we do not expect to see significant growth. **Host Hotels and Properties (HST)** is very small, with only 749 thousand shares outstanding, which may lead to excessive volatility. Growth may be limited by its small capitalization.

current price. This valuation is low because of the impaired third quarter income, but should be improving in 2018 along with income.

Hersha was forced to close six of their south Florida hotels in September because of Hurricane Irma. The company sees a recovery in 2018 based on the reopening of the Miami Convention Center and a diminished supply of competing hotels. Meanwhile, revenue growth remained healthy from its eight hotels on the West Coast and its 10 New York City hotels. The dividend yield is attractive and lowers the risk profile.

RLJ Lodging Trust (RLJ) is selling at a steeper discount to its hotel assets than HT. Based on the latest trailing four quarters’ financials reported, including the most recent 2017 third quarter, and using a 7.5 percent cap rate to evaluate the company’s portfolio, we value RLJ at \$38.21 per share which is considerably higher than the current price. The high dividend yield is also attractive and lowers the risk profile.

Third Avenue Real Estate Value Investor Fund (TVRVX) is a global real estate fund which means it is not confined to US real estate with low cap rates. 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 searches for opportunities in different aspects of a real estate company’s capital structure by investing in senior debt in addition to equity. Also unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities.

This fund is loaded with good values substantially below net asset value (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. Just as we do at *Sound Advice*, they eat their own cooking – they invest a substantial amount of their personal assets into their funds.

Medically-Related Selections

The health care industry is still blanketed by uncertainty over the repeal and replacement of the Affordable Care Act (Obamacare). The entry of Amazon into the health care and pharmaceutical industries also a disrupting force that is changing the landscape. We are comfortable with our current recommendations in this sector based on their own individual merits.

Boston Scientific (BSX) posted impressive fourth quarter results with revenue growth across all segments. The company said it expects a revenue of between \$9.65 billion and \$9.80 billion in 2018 and operating earnings per share in the range of \$1.35 to \$1.39.

In January BSX received FDA approval for its Vercise Deep Brain Stimulation (DBS) System to treat the symptoms of Parkinson’s disease. The company also received FDA approval for the Spectra WaveWriter Spinal Cord Stimulator System.

Boston Scientific 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’s medical products are well suited for an aging population.

Stryker (SYK) reported fourth quarter operating earnings in January of \$1.96 per share, an annual growth of 10.1 percent. The company said it expects steady growth in 2018, with earnings of \$7.12 per share.

The company provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products but is best known for its orthopaedic devices for artificial knees and hips.

Stryker's healthy balance sheet has allowed it to make many acquisitions in the recent past which are now paying off, such as Mako whose surgical robots have been used in 50 percent of the 9,400 Mako knee surgeries since the launch in mid-2016. In 2017, it purchased Novadaq Technologies to enhance its position in the endoscopy market and expand Stryker's capabilities in imaging. Stryker also acquired the majority of Vexim in 2017 to expand its portfolio of minimally invasive technologies and complements Stryker's interventional spine business.

Tekla Life Sciences Investors (HQL) is a good way to invest in the most explosive profits in the healthcare industry with a portfolio of biotech companies. Over the last 15 years, biotechnology has become a major industry and the source of the world's top breakthrough drugs. Biotech companies tend to be high risk and high reward investments which makes diversification essential.

Financials

Both of our bank selections will benefit in 2018 by reduced tax rates, and both will benefit from rising interest rates. Our two choices are good values now.

JP Morgan Chase (JPM) reported fourth quarter earnings of \$1.07 in January after adjusting for a one-time charge of \$2.4 billion related to the new Tax Cuts & Jobs Act that was largely driven by a deemed repatriation of unremitted overseas earnings. Before the charge, operating earnings were \$1.76 per share.

In its earnings conference call, the company said it will benefit from a reduction in its effective tax rate in 2018 to 19 percent, and that the tax savings will provide a significant boost to earnings. The company stated that it will use the tax savings to invest across all of their business sectors. This includes investments for bankers, offices, global expansion, digital capabilities, copayment capabilities, and employee benefits with a focus on being sustainable. Those efforts should help JPMorgan strengthen as a business and help accelerate the pace of growth.

Prior to the Tax Cuts & Jobs Act, the 2018 earnings estimate consensus was \$7.60 per share. Now the consensus is \$8.78, an increase of 15.5 percent. At a

forward P/E ratio of 15, which is substantially below the market average, JPM would be \$131.70 by the end of 2018. JPM is still cheap in comparison to the rest of the market.

Wells Fargo (WFC) reported fourth quarter earnings of 96 cents in January. Unlike JPM, there was not a substantial charge for deemed repatriation of unremitted overseas earnings because Wells does very little business and has negligible earnings outside the US. There was a benefit to earnings because of a reduction in tax liabilities. WFC also expects its 2018 effective tax rate to drop to 19 percent.

Prior to the Tax Cuts & Jobs Act, the 2018 earnings estimate consensus was \$4.32 per share. Now the consensus is \$4.71, an increase of 9 percent. At a P/E ratio of 15, WFC would be \$70.65 in 2018. WFC is also currently cheap in comparison to the rest of the market.

Small Caps

Numerous studies show that small caps perform better over the long run than the market as a whole. Small Caps 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.

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 (TVRVX). Management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value, 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.

Apple (AAPL) reported fourth quarter earnings on February 2. The bad news was that Apple "only" sold 77.3 million iPhones, less than of expectations of 80 million and slightly less than last year's quarterly total of 78.3 million. The good news was that revenue and profit hit record

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highs, with record sales of \$88.3 billion (up 12.7%) and net income close to \$20 billion. In addition to higher unit prices from selling higher priced iPhones, revenue rose 18 percent from its software and services to \$8.5 billion. The App Store, Apple Music, iCloud and Apple Pay all had their biggest quarters ever from the 1.3 billion active devices in the hands of customers. During the week beginning Dec. 24, a record number of customers made purchases or downloaded apps from the App Store, spending over \$890 million.

Apple has a pristine balance sheet, with as much cash as long-term debt. The company carries the highest A++ financial rating. Although this is a premier growth stock, its P/E is still at a discount to the rest of the market. AAPL had \$216 billion of overseas cash which is 25 percent of its market capitalization. A repatriation of that cash hoard is likely to spur investment in growth avenues inside the US as well as share buy-backs and dividend increases.

Intel (INTC) reported fourth quarter operating earnings of \$1.08 in January and the stock reacted positively. The company also announced it expects 2018 earnings to be \$3.55. The company also said it expects a 2018 tax rate of 14%, compared to 23% in 2017. Along with the earnings report, the company also announced a 10% rise in its annual dividend to \$1.20 a share.

In early January, it became evident that most microprocessors are vulnerable to two hacker attacks called *Meltdown* and *Spectre*. Chief Executive Brian Krzanich said Intel is working around the clock to fix the flaws but the company has said that it doesn't expect the security flaws to affect its finances.

INTC has been making significant acquisitions that are now leading to renewed growth. The 2017 Mobileye acquisition is a prime example, which has launched Intel into the burgeoning assisted-driving and autonomous vehicle arena, and extends to markets for autonomous ships, planes, drones, and a wide range of weapons. Tesla announced that it will be using Intel's chips instead of those from NVIDIA to power its massive infotainment console. The new Model 3 and new versions of Tesla's Model X and Model S will rely on the Intel chips. Intel is also a supplier to Google's (Alphabet's) Waymo self-driving car unit. Fiat Chrysler has joined Intel's automotive partner base. The company's team also includes BMW.

These stronger growth prospects make INTC undervalued at its current price. The company has the size, diversity, and industry dominance to offer a relatively safe investment in a high-growth, and often high-risk business. Intel can leverage new technology into its existing large platform without introducing unacceptable risks. A history of established cash flow and an attractive dividend, along with the currently low P/E ratio, diminishes the risk profile of the stock. Yet, substantial growth prospects have been introduced that now justify a higher P/E and thus, a higher stock price.

Even at \$50 per share, the forward P/E is 14, substantially below the rest of the market. At a P/E of, say 18, which is still below the market, the stock price would be close to \$64. The current dividend yield is also attractive.

International Business Machines (IBM) reported fourth quarter operating earnings in January of \$5.18 per share, an increase of 3% year over year, on revenue of \$22.54 billion -- finally ending more than a five year string of quarterly revenue declines. Both earnings and revenue were slightly better than analysts had expected.

IBM is turning into a growth stock but it is not priced like one. Watson, IBM's super computer, is at the heart of IBM's new growth business which the company calls "Strategic Initiatives" which will soon account for one-half of the company. Watson is the closest thing to artificial intelligence because it can "think" like a human. Watson cognitively scans a world of data and applies relevant information to what it learns about a company's business and systems to create new revenue streams, reduce expenses, and make existing operations more efficient.

IBM is a good value now. The company expects 2018 earnings to be at least \$13.80 per share. The stock is still selling at a P/E ratio substantially below the market. At \$160 per share, the stock is only 11.6 times earnings. A P/E ratio of 15 puts IBM above \$200 per share.

While we are waiting for growth, the \$6.00 annual dividend provides an attractive yield. IBM has increased its dividend each year, for the past 22 years. IBM still generates over \$12 billion of free cash flow each year, which can be used for continued investment, as well as share buybacks and dividends.

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

The "self check out" market is growing rapidly and NCR, which owns nearly three-quarters of the self-checkout market, is well-positioned to benefit. For example, Kroger is leading the new technology race by rolling out its "Scan-Bag-Go" technology to over 400 stores this year. Walmart, which already has the technology in some stores is expanding to 100 more this year. Using their smartphones, or a handheld scanner provided by the store, customers scan items from the shelves as they add them to their cart. At checkout, they input either device into the register, and it spits out the tally.

This technology is driving the new Amazon Go store, which is bound to drive the entire supermarket industry to implement self-checkout technology. Amazon Go, Kroger, and Walmart are leading the cutting edge of grocery stores, but NCR is the power behind the trend.

NCR is in our portfolio because it is an outstanding value, with a P/E currently below 12, which is a considerable

discount to the rest of the market. With its new growth prospects, NCR deserves a much higher P/E. At a P/E ratio of, say 16, which is still a discount to the rest of the market, the stock belongs above \$50 per share.

Symantec (SYMC) reported a fourth quarter operating profit in January of 49 cents per share, higher than expected, on revenue of \$1.21 billion which was slightly lower than expected. Customer billings grew 32.1 percent on a year-over-year basis while operating gross profit of \$985 million was up 15.5 percent and operating income surged 40 percent.

Symantec is the world’s leading cyber security company offering organizations strategic, integrated solutions to defend against sophisticated attacks across endpoints, cloud, and infrastructure. Symantec operates one of the world’s largest civilian cyber intelligence networks, allowing it to see and protect against the most advanced threats. Our mantra with this stock has been “If there ever was a more certain growth industry, protection from cyber espionage is it.”

Tetra Tech (TTEK) reported in January record-high quarterly revenue for the first quarter and operating earnings per share of 81 cents which were up 33 percent from a year ago. The company’s Water, Environment and Infrastructure segment revenues continued on a solid growth trajectory, benefiting from strong US federal and Infrastructure projects. The company is hopeful that the new administration will be able to introduce additional opportunities for Tetra Tech for more US infrastructure Projects.

TTEK also has a higher annual dividend of 40 cents per share. The company said it expects to earn \$2.40 to \$2.60 per share in 2018 and that it has \$75 million in stock to buy back from its \$200 million 2017 buy-back program.

Tetra Tech is a leading company in water technologies and environmental remediation. The company’s record high of \$2.54 billion backlog reveals a robust pipeline with major governmental organizations like the US Department of State, Environmental Protection Agency (EPA), US Army Corps of Engineers, and the US Air Force. TTEK has a very healthy balance sheet.

Xerox (XRX) reported at the end of January that it is combining with one of its joint venture partners, Fuji Xerox. XRX responded positively to the news, and **we are taking the opportunity to sell this stock.**

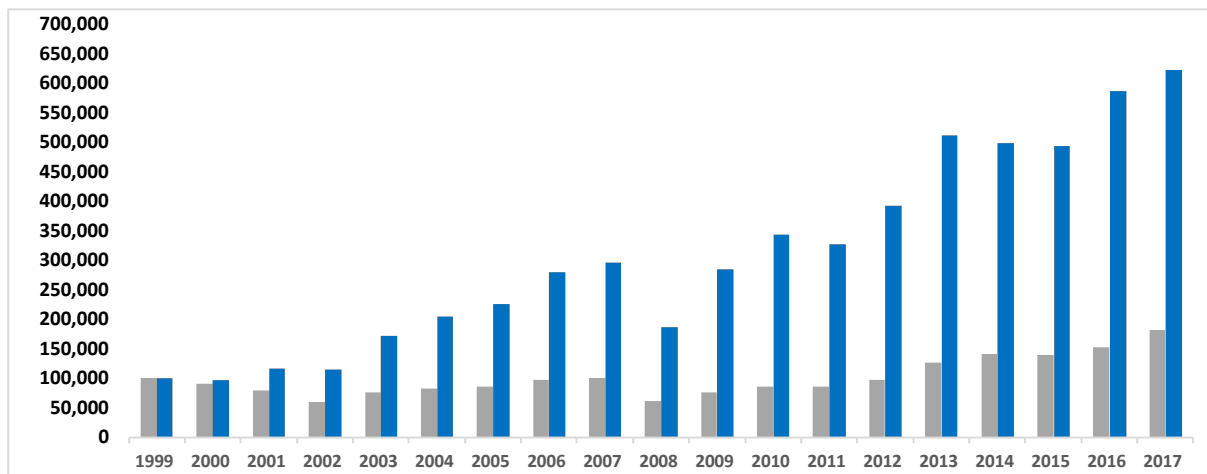
The terms of the merger are complicated. Xerox shareholders will receive a cash dividend of approximately \$9.80/share and will own 49.9% of the combined company. Fujifilm will own 50.1% of the combined company (Fuji Xerox) and control the new board. The resulting company will also be complicated and difficult to analyze. Carl Icahn and Darwin Deason, who control over 15% of Xerox are not fully on board with the transaction, which introduces uncertainty as to whether the transaction will actually occur.

Hedging the Portfolio

The **ProShares UltraShort S&P 500 (SDS)** is a reverse ETF that essentially short-sells the market and will benefit from down-drafts in the S&P 500. It is designed to produce two times the daily fluctuations of the S&P 500 index. 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 is performing as it should, with daily premiums and discounts within 0.5 percent. It is also very liquid.

Sound Advice vs the S&P 500

This chart shows the growth of \$100,000 invested in the S&P 500 (in gray), which would have grown to \$181,971, versus \$100,000 invested in the *Sound Advice* recommendations (in blue), which would have grown to \$620,567.



Energy/Natural Resources	Symbol	Price / NAV	Yield	Action	Limit
Chesapeake Energy Corp	CHK	\$3.33	0.00%	BUY	\$4.00
Chevron	CVX	\$118.58	3.45%	BUY	\$129.00
Fidelity Select Nat. Gas Fund *	FSNGX	\$23.35	0.52%	BUY	\$25.00
ICON Energy Fund Class S *	ICENX	\$11.99	0.44%	BUY	\$13.00
Valero	VLO	\$93.19	2.50%	BUY	\$99.00
Real Estate					
Hersha Hospitality Trust	HT	\$18.10	6.04%	BUY	\$19.19
RLJ Lodging Trust	RLJ	\$22.24	5.71%	BUY	\$24.00
Third Avenue Real Estate Value Investor *	TVRVX	\$34.26	0.47%	BUY	\$37.00
Medically Related					
Boston Scientific	BSX	\$27.39	0.00%	BUY	\$30.00
Stryker Corp.	SYK	\$162.25	1.03%	BUY	\$170.00
Tekla Life Sciences Fund	HQL	\$20.22	0.00%	BUY	\$22.00
Financials					
JP Morgan Chase	JPM	\$114.28	1.94%	BUY	\$120.00
Wells Fargo	WFC	\$64.07	2.37%	BUY	\$68.00
Small Caps					
Third Avenue Small-Cap Value Investor Fund *	TVSVX	\$20.68	0.28%	BUY	\$23.00
Special Situations					
Apple	AAPL	\$160.50	1.36%	BUY	\$170.00
Intel	INTC	\$46.15	2.49%	BUY	\$50.00
International Business Machines	IBM	\$159.03	3.67%	BUY	\$175.00
NCR Corp	NCR	\$35.98	0.00%	BUY	\$39.00
Symantec	SYMC	\$27.02	1.18%	BUY	\$32.00
Tetra Tech	TTEK	\$50.65	0.72%	BUY	\$54.00
Xerox	XRX	\$31.63		SELL	
ETFs for Rising Interest Rates					
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	\$20.83	0.00%	BUY	\$24.00
ETF - ProShares Short 20+ Year Trsry	TBF	\$23.19	0.00%	BUY	\$25.00
ETF - ProShares UltraShort 20+ Year Trsry	TBT	\$37.84	0.00%	BUY	\$42.00
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	\$38.53	0.00%	BUY	\$44.00

This table has live prices, charts & buy limits on our website: <http://www.soundadvice-newsletter.com/members>

Notes to the table: The right hand column is the highest recommended price limit for purchases.

See our website for live pricing and buy limits: <http://www.soundadvice-newsletter.com/members>

* It is not possible to offer live pricing on our recommended mutual funds.

General Comments: Our statistics are based on the assumption that \$10,000 is invested in each position. When a new position is added, we assume the same \$10,000 amount is invested in the new recommendation. When we recommend adding to a particular position, as we have done over the years, we assume another \$10,000 is invested again in that position.

If you are picking and choosing, you can focus on the sector of the portfolio that matches your investment objectives. Alternatively, you may have a higher degree of comfort with certain industries, funds, or stocks because of past experience or your profession. In that case, you may want to invest more heavily in one sector, or in one or more individual recommendations.

As always, broad diversification will temper volatility, add to safety, and improve long-term performance.

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 under performing 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.

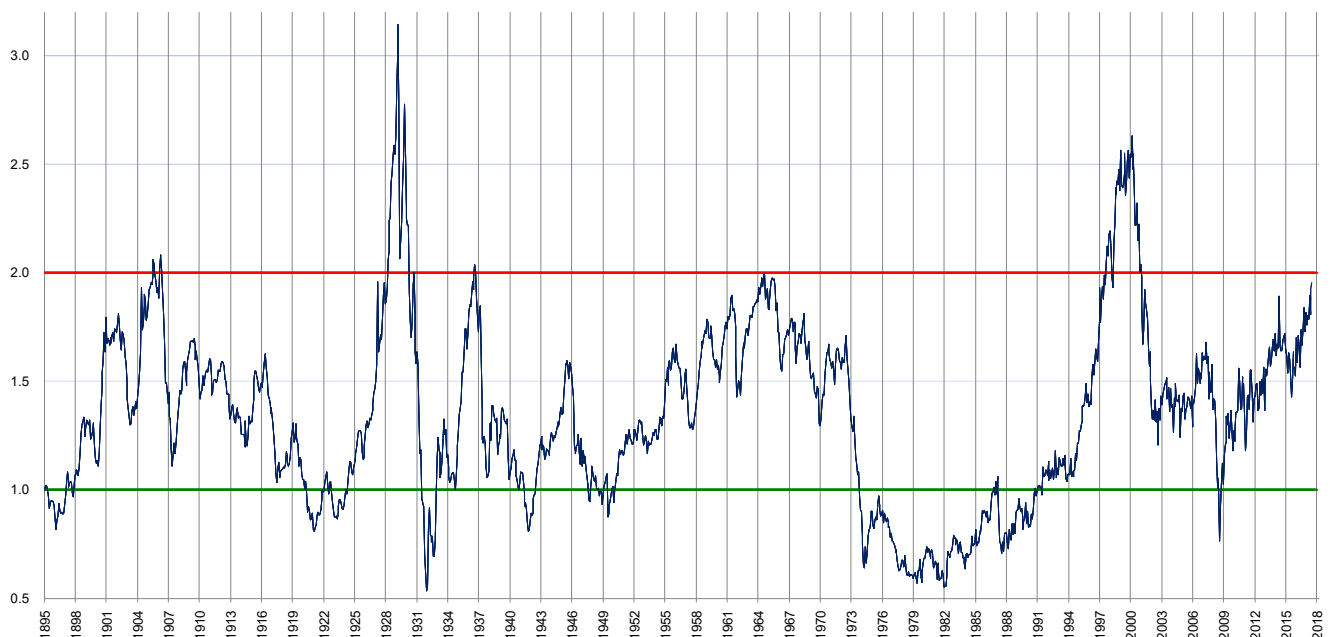
The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$16.7 million in stocks and to \$1.78 million in houses.

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 \$663 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.

The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6. **Based on the latest median house price of \$334,900 for November, and with the S&P 500 at 2823.81 at the end of January, the SoundAdvice Risk Indicator reads 1.94, which reveals that it is a high-risk time for stocks.** If house prices remain the same, and the S&P rose to 2910, the SoundAdvice Risk Indicator would hit 2.0.

The New York Times
"Cardiff's equation reveals an elegant financial minuet as each market takes turns outperforming the other."

The SoundAdvice Risk Indicator



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, and take the percentage of those increasing.

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 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.

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. This reading reveals that the US economy is strong enough to put upward pressures on interest rates.

Current Status

The **SoundAdvice** Diffusion Index of **LEADING Indicators** dropped to zero in September because of weakness in the employment and building permit components caused by the temporary impact of the hurricanes. While this was an official reversal of our Caution Signal, we did not change our cautious approach to the market because it is likely that this Aggressive signal will be reversed soon, as the affected area begins to rebuild and hire the massive number of workers needed for rebuilding.

Indeed, the leading indicators rebounded in October, November, and December (the most recent data). As a result of this strength, the **SoundAdvice** Diffusion Index of **LAGGING Indicators** climbed to 100 percent, giving us a new Caution Signal.

Track Record of the SoundAdvice Diffusion Indexes

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
Sep-17	2,492.8	Jan-18	2,823.8
Ave +/-	30.8%		3.6%

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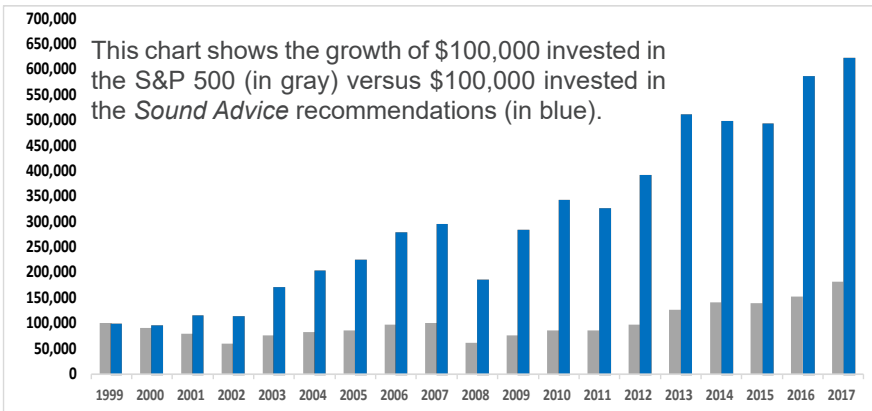


The Science of Making Money in the Stock Market

This is the book that explains all of the **SoundAdvice** indicators, including the Diffusion Indexes and the Risk Indicator, and exactly how they work, along with a detailed history to back up the track records. Visit the web

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