

SoundAdvice

Advising Investors for 35+ years

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Quantifying Risk

"Risk comes from not knowing what you're doing."

-- Warren Buffett


Risk is one of the most elusive factors in investing. Even if considered by many investors, it is not something they usually evaluate. An investment may seem risky or safe, but how do we really know?

In 1966, William F. Sharpe proposed his "reward-to-variability" ratio as part of his work on his capital asset pricing model for which he won the Nobel Prize in economics in 1990. Sharpe's ratio became useful in analyzing reward-to-risk ratios of investments, and it is now known as the "Sharpe Ratio".

The Sharpe Ratio is a widely employed industry standard used to quantify the inherent risk of an investment. The returns from various investments can be adjusted for their inherent risk, and then compared to determine which provided the best return for the same risk. When comparing investments, the one with the highest Sharpe ratio provided the best return for the same risk.

During the previous three years the *Sound Advice* Model Portfolio had a substantially higher Sharpe Ratio than major stock market indexes, including the S&P 500 Index, the Dow-Jones Industrial average, the Russell 2000 Index, and the NASD Composite Index, indicating that the Fund produced a substantially better risk-adjusted annual return.

The table below shows the Sharpe ratios for the *Sound Advice* Model Portfolio and the above market indexes, the results of investing \$100,000 in each; the percentage returns for 2021, 2022, and 2023; the compounded annual returns for the three-year period; and the standard deviation of the annual returns.



Since the beginning of 2000 through the end of 2023, the *Sound Advice* Model Portfolio produced an average annual return of 9.26 percent versus 5.25 percent for the traditional S&P 500 Index, compounding to 2.4 times more capital growth.

Gray Emerson Cardiff,
Editor Since 1988

	SA Portfolio		S&P 500		Russell 2000		NASD Composite		DJ Industrial Ave.	
		100,000		100,000		100,000		100,000		100,000
2021	13.3%	113,287	26.9%	126,893	13.2%	113,157	21.4%	121,389	18.7%	118,727
2022	4.0%	117,841	-19.4%	102,225	-22.1%	88,160	-33.1%	81,209	-8.8%	108,301
2023	10.2%	129,846	24.2%	126,994	15.8%	102,080	43.4%	116,473	13.7%	123,142
Annual Return	9.1%		8.3%		0.7%		5.2%		7.2%	
Standard Deviation	7.7%		19.5%		12.5%		16.6%		12.6%	
Risk-Free Return	3.0%		3.0%		3.0%		3.0%		3.0%	
Sharpe Ratio	0.79		0.27		(0.19)		0.13		0.33	

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The Sharpe Ratio uses the standard deviation of an asset's investment return, which is a measure of the disparity of the annual returns from the average over the period. A large standard deviation indicates more volatility and risk. The standard deviation is then compared to the actual annual investment returns after they are reduced by the risk-free rate, such as on a Treasury bond.

For example, the *Sound Advice* Model Portfolio had a relatively small standard deviation of 7.7 percent and produced a compound annual return of 9.1 percent over the past three years, while the more volatile S&P 500 Index with a large standard deviation of 19.5 percent returned 8.3 percent. Using the risk-free rate of 3 percent over the three-year period, the respective Sharpe ratios are calculated as follows:

Sound Advice Model Portfolio: $(9.1\% - 3.0\%) / 7.7\% = 0.79$

S&P 500 Index: $(8.3\% - 3.0\%) / 19.5\% = 0.27$

Although the annual investment returns are reasonably close for the three-year period, the *Sound Advice* Model Portfolio had a substantially higher Sharpe Ratio, revealing that it gained more per unit of total risk than the S&P 500 Index. It had a better risk-adjusted return than the S&P 500 Index.

This risk-adjusted return can also be seen by comparing the investment of \$100,000 in the *Sound Advice* Model Portfolio to the S&P 500 Index. While capital growth was relatively close, the respective volatilities were substantially different. The S&P 500 investor was exposed to much more stressful volatility and considerably more risk. Accordingly, the risk-adjusted return from the *Sound Advice* Model Portfolio was substantially better than the S&P 500 Index.

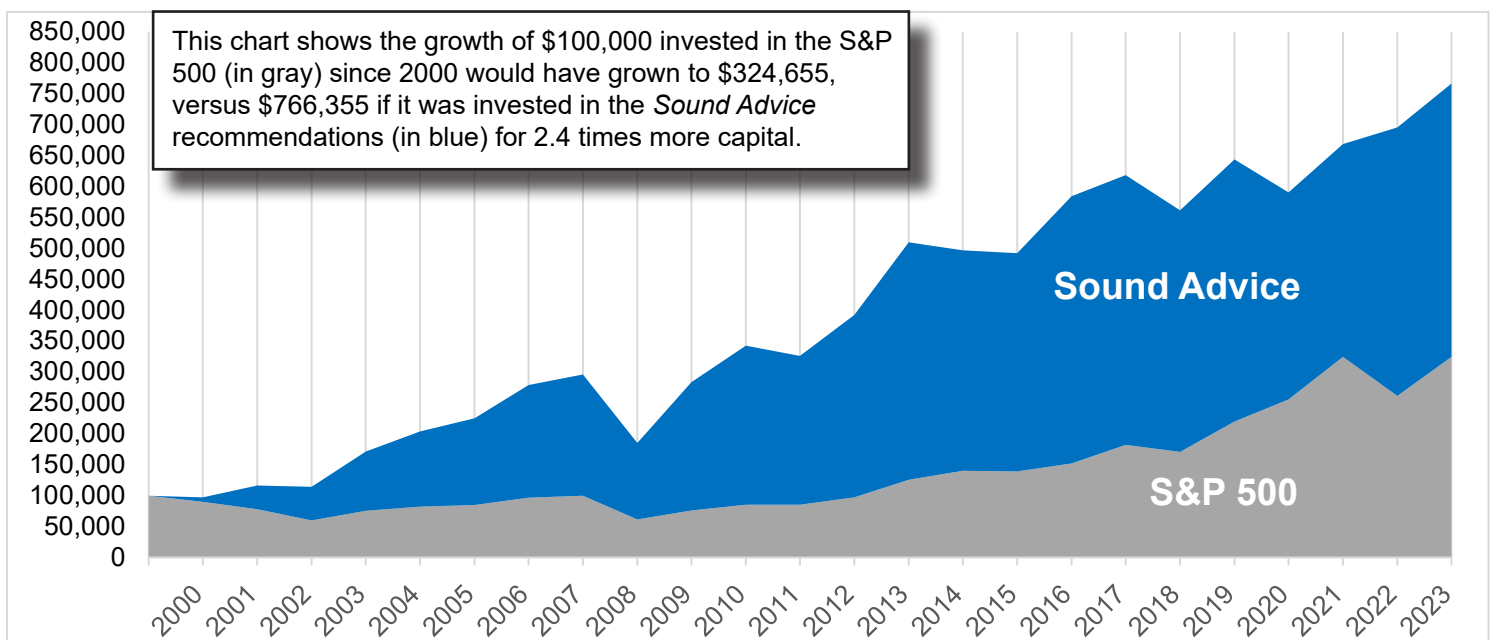
While prior investment returns cannot be used to predict future returns, the Sharpe Ratio can be used to measure the management of risk by a money manager. A higher Sharpe Ratio indicates the likelihood of better risk-adjusted investment returns in the future.

The Sound Advice Diffusion Indexes

Our Diffusion Indexes (page 11) have predicted business cycles for 49 years. The only thing that is different is the degree. All market crashes have occurred during "Caution" signals. When the stock market was not crashing, the S&P 500 either meandered, climbed moderately, or declined in an extended bear market, recording an average decline of 0.6 percent. Conversely, during "Aggressive" signals, the S&P 500 climbed an average of 31.5 percent, and the market never crashed. These have been times of declining or low interest rates, along with declining or low inflation.

At the beginning of 2022, we were in "Caution" mode which proved prophetic. The S&P 500 Index ended the year down 19.4 percent. As a result of heeding our caution signal and positioning our holdings accordingly, the *Sound Advice* portfolio gained 4.02 percent in 2022. In addition to telling us the general direction of stocks ahead, the "Caution" signal told us where to invest, such as areas that would benefit from rising inflation and interest rates while hedging for downside profits.

Sound Advice versus the S&P 500



As we began 2023, we had a completely different situation. Our Diffusion Indexes changed from “Caution” to “Aggressive”, telling us that the end of the rise in interest rates was visible. That signal also proved prophetic as we began a new bull market. As we begin 2024, our Diffusion Indexes continued to tell us that we are in a bull market.

The Sound Advice Model Portfolio

Our individual stock recommendations are special situations offering a compelling value proposition. We are also recommending liquid electronically traded funds (ETFs) investing in sectors that are bound to benefit in the months and years ahead. All of the recommendations, as well as their dividend yields and buy/hold/sell recommendations, are summarized in the table on page 8 and sorted by investment objective categories and then in alphabetical order.

We eat our own cooking at *Sound Advice*. The editor and affiliates are investors in the [Sound Advice Diversified Growth Fund](#), which invests exclusively in the *Sound Advice* Model Portfolio recommendations. The 35+ year editor of *Sound Advice*, Gray Cardiff, manages the Fund and is also an investor on a side-by-side basis with the other investors. You can request a prospectus on the log-in page you used to download this issue of *Sound Advice*.

Downside Hedges

We include downside hedges as part of the portfolio to reduce risk and dampen volatility by profiting during adverse market conditions. As we point out regularly, minimizing losses even at the expense of limiting the upside, is a key to outperforming the overall market over the long run.

[ProShares UltraShort S&P 500 \(SDS\)](#) is designed to produce two times the daily fluctuations of the traditional S&P 500 Index, only in reverse. For example, a decline of say, 1.0 percent in the Index will cause SDS to increase by 2.0 percent. Conversely, an increase in the Index will cause SDS to decline by 2.0 percent.

Most people have the impression that the traditional S&P 500 Index is a diversified balanced index comprised of 500 stocks. However, the Index is anything but balanced. In fact, it is so unbalanced that it presents more risk than the stock market as a whole.

Each of the 500 stocks is weighted according to its capitalization (the number of shares outstanding multiplied by the price of the stock). The unequal weighting has caused 7 stocks to dominate the S&P 500 Index and comprise 28.1 percent of the Index, as opposed to 1.8 percent if they were equally weighted.

These 7 stocks are Apple, Microsoft, Amazon, Nvidia, Alphabet Class A (Google Class A & C), Tesla, and Meta Platforms Class A. They have become known as the “Magnificent Seven” because they have rallied sharply since 2022. The S&P 500 Index is bloated by the recent runup of the Magnificent Seven.

The average trailing 12-month (TTM) price/earnings (P/E) ratio of the Magnificent Seven is an astronomical 39.6. P/E ratios this high are recipes for disaster. Any interruption in growth trajectories let the air out of inflated prices.

Since the beginning of the last bull market in 2009, the TTM P/E ratio of the traditional S&P Index has averaged 21.6. One standard deviation from the average is 4.9 percentage points, which means this P/E ratio has been within plus or minus this amount 68 percent of the time, for a range of 26.5 to 16.7. The current P/E ratio of 26.7 is above the average and close to one standard deviation above the average, which means this Index currently has hidden risks with limited upside.

Another sign that the traditional S&P 500 Index is inflated is revealed from our [Sound Advice Risk Indicator](#) (page 10), which compares the Index to house prices for more than 125 years. The latest reading for February was 2.66 which puts the S&P 500 Index well above the high-risk watermark of 2.0.

The Russell 2000 Index

The Russell Index is comprised of small and mid-sized domestic companies which tend to be more volatile than the overall market, especially during market corrections. The two ETFs below can also be used as a downside hedge because they short-sell the Russell 2000 index. They differ in the leverage employed, which you can choose one according to your investment objectives and risk tolerance.

[ProShares UltraShort Russell2000 \(TWM\)](#) is designed to produce two times the daily fluctuations of the Russell 2000 index. A decline of say, 1.0 percent in the Russell 2000 will cause TWM to increase by 2.0 percent. Conversely, an increase in the Russell 2000 will cause TWM to decline in the same fashion.

[ProShares UltraShort Pro Russell2000 \(SRTY\)](#) is designed to produce three times the daily fluctuations of the Russell 2000 index.

Special Situations

The following stocks are individual companies presenting extraordinary values within their respective industries. Here they are in alphabetical order:

Apple (AAPL) was added to the portfolio in 2016 at \$29.08 per share. As one of the “Magnificent Seven”, AAPL has done very well. However, like the other Magnificent Seven, AAPL has become inflated with a lofty P/E ratio which is anticipating an unrealistically high growth rate.

China has been a very important market for Apple, accounting for nearly 20 percent of total revenues, but strong headwinds are threatening that important source of growth. Chinese competitors have been undermining Apple’s market share by introducing cheaper devices. Sales were down by \$3.1 billion in the most recent quarter, and that trend is bound to continue. Geopolitical risks are also growing as exemplified by China’s ban on iPhones for its government employees in all Chinese provinces.

We recommend holding AAPL for now and adding to your position under \$150 per share. This price target puts the TTM P/E at 23 which is on the high side for most stocks but a reasonable value for AAPL’s long-term prospects.

Cisco Systems (CSCO) reported quarterly earnings in mid-February that beat expectations. The company is expecting to earn in the vicinity of \$3.70 this year. At its current P/E of 15, the stock price should be above \$55 which is substantially higher than it is now.

For the long term, Cisco is a direct beneficiary of the major upgrade cycle into the fifth generation (5G), which can download data 100 times faster than the previous generation of 4G. Operating in 5G requires upgrading to faster equipment. The rollout of 5G is bound to boost growth for several years.

Management believes the purchase of the cybersecurity company Splunk will immediately boost cash flow in its cyber security division in the first year after closing, which is expected by the end of September 2024. Splunk’s primary business is the backbone security system in data centers, providing customers with artificial intelligence (AI) and other tools to analyze their data and detect security threats. The acquisition is a good strategic fit because it will give Cisco a much-needed boost to its cloud security offerings.

Crown and Castle International (CCI) has declined substantially, offering an attractive buying opportunity with a high dividend yield. The activist hedge fund, Elliott Investment Management, agrees. The hedge fund recently invested \$2 billion in CCI with the intention of improving oversight from CCI’s board of directors. Management has promised to maintain the current dividend and believes CCI is positioned to return to the company’s long-term annual dividend per share growth target of 7% to 8% beyond 2025.

Crown and Castle has an extensive portfolio of mission critical communication infrastructure assets comprised of 40,000 cell towers, 115,000 small cells, and 85,000 route miles of fiber concentrated in the top US markets. These assets are difficult to create because of scarce locations in urban areas, zoning and governmental regulations, and sheer cost. These assets are leased to credit-worthy tenants with pre-determined escalating rent clauses.

JP Morgan Chase (JPM) is a good value for what is considered to be the world’s highest quality banking enterprise with diversified businesses and prudent underwriting policies. JPM became an even better value when it acquired most of the assets of the failed First Republic Bank. JPM has been taking substantial quarterly charges against earnings to anticipate and cover adverse circumstances that may lie ahead. The annual dividend is \$4.00 for an attractive yield.

Moderna (MRNA) is a pure investment play on Messenger RNA (mRNA) technology. This revolutionary technology is on a path to provide solutions for not only vaccines, but for cures and treatments for the most deadly and debilitating diseases haunting humanity.

In late February, Moderna reported earnings that beat expectations on increased Covid vaccine revenue from an increased market share during the fourth quarter. Management believes that the company’s cash reserves of \$13.3 billion along with continuing revenue from Covid vaccines, will be sufficient to sustain the business while it develops other vaccines and treatments through its 40+ programs in development with an R&D budget of \$4.5 billion. Management expects net sales for 2024 of approximately \$4 billion and expects to return to growth in 2025. Capital expenditures are winding down as construction of facilities near completion.

Moderna's first vaccine beyond Covid will be for the Respiratory Syncytial Virus (RSV), a highly contagious seasonal respiratory virus and a leading cause of lower respiratory tract infections and pneumonia. Data shows sustained efficacy through two seasons, including the large RSV season of 2022 and 2023, and approvals are expected in the first half of 2024 with commercial launches shortly thereafter. Moderna is expected to be the only company to offer an mRNA RSV vaccine in ready-to-use prefilled syringes. The RSV market is estimated to be a \$10 billion opportunity, consisting roughly of \$6 billion to \$8 billion in older adults and \$2 billion to \$4 billion in the pediatric and maternal setting.

Trials for its innovative mRNA-1083 vaccine for both Covid and Flu recently showed solid results with significant immune responses to both viruses, equaling or exceeding responses from currently approved non-mRNA quadrivalent flu vaccines aimed at four flu virus strains. Final phase 3 trials are expected to lead to approval in 2025.

The Company expects these respiratory vaccine sales in 2027 to be in the range of \$8 billion to \$15 billion with operating profits in the range of \$4 billion to \$9 billion.

Another significant development in the works is a new vaccine for the Cytomegalovirus (CMV) which is the leading cause of birth defects in the US. The Phase 3 trial is now fully enrolled. Potential revenues would be in the range of \$2 billion to \$5 billion annually.

Results have been promising from Moderna's personalized cancer vaccine used in combination with Merck's monoclonal antibody Keytruda. This personalized cancer vaccine uses cells from the patient's tumor and subjects them to RNA sequencing. The cancer vaccine is designed to prime the immune system so that a tailored anti-tumor response is generated that is specific to a tumor's mutation signature. Phase 3 clinical studies are now actively enrolling for both adjuvant melanoma and non-small cell lung cancer. Additional tumor types will also be explored this year.

Overall, Moderna's mRNA platform is expected to be involved in 15 revolutionary RNA vaccines, drugs, and treatments during the next five years.

Perhaps the most exciting upside potential will come from developments regarding the ability to see fragments of cancer cells in a blood draw, allowing the detection of cancer in early stages, before it graduates into more serious later stages. Data will be transmitted through the cloud to Moderna's IT system, and Moderna will use AI algorithms to analyze and compare an individual's particular cancer cell mutation to the hundreds of thousands of possibilities and to the treatments that are currently effective. Management says Moderna will be able to analyze and develop a treatment customized for an individual patient within 30 days of the blood draw, and over time with more and more data, the process will become more efficient and accurate.

Energy

We recently added **Chevron (CVX)** and **Exxon Mobil (XOM)** because they both represent compelling long-term values. Both have attractive dividend yields which put a floor under their stock prices, reducing downside risk. Both have earnings growth prospects that support a history of dividend increases.

Although the world supply of oil is currently adequate, the price of oil began rising in mid-December as tensions in the Middle East became more regional, increasing the possibility of potential supply disruptions.

Chevron (CVX) announced another year of solid results in 2023 in early February. During 2023, Chevron increased the dividend by 8 percent, reflecting confidence in expected future free cash flow growth. Debt was reduced by over \$4 billion, and the company purchased about 5% of the outstanding shares.

With its strong position in the Permian basin, management expects to increase production in 2024 to 900,000 barrels per day (BPD) from 867,000 in 2023 and expects to top one million BPD in 2025.

Chevron improved its longer-term cash flow prospects with the acquisition of the Hess Corporation which strengthened Chevron's existing US shale assets and brings cost-saving synergies while increasing profitability. The acquisition also brought access to the massive Guyana oil basin, the largest discovery of oil reserves in decades, with potentially more production capacity than Saudi Arabia. Management believes the acquisition will be accretive by 2025 with a favorable impact on dividend growth.

Exxon Mobil (XOM) also reported results for 2023 in early February that surpassed expectations. Exxon expects to sharply boost its production in the Permian Basin with its recent acquisition of Pioneer Natural Resources, which will bring substantial cost-saving synergies to Exxon's existing assets there. The purchase is an all-stock transaction, preserving the company's cash, and management believes it will be substantially accretive immediately.

Prior to the Pioneer acquisition, Exxon Mobil had been developing its large stake in the Guyana basin where production has just started to come on-line. With its acquisition of Hess, Exxon Mobil became partners with Chevron in the Guyana Basin which offers both companies a substantial source of long-term production growth.

Valero Energy (VLO) was added to the portfolio at \$60.41 per share. As earnings have grown, VLO is still a bargain at \$140 per share with a TTM P/E less than 6.

Valero makes its money from the “crack spread”, which is the profit margin derived from purchasing crude oil, turning it into refined products such as gasoline and jet fuel, and selling those refined products.

Valero has the unique ability to achieve discounts for its crude oil feedstocks because it can refine a variety of crude oil types. This flexibility and access allow Valero to capture the highest margins among its competitors because it can take advantage of the temporary gluts of crude, whether it's low or high-quality crude or light sweet (low sulfur) or heavy sour (high sulfur) crude, and receive the best available discounts for its feedstocks. The company's refineries also have access to the US pipeline network from its gulf coast locations.

Valero is diversifying into “green energy” through its joint venture with Diamond Green Diesel, which is producing renewable diesel at large profit margins. Renewable diesel is made from animal or plant waste material which reduces greenhouse gas emissions up to 80 percent because it only releases as much carbon dioxide as the material originally contained. Renewable diesel does not congeal at low temperatures which means it can be easily transported through pipelines. Cash flow from diesel production turned positive in 2016 and is increasing. Use for Sustainable Aviation Fuel (SAF) is expected to be a primary escalating demand factor. Valero's Port Arthur plant is being upgraded to produce close to 50 percent of the plant's current renewable diesel production capacity to SAF. After completion in 2025, this plant is expected to be one of the world's largest SAF manufacturers.

Real Estate

RLJ Lodging Trust (RLJ) was introduced to the portfolio in early August 2023 along with **Hersha Hospitality Trust (HT)**. An announcement was made in the final days of August to purchase **Hersha Hospitality Trust** at a large premium over the price of the common stock. If you acted on our advice, you reaped a 50+ percent profit. (You also made a 25+ percent profit in August on the \$25 preferred stock we were recommending, and a much larger profit based on the originally recommended price of under \$4.00 during the pandemic.)

RLJ is also a comparable acquisition target at a stock price considerably higher than it is now. We know this by establishing the value of its real estate portfolio and translating that value to the price of the stock. Here is how we do it.

In real estate parlance, a capitalization rate (cap rate) is the percentage yield of the net operating income divided by the value of the portfolio. This is comparable to the yield of a bond whereby the coupon income from the bond is divided by the market value of the bond. For example, if a real estate portfolio provides \$100,000 of net operating income (NOI), and the portfolio is worth, say \$2 million, it will have a cap rate (yield) of 5 percent.

With an individual REIT, such as RLJ, we can obtain the value of its portfolio by reversing the math. If we divide the NOI of its portfolio by a reasonable cap rate, we will have the value of the portfolio. After adding other assets, subtracting liabilities and the liquidation value of any preferred stock, we arrive at the equity, or net asset value, available to common shareholders. Dividing that equity by the number of shares outstanding gives us a net asset value per share of stock.

We can arrive at a reasonable cap rate by looking at recent comparable property sales. Hersha sold off non-core hotel real estate assets in recent years. Property sales occurred at a weighted average cap rate of 6.0 percent from 2016 through 2018. Because cap rates generally follow the trends of long-term interest rates, cap rates increased into 2022 along with the increase in long-term interest rates. In mid-2022, Hersha sold \$505 million of non-core properties at a 7.3 percent cap rate. That cap rate was based on the 2019 pre-pandemic NOI of the properties which, although higher than the current NOI, reflected the stabilized income potential of those properties. Because these sales were not the best assets in the portfolio, a lower cap rate would be a reasonable cap rate for high-end hotel properties. However, to be reasonably conservative, we can use a higher cap rate of 7.5 percent based on the current NOI of the properties.

RLJ Lodging Trust (RLJ) has a larger and more diversified portfolio of hotel properties than Hersha's. RLJ has 97 premium-branded, high-margin, focused-service and compact full-service hotels located in 23 states and Washington DC. This company also suffered during the pandemic. As it began to recover, we recommended the company's only preferred stock, which is still in the *Sound Advice* Model Portfolio (see below). Since the pandemic, the company's operating revenue has recovered beyond the pre-Covid level. This is a low-leveraged REIT because the company's debt is only 45 percent of its (book value) assets.

In early November, RLJ reported its third quarter earnings. The portfolio's NOI for the trailing four quarters totaled \$394 million. Using a 7.5 percent cap rate produces a portfolio value of \$5.25 billion. Adding other assets and subtracting liabilities leaves the company equity of \$3.5 billion. After subtracting the liquidation value of the company's only preferred stock of \$322 million leaves equity for the common shareholders of \$3.18 billion. Dividing that equity by the 155 million shares of RLJ outstanding translates to a net asset value of \$20.49 per share – much higher than the stock price now.

Even without an acquisition, the stock price has considerable upside potential as the market recognizes the discount to net asset value. The \$0.40 annual dividend has been increased three times in recent years and is still well-covered by the company's cash flow.

RLJ's \$1.95 Series A Cumulative Convertible Preferred (RLJPRA) is RLJ's only preferred stock. This preferred stock has a liquidation preference of \$25.00 per share.

Preferred stocks can, and often do trade above their liquidation values, but an acquisition of the company would likely result in receiving the liquidation preference price. Accordingly, we recommend confining purchases below \$25 per share.

The dividends for this preferred only consumed 11.6 percent of the company's cash income during the previous four quarters, making the 8+ percent income yield secure. This is an opportunity to lock in a safe and extraordinary current yield of nearly 8 percent.

Sector ETFs

Included in the *Sound Advice* model portfolio are the following electronically traded funds (ETFs) investing in sectors that are bound to benefit in the months and years ahead from fundamental changes in geopolitical, medical, and economic landscapes. These ETFs contain a portfolio of stocks, much like a mutual fund but ETFs are liquid and trade like stocks with their own ticker symbols. Their prices are determined by the value of the portfolio of stocks they hold.

Equally Weighted S&P 500

Invesco S&P 500 Equal Weight ETF (ticker symbol RSP) invests in all of the S&P 500 stocks but on an equally weighted basis and rebalances its portfolio each quarter to maintain its equal weights. This rebalancing process preserves value by reducing stocks that have recently outperformed while adding recent laggards. This preservation of value explains the superior performance over the traditional S&P 500 Index.

An equally weighted portfolio of the S&P 500 stocks has outperformed all the major indexes since the beginning of 2000 through the end of 2023, with an annual percentage rate (APR) of 6.72%. This compares to the Dow Jones Industrials with an APR of 5.35%; the Russell 2000 with an APR of 4.98%; the Nasdaq Composite with an APR of 4.77%; as well as the traditional S&P 500 Index with an APR of 5.25%.

Artificial Intelligence

Global Robotics and Automation Index ETF (ROBO) is investing in the key to making the world's companies more efficient -- robotics and automation. Approximately half of the portfolio is in robotics technologies, and the other half is in the technology controlling the robots – sensing, computing actuation, and artificial intelligence (AI). ChatGPT, the open, generative AI chatbot, is giving us a glimpse into the next technology frontier. Artificial intelligence will play an increasingly greater role and a significant source of growth in the way companies operate around the world.

Biotech ETFs

Biotech companies offer explosive profits because they are the source of the world's top breakthrough vaccines and treatments. Their stocks are often volatile, making diversification essential. This can be accomplished by investing in a diversified electronically traded fund (ETF) investing exclusively in a portfolio of biotech companies.

ARK Genomic Revolution Multi-Sector (ARKG) is an actively managed biotech ETF investing in companies expected to benefit by incorporating technological and scientific developments, along with advancements stemming from mapping the human genome. Technological breakthroughs in artificial intelligence and other high-tech

advancements have cut the cost substantially of opening new opportunities and putting this sector on the cutting edge of many new innovations.

Virtus LifeSci Biotech Products (BBP) is a passively managed biotech ETF that weighs the portfolio selections essentially equally, as opposed to the more typical practice of weighing selections according to market capitalization. This is an important aspect because biotech ETFs who weigh their portfolio selections essentially equally have been the best performers because they have larger investments in smaller biotechnology companies which have become acquisition targets for large pharmaceutical companies looking for ways to expand.

Balanced Sector ETFs

The following ETFs rebalance their holdings quarterly to equalize the values, which offers a greater degree of evenly weighted diversification and adds stability as well as safety to a portfolio. This practice often provides a superior performance because it offers upside from stocks that are often under-weighted in the portfolios of other ETFs and mutual funds.

Health Care

Health care stocks have several traits that make them desirable long-term investments. They are well-suited for an aging population, which exerts disproportionate demands on the health care industry. As the world's population continues to age, this trend is inexorable, making the health care sector defensive in nature and more insulated from economic cycles than other sectors. Health care companies are also prime candidates for new AI technologies that are bound to improve efficiency and accelerate growth.

One of the main criticisms of most health care ETFs is that they are dominated by a relatively small number of large companies, such as Johnson & Johnson, which distort the performance of the typical health care ETF portfolio.

Invesco's S&P 500 Equal Weight Health Care ETF (RSPH) tracks the S&P 500 Equal Weight Health Care Index, which tracks 65 health care stocks represented in the S&P 500, but weights each holding evenly. Both the Index and RSPH are rebalanced quarterly. This approach has given RSPH a better performance than the large health care ETFs.

Consumer Staples

Invesco S&P 500 Equal Weight Consumer Staples ETF (RSPS) invests in consumer staple stocks within the S&P 500 Index. Consumer staples are those unexciting products we use every day without much thought, ranging from food, beverages (including alcohol), household goods (including cleaning supplies), and hygiene products. These are products that people are unable (or unwilling) to remove from their budgets regardless of their financial situation. The nature of these products makes this sector defensive and much less vulnerable to recessions and bear markets.

US Infrastructure

The Infrastructure Investment and Jobs Act, enacted in November 2021, targeted \$1.2 trillion to fund improvements, repairs, and upgrades for a wide range of infrastructure needs, from bridges and highways to water and electric grid systems. This infrastructure spending will benefit both of the following two ETFs in the years ahead.

Invesco S&P SmallCap Industrials ETF (PSCI) is based on the S&P SmallCap 600 Capped Industrials Index which is designed to measure the overall performance of the securities of US industrial companies with small capitalizations (caps). These domestic companies are engaged in the business of providing industrial products and services, including engineering, heavy machinery, construction, electrical equipment, aerospace, and defense, as well as general manufacturing. They will reflect the positive impacts more strongly than larger companies from an increase in infrastructure spending. Small cap construction companies are also typically domestic companies operating inside the US, and construction projects tend to employ local companies as subcontractors even when general contractors may be national companies.

Invesco S&P 500 Equal Weight Materials ETF (RSPM) invests in the companies that comprise the S&P 500 Equal Weight Materials Index. The portfolio contains prime examples of basic materials companies outside of the oil and gas industries. Basic materials companies are bound to benefit in the years ahead with increased infrastructure spending.

Portfolio Summary Table

Income with Growth	Symbol	Price	Yield	Action	Limit *
RLJ Lodging Trust - Preferred A	RLJPRA	\$24.90	7.83%	BUY	\$25.00
Crown and Castle	CCI	\$109.94	5.69%	BUY	\$115.44
Growth with Income	Symbol	Price	Yield	Action	Limit *
Chevron	CVX	\$152.01	3.97%	BUY	\$159.61
Cisco Systems	CSCO	\$48.37	3.23%	BUY	\$50.79
Exxon Mobil	XOM	\$104.52	3.64%	BUY	\$109.75
Invesco Consumer Staples ETF	RSPS	\$31.49	0.51%	BUY	\$33.06
JP Morgan Chase	JPM	\$186.06	2.15%	BUY	\$195.36
RLJ Lodging	RLJ	\$11.87	3.37%	BUY	\$10.75
Valero	VLO	\$141.46	2.88%	BUY	\$148.53
Growth	Symbol	Price	Yield	Action	Limit *
Apple	AAPL	\$180.75	0.53%	HOLD	\$150.00
Genomic Revolution Multi-Sector	ARKG	\$31.51	0.00%	BUY	\$33.09
Golbal Robotics & Automation ETF	ROBO	\$57.41	0.21%	BUY	\$60.28
Invesco Basic Materials ETF	RSPM	\$34.03	0.41%	BUY	\$35.73
Invesco Health Care ETF	RSPH	\$30.86	0.58%	BUY	\$32.40
Invesco Small Cap Industrials ETF	PSCI	\$120.92	0.70%	BUY	\$126.97
Moderna	MRNA	\$92.24	0.00%	BUY	\$96.85
S&P 500 Equal Weight ETF	RSP	\$162.79	1.56%	BUY	\$170.93
Virtus LifeSci Biotech Products	BBP	\$59.72	0.00%	BUY	\$62.71
Hedges	Symbol	Price	Yield	Action	Limit *
ProShares UltraShort S&P 500	SDS	\$26.63	0.00%	BUY	\$27.96
ProShares UltraShort Russell2000	TWM	\$11.29	0.00%	BUY	\$11.85
ProShares UltraShort Pro Russell2000	SRTY	\$28.51	0.00%	BUY	\$29.94

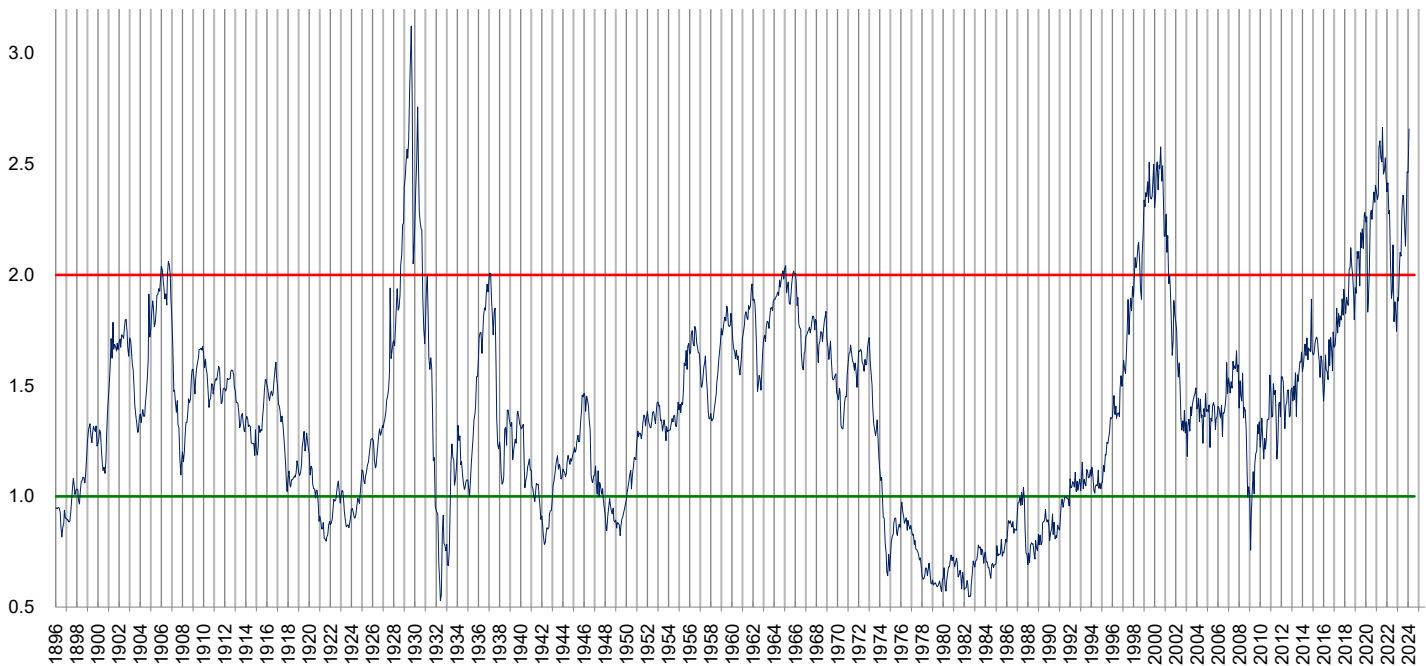
* **Note to the table:** The right hand column is the highest recommended price limit for purchases.

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 120+ 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 based on the ratio of the S&P 500 Stock Index to median price of new houses 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 label this new tool the **Sound Advice** “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 **Sound Advice** 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 **Sound Advice** 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.

But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing, had an investor followed the signals of the **Sound Advice** Risk Indicator, he or she would have made \$575 million versus \$27.5 million by simply holding stocks through the ups and downs, or 23 times more money.

With the latest median house price at 413,100 in December 2023 (the latest data) and with the S&P 500 averaging 5007 in February, the **Sound Advice** Risk Indicator read 2.66.

The New York Times

“Cardiff’s equation reveals an elegant financial minuet as each market takes turns outperforming the other.”



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Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

The Risk Indicator reveals long macro cycles. An analogy can be made to the way radio waves work. Long radio waves have frequencies which are assigned to various radio stations, allowing you to distinguish them on your radio. Riding along the path of these long waves are short waves that produce the sound you actually hear on a particular station. These short waves are like the bull and bear markets revealed by the Diffusion Indexes.

While the path of the long cycles revealed by the Risk Indicator may be in a certain direction, there are bull and bear markets along the way. Of course, these relatively short bull and bear markets are significant during our investing careers. Even during times when the Sound Advice Risk Indicator is above the “low risk” reading, such as it is now, there have been substantial bull markets. We will rely on our Diffusion Indexes to reveal when that will be.

The data we need is contained in the leading and lagging economic indicators. 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.

To construct our *Sound Advice* Diffusion Indexes, we observe changes in each of our selected indicators over a five-month period, and take the percentage of those increasing.

When the *Sound Advice* 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 five 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 December 2008, 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 *Sound Advice* 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.

A Powerful Overriding Force

Most of the time, the Diffusion Indexes are excellent detectors of the natural business cycle and a path to the science of making money in the stock market. However, the forces of the natural business cycle can be dominated by extraordinary changes in monetary policy during emergency situations.

The COVID-19 pandemic was the most recent example. In mid-March 2020, the Federal Reserve declared the institution of its fourth “Quantitative Easing” (QE) program whereby it dropped the Federal Funds rate to zero and commenced buying massive amounts of US Treasury bonds. With its mighty power, the Fed drove down interest rates and infused massive amounts of liquidity into the US economy. The money supply mushroomed.

Track Record of the SoundAdvice Diffusion Indexes

Drumming the last 49+years, after each “Aggressive” signal, the S&P 500 climbed an average of 31.5 percent. During “Caution” signals, the S&P 500 either crashed, meandered, or climbed, recording an average decrease of 0.6 percent.

Signal Dates (Month-Year)			
Aggressive	S&P 500	Caution	S&P 500
Sep-74	68.12	Apr-76	101.9
Jul-76	104.20	Dec-76	104.7
Oct-78	100.58	Jun-79	101.7
Nov-79	100.00	Oct-83	167.7
Aug-84	164.48	Jun-85	188.9
Jul-86	240.18	Aug-87	329.4
Feb-88	258.13	Jun-88	270.7
Mar-89	280.00	Mar-93	449.7
Mar-95	493.15	Dec-98	1,141.0
Jun-00	1,429.40	Dec-00	1,320.3
Jun-03	974.50	May-05	1,191.5
Jun-06	1,276.66	Mar-08	1,325.4
Dec-08 (1)	865.58	Apr 10 (2)	1,197.3
Sep 10 (3)	1,122.08	Jun 12 (4)	1,359.8
Sep-12 (5)	1,437.82	Nov 14 (6)	2,044.6
Mar-15	2,079.99	May-15	2,111.9
Sep-17	2,492.84	Feb-18	2,705.2
Mar-20 (7)	2,761.98	Nov 21 (8)	4,667.4
Dec-22	3,912.38		
Ave +/-	31.5%		-0.6%

Quantitative Easing (QE) Overriding Signals

- (1) QE-1 announced 4 months before Aggressive signal
- (2) QE-1 terminated into existing Caution signal
- (3) QE-2 announced but already in Aggressive mode
- (4) QE-2 terminated into existing Caution signal
- (5) QE-3 announced, changed to Aggressive mode
- (6) QE-3 terminated into existing Caution signal
- (7) QE-4 announced, changed to Aggressive mode
- (8) QE-4 terminated into existing Caution signal

At times like this, we need to ignore readings from the Diffusion Indexes. Interest rates are dropping by the Federal Reserve’s mandate, just as if the Diffusion Index of Leading Indicators had plunged to zero. Conversely, whenever the Federal Reserve declares an end to its QE program, we return to our Diffusion Indexes to follow their readings. If the Diffusion Index has moved to a “Caution” signal during the QE program, we should follow that reading. This is the most likely pattern of events because the economy will likely have strengthened in order for the Federal Reserve to end its QE program.

The impact of the Federal Reserve’s four QE programs on existing Diffusion Index signals are noted in the footnotes under the track record table.

Current Status

The latest leading leading and lagging economic indicators were published in late February for the month of January.

Our current “Aggressive” mode was established by a zero reading for the Diffusion Index of LEADING Indicators in December 2022 based on the leading indicators for November 2022.

Our next signal will be a “Caution” signal from a 100 percent reading on the Diffusion Index of LAGGING Indicators which recorded 33 percent based on the latest lagging indicators.