

Searching for Value



The *Sound Advice* portfolio is up close to 1 percent so far this year, assuming an equal amount was invested in each position at the beginning of the year. This doesn't sound like much, but it is positive in a tumultuous market.

If we look back to the beginning of last year, the portfolio is up 28 percent. We have an average gain of 89 percent based on the prices at which each stock, ETF, or mutual fund was originally recommended.

The *Wall Street Journal* published an article last Saturday by Mark Hulbert called "Stock Picks From Intrepid Advisers - What Advisers Who Beat the Market During Both Bull and Bear Markets Are Recommending Now." We were included among six services that outperformed the Wilshire 5000 during both the last bull market as well as the preceding bear market.

The article pointed out "a noteworthy degree of agreement among the six". When asked for our 2014 forecast for the S&P 500, the range was up between 10 and 15 percent.

It is unsettling to be in the consensus, because the consensus is usually wrong at major turns in the market. However, this is pretty sophisticated company, and we do not see a major turn ahead. So we are still comfortable with our prediction of a 15 percent increase this year.

-Gray Emerson Cardiff

One problem with bull markets is that rising prices make good values harder to find. In our quest, we found a mutual fund group with our orientation to value investing, the Third Avenue Funds.

Last October, we introduced the **Third Avenue Real Estate Value Investor Fund (TVRVX)** into our portfolio. It has led the pack of all real estate mutual funds during the last 3 years. This is still where the best real estate values can be found in a mutual fund.

Third Avenue management uses the same value-oriented approach for its other funds as well. This month we are recommending the **Third Avenue Small-Cap Value Investor Fund (TVSVX)** which invests in companies with small capitalizations, or "small caps" in Wall Street vernacular. This mutual fund was up 31.5 percent in 2013 and 16.5 percent in 2012.

The Third Avenue management team looks for 4 fundamental characteristics before making investments:

- 1) The issuer has an especially strong financial position.
- 2) The common stock is selling at a price that reflects at least a 20% discount from Net Asset Value ("NAV").
- 3) There is comprehensive disclosure including reliable audited financial statements.
- 4) The prospects are that over the next three to seven years, NAV will be increasing by at least 10 percent annually (including dividends).

Why Small Caps?

There are many credible academic studies concluding that small cap stocks perform better than large cap stocks over the longer term. There are several reasons for this.

The pure benefits of the early stages of new industries and inventions can be captured in a meaningful way without the obfuscation and dilution of other businesses that are typically contained in large cap stocks. More dynamic and entrepreneurial management often heads the company, and will adapt to changes in economic conditions more quickly than larger companies. Mathematically it is easier for a small company to experience large growth rates simply because it is starting from a small size. A small cap is also much more likely to be the target of an acquisition or merger which is usually profitable.

In addition, because of the relatively small number of shareholders of small cap companies, it is not economical for stock brokerage and investment banking firms to dedicate coverage from their analysts. The lack of the usual promotion and attention leads to market inefficiency, and extraordinary value can go unnoticed, leaving opportunities to discover gems through skilled independent research -- in that lonely ground that lies ahead of the crowd.

Not only do small caps perform better over the long run, they are generally more volatile and benefit strongly from a recovering economy. The price/earnings ratios of small caps are generally higher because of their higher growth potential, and this premium widens as confidence in the economy grows.

Accordingly, we believe an investment in a well-managed small cap fund, such as TVSVX, is particularly timely now.

Safe and Cheap

The Third Avenue funds are managed based on the mantra “safe and cheap”, coined by the Third Avenue founder and Chairman of the board, Martin J. Whitman, who is a value-investor legend. His book, *Modern Security Analysis*, is an extraordinary treatise on the principles of value investing.

“Safe” companies are those with strong balance sheets along with the financial might to weather stormy economic times. They also have reliable accounting.

“Cheap” companies are those whose stock is trading at a substantial discount to their net asset values.

In addition to safe and cheap, there must be the conservative prospect of net asset growth, of at least 10 percent. Third Avenue Management admits to mimicking Warren Buffet’s Berkshire Hathaway mode to earn such returns. In letters to investors, Third Avenue management says *“A meaningful number of common stocks in Third Avenue portfolios enjoy Berkshire-Hathaway characteristics, i.e., finances are strong, the companies have superior managements and the prospects for NAV growth appear very good. Unlike Berkshire Hathaway, the various common stocks in the portfolio are priced at meaningful discounts from readily ascertainable NAVs.”*

Resource Conversion

Another reason TVSVX focuses on small cap companies with strong financial positions is because it increases the odds of “resource conversion” which is a host of positive events that can include the acquisition of the company, large share repurchases, special dividends, and the profitable sale of assets. Management views the potential for resource conversion as particularly important during sluggish economic times because it can boost otherwise low investment returns.

Diverse Investments

On January 31, TVSVX held 83 stocks in a variety of industries. Below are brief descriptions of some of the holdings which exemplify management’s quest for value, diversity, and potential for resource conversion.

During the fourth quarter, the fund initiated a position in the common stock of World Fuel Services (WFS) which is a global powerhouse in the brokerage and trading of fuel and related services to aviation, marine, and land transportation markets. Customers include the mammoth shipping container company MAERSK and FedEx. WFS manages and finances the billions of gallons of fuel needed to support global operations. It has been run by a pair of entrepreneurs for the last 13 years, during which the book value per share has compounded growth at close to 19% annually.

A recent setback with the winding down of a large NATO contract in Afghanistan allowed TVSVX to establish its position at substantial discount to NAV. Third Avenue

believes *“the company will replace the lost volumes in time and that the setback represents only a minor (and fixable) dent in an otherwise formidable company.”*

Third Avenue has a “Work In Process” library of stocks that are followed before initiating a position. SunCoke has been on the radar since 2011 when it was spun off by Sunoco. SunCoke is the largest independent producer of coke for the North American steel industry. SunCoke has been lowering its costs of metallurgical coal operations, overhauling its Indiana Harbor operations, and opening a new Kentucky plant, all of which could start to add significant cash flow as early as 2017. SunCoke has a solid financial position. TVSVX’s cost basis is 25% to 30% below NAV.

Other new positions added in the fourth quarter include:

American Homes 4 Rent (AMH), a REIT focused on acquiring, renovating, leasing, and operating single-family homes as rental properties.

Multi-Color Corp (LABL), established in 1916, is a leader in global label solutions for prominent brands including leading producers of home and personal care, wine and spirit, food and beverage, and specialty consumer products.

Tredegar Corp (TG) is a global manufacturer of plastic films and aluminum extrusions for applications in diverse end-use markets, including personal care, electronic display, food packaging, and lighting.

VCA Antech (WOOF) is the leading provider of pet health care services in the US with a nationwide clinical laboratory system and over 600 free-standing animal hospitals in 41 states and Canada.

In the third quarter, TVSVX purchased Brookdale Senior Living (BKD) at a significant discount to NAV. BKD is the largest operator of senior housing in the US. Growth is certain as the US population ages and seniors sell their houses to pay rent for assisted living. Management believes this high-quality portfolio of private-pay senior housing properties is likely to fetch significant interest from strategic and financial buyers.

TVSVX’s top performer in 2013 was Oshkosh Corporation (OSK) which manufactures military trucks along with fire and emergency apparatus. OSK added cash to its balance sheet while reducing debt and is on track to improve earnings. The company recently announced a large share repurchase program.

The second top contributor to 2013 performance was EnerSys (ENS), the world’s largest producer of motive power batteries which are used in electric forklift trucks and commercial vehicles. END also produces reserve power batteries which are used in applications requiring stored energy in the telecom and utility industries, aerospace/defense systems, and uninterruptible power supplies.

Conclusion

The Federal Reserve is encouraging economic expansion through its easy money monetary policy. As the economy

gains traction, small caps will be one of the strongest beneficiaries. A well-managed and diversified small cap fund like TVSVX is bound to do very well. We take comfort in the value oriented approach because it adds safety. We recommend investing now.

Our “No-Brainers”

Our “No-Brainers” are ETFs designed to benefit from rising long-term Treasury bonds yields. We have dubbed these ETFs as “No-Brainers” because interest rates always rise after a recession during the recovery. It is as simple as that.

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

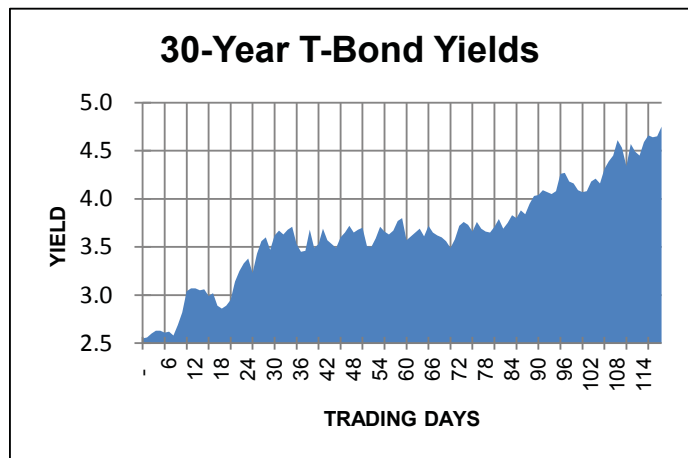
The **Proshares Ultrashort Lehman 20 Plus Year Treasury (TBT)** uses 2:1 leverage.

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

We have substantial gains in these ETFs since we recommended them. However, they have retreated since the first of the year. Mixed economic reports have contributed to the weakness in these ETFs as well as the temporary flight to safety caused by the Crimean conflict from stocks into Treasuries. The bad weather has been a culprit as well. However, spring is here, and the Federal Reserve is stoking the economy by holding short-term interest rates close to zero. This adds certainty to the economic recovery.

A continued US economic expansion is certain to push up bond yields and the prices of these ETFs. We know that. What we do not know is how fast and how much. However, we can use the recent past as a gauge.

The most recent time long-term Treasury bond yields rose significantly was from December 18, 2008 to June 10, 2009, (118 trading days) when 30-year Treasury bond yields rose from 2.55 percent to 4.75 percent, or 220 basis points. The chart below shows the pattern.

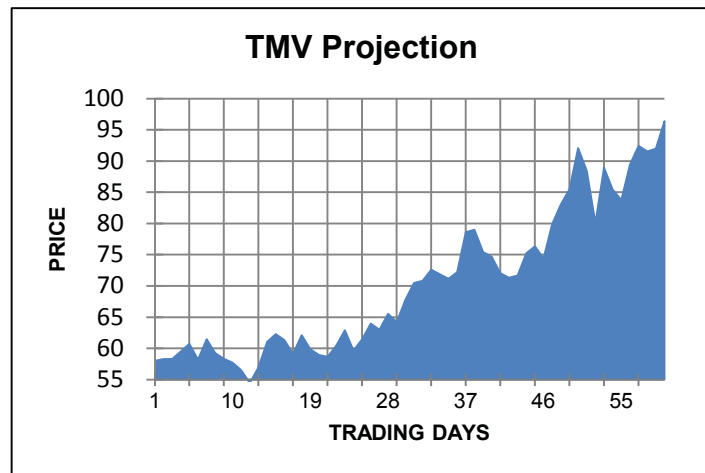


Our No-Brainer ETFs did not exist during this entire period, so we don't have historical track records to view. However, we know how these ETFs work, and can model them to get an idea of the profit potential.

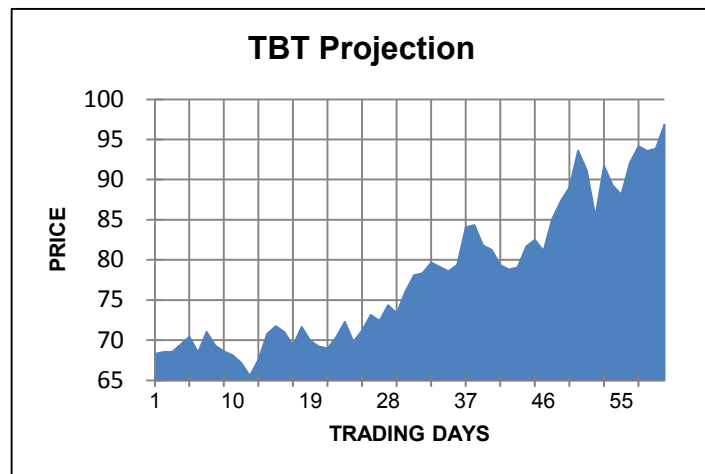
The price action of these ETFs is based on the changes in long-term treasury bonds, specifically BlackRock's iShares 20+ Year Treasury Bond ETF (symbol TLT) which holds a portfolio exclusively of long-term Treasury bonds with an average maturity length of close to 27 years. The prices of our No-Brainer ETFs fluctuate in accordance with the daily fluctuations of TLT, only in the opposite direction, multiplied by the leverage each uses. For example, a decline of say, 1.0 percent in TLT will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in TLT will cause these ETFs to drop in the same fashion.

To construct our models, we start with a projection of an increase in 30-year Treasury bond yields. A conservative approach would be to assume that long-term Treasury bond yields will not rise beyond 4.75 percent -- not any higher than the last peak. We can use the pattern of the last 60 days of the 220 basis point rise when yields rose from today's yield of 3.6 percent to the peak of 4.75 percent. In that scenario, our No-Brainers would rise to the following levels:

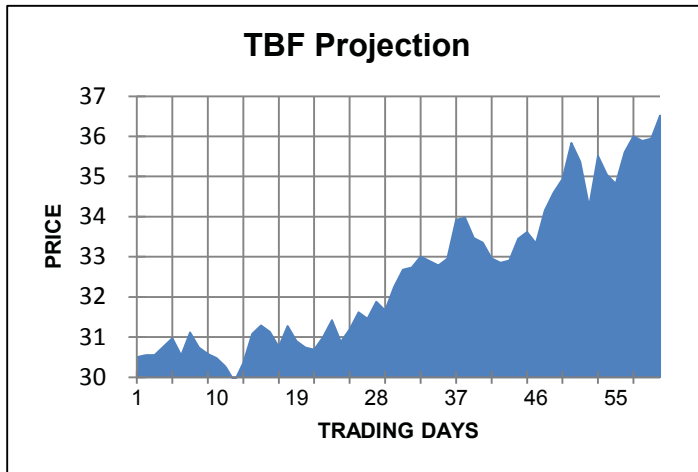
TMV would climb to \$96, for a 66 percent gain. See the chart below.



TBT would climb to \$97, for a 42 percent gain. See the chart below.



TBF would climb to \$36.5, for an 20 percent gain. See the chart below.



While the pattern of today's rise is unlikely to be exactly the same as the previous rise, we believe a 4.75 percent yield serves as a reasonable target. After yields rose to 4.75 percent on the last rise, the economy was considerably weaker than it is today and subsequently went into a decline.

Note that a target of 4.75 percent does not require a full recovery to the inflationary stage of the business cycle. That usually takes several years, and we would not recommend holding these ETFs for that long. The prices of these ETFs will erode with bond yields churning up and down over a long period of time. Accordingly, the objective is only for Treasury bond yields to recover to normal levels, of approximately 4.75 percent, from the artificially low yields caused by the 2008-09 economic meltdown and the subsequent massive bond purchases under the Federal Reserve's unprecedented quantitative easing (QE) programs. Since January, the Federal Reserve is pulling its support from the Treasury bond market by tapering its QE bond purchases and states that it intends to continue to do so.

Long-term Treasury bond yields are still historically low, and significant movements from here can only be upward.

Alternatives to Bonds

In January, *Sound Advice* was quoted in a Wall Street Journal article and in Market Watch, written by Mark Hulbert who publishes the Hulbert Financial Digest which we call the "Watchdog" of the newsletter industry because it independently audits and ranks specific recommendations from investment newsletters. The article was titled "*What to Buy Instead of Bonds*". The excerpt on *Sound Advice*

accurately sums up our recommendations.

"Attractive alternatives to traditional bonds are hard to find... Gray Cardiff, editor of the Sound Advice service, recommends four REITs that he says are trading at significant discounts to their per-share net asset values: Associated Estates Realty (NYSE:AEC), Commonwealth REIT (NYSE:CWH), Hersh Hospitality Trust (NYSE:HT), and Retail Opportunity Investments (NASDAQ:ROIC). These four REITs' average yield is 4.4%. [The Third Avenue Real Estate Value Investor Fund (TVRVX) should have also been included.]

REITs might seem an inappropriate bond substitute, since they are themselves quite interest-rate sensitive. But, Cardiff argues, "while rising interest rates is a near-term negative for real estate stocks, rising rental rates from an improving economy should more than compensate in the longer run."

Clearly, rising rental rates more than compensate for upticks in interest rates. A further explanation was beyond the scope of this article. Active real estate investors appreciate the leveraged results of rising rental rates, but the math appears to be lost on most stock investors.

Not to get bogged down in too many numbers, but a brief illustration is important. A property with, say, \$15,400 in rental income and operating expenses of \$5,390 (35 percent of income), would have an annual net operating income of \$10,010. Today, capitalization rates are around 7 percent, which puts the value of the property at \$143,000 ($\$10,010/0.07$). Let's say the mortgage is \$75,000 (approximately 50 percent of value), which leaves an equity of \$68,000.

Now, let's raise the rent by merely 5 percent. Assuming expenses stay the same, the net operating income increases to \$10,780. At a 7 percent capitalization rate, the property is worth \$154,000. Subtracting the mortgage leaves an equity of \$79,000. Note that this is a growth in equity of 16.2 percent, all from a mere 5 percent increase in rental income.

It would take a whopping increase in the interest rate on the mortgage to make a dent in the gain of cash flow and equity caused by a mere 5 percent increase in rental rates. During economic expansions, rental rates increase dramatically, compounding for many years. The investment returns and equity growth are excellent from commercial real estate – better than the average stock, and most notably, far superior to bonds. As inflation pushes up rental rates, it also pushes up bond yields which pushes down bond prices.

During times like now, when many high-quality real estate securities at substantial discounts to NAV are still available, the opportunity is particularly good. All of our real estate recommendations qualify:

Sound Advice is published monthly by S.A. Newsletters, LLC. ©2013 S.A. Newsletters, LLC. Editor-in-Chief: Gray Emerson Cardiff. Executive Editor: Linda Cardiff. Real Estate Consulting Editor: John Mason. Subscription rate: \$195 per year. Send subscription requests to: Sound Advice, 140 Town & Country Drive, Suite E, Danville, CA 94526. Phone: (925) 838-6710. Fax: (925) 838-0522. Information presented in Sound Advice may be used provided the newsletter—its name, address, and website—is mentioned as the source. The information contained herein has been carefully compiled from sources believed to be reliable, but accuracy cannot be guaranteed. When securities are initially recommended herein, the editors, affiliates, and associates of the editors do not have positions in such securities and are required to wait at one business day from the date Sound Advice is posted before placing orders for them. After the initial recommendation, editors and staff members may own stock of any or all of the securities discussed herein. Gray Emerson Cardiff owns all of the stocks mentioned herein.

The **Third Avenue Real Estate Value Investor Fund (TVRVX)** is up 8.1 percent and is the best real estate fund since we introduced it last October. It has led the pack of all real estate mutual funds during the last 3 years. It is replete with stellar values substantially below NAV with strong growth prospects.

Associated Estates Realty Corp (AEC) is up 10.5 percent so far this year, extending our gain to 25 percent.

What originally attracted us to AEC was the fact that it was selling at a substantial discount to the value of its net assets. The underlying equity of AEC is worth close to \$22 per share which is 33 percent more than the current price. AEC pays a nice dividend that is close to 5 percent.

AEC is a REIT that owns 54 apartment communities with 13,964 apartment units in ten states. During 2013, AEC made significant moves to reduce its debt and diversify into California, both of which are certain to benefit the bottom line.

Commonwealth REIT (CWH) is up 19.4 percent this year, extending our gain to 167 percent. We originally introduced CWH when it was selling for close to a 50 percent discount to its NAV.

In late March, Corvex/Related announced they had received consents from Commonwealth (CWH) shareholders representing an astonishing 81 percent of shares to remove the current management and the entire board. CWH acknowledged that all of its trustees have been ousted. A special meeting will be held on or before May 23 to elect a new board. Candidates include Sam Zell and co-president David Helfand of Zell's Equity Group Investments.

Based on the latest financials for the fourth quarter, we currently value CWH stock at approximately \$32.50 per share. Corvex/Related have contended the stock is worth more than \$40 per share with better management. At any rate, there is more upside left from today's close of \$26.57, especially if new management improves operations.

Hersha Hospitality (HT) is up 5.6 percent since our recommendation in December 2013. Our principle reasons for recommending HT was because hotel assets in general are sensitive to the business cycle and will benefit strongly from the economic recovery.

In addition, the price of the stock is depressed and selling at a discount to its net asset value because many of its major properties have been undergoing renovations, and the income potential has not yet been realized.

Also adding to growth potential is the sale of 16 properties that were performing below the average of the rest of the portfolio, and replacing them with better performing properties.

Based on the fourth quarter financials, we value HT's NAV at \$7.52 per share, which is 26 percent higher than the current price of the stock. This NAV is a substantial increase from the previous quarter's value of \$6.36 per share. The value improved because of increases in net operating income. We expect to see further increases in the immediate quarters ahead as income from new acquisitions are realized along with

increased income from completed renovations.

HT has an excellent risk/reward ratio. Risk is minimized with the stock below a currently depressed net asset value. The dividend is solid because it is well-covered by funds from operations (FFO). A yield of more than 4 percent is attractive and limits downside movement in the stock price.

Retail Opportunities Investment Corp (ROIC) is up 2 percent this year, extending our profit at 42 percent. This REIT began as an IPO in October 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains.

ROIC buys distressed retail properties with high-quality demographics, refurbishes them, and then leases them at a premium. During 2013, ROIC acquired ten grocery-anchored shopping centers for \$368 million. Funds from operations (FFO) increased during the year as these properties were added.

As new properties are added, along with tenant upgrades, FFO is bound to continue to rise, along with the dividend, and push the price of this REIT upward. Meanwhile, ROIC pays a 4+ percent dividend that is bound to increase in the years ahead.

Portfolio Updates

Here are updates on the rest of our recommendations in alphabetical order. The table on page 9 details our buy limits and other information on each recommendation, and organizes them by investment objective. Also see our website for live pricing.

Agrium (AGU) is up 6.6 percent this year, extending our profit to 741 percent. AGU has a broad mix of agricultural products and services that are poised to benefit from growing demand as arable land continues to disappear around the world and the need for higher food production per acre increases. Growth is also bolstered by an expanding worldwide population along with increasing per-capita income.

In late March, AGU responded positively to CEO Chuck Margo's statement that he is open to selling the company's potash production operation. One of his reasons was that production requires purchasing phosphate rock which hurts margins. This comment comes after more than a year of a tumultuous potash market and volatile potash prices.

AGU is buying back its own stock and recently doubled the dividend to \$3.00 a share. With a solid 3%+ dividend yield and with the stock price close to 10 times earnings, AGU is an excellent value with promising growth ahead.

AMN Healthcare (AHS) is down 3 percent this year, trimming our profit to 169 percent. AMN Healthcare provides temporary healthcare staffing services to the healthcare industry, ranging from nurses to physicians. We recommended this stock at an average price of \$5.35 based on the rationale that it was a two-fer. AHS was not just an opportunity to invest in healthcare, which is traditionally a non-cyclical industry, but it was also a chance to buy into a healthcare business that would benefit

from a recovery in the economy.

As our growth forecast was panning out, the stock advanced sharply in 2013. As its price/earnings (P/E) ratio expanded above 20, we recommended holding off on purchases. Since then, the stock price has not changed significantly, and we continue advising waiting for a better value, a dip below 12, to increase your position.

Boston Scientific (BSX) is up 13 percent so far this year, extending our profit to 43 percent. BSX's medical products are well suited for an aging population in the US. The Company's mission is to transform lives through innovative medical solutions that improve the health of patients around the world. BSX has been a global medical technology leader for three decades by providing a range of high performance solutions aimed at addressing medical needs and reducing healthcare costs.

BSX is comprised of 7 divisions, all of which are on a positive path.

Cardiac Rhythm Management division features BSX's subcutaneous implantable defibrillator (S-ICD), the world's first and only one of its kind. This defibrillator utilizes a pulse generator without touching the heart.

Interventional Cardiology produces catheters and stents and is BSX's largest division.

Endoscopy includes technologies for diagnosing and treating diseases of the digestive system, airways, and lungs.

Neuromodulation includes micro-electronic implantable devices aimed at managing chronic neuropathic pain and neurological diseases.

Peripheral Interventions products are aimed at treating vascular system blockages.

And finally, there is the Urology/Women's Health division.

In addition to these divisions, BSX is expanding in Shanghai with its Institute for Advancing Science (IAS) as well as its new Innovation Center. Through these facilities, BSX is fostering local talent to develop new technologies uniquely suited to the China market.

BSX is continuing to repurchase its own shares, after buying back 54.1 million shares in 2013.

Chesapeake Energy (CHK) is down 3.7 percent this year, trimming our gain to 59 percent. CHK is the second largest producer of natural gas and pioneered the use of fracking technology to produce oil liquids and natural gas from shale. We added CHK to the portfolio because it was at a substantial discount to its net assets. The stock price was cheap because of low natural gas prices, poor corporate governance, and because it was in the midst of a financial squeeze. We could see all of these conditions were likely to be remedied, and indeed they were.

CHK recently announced that it filed a registration statement with the SEC to spin off its oilfield services division into a separate company called Seventy Seven Energy and distribute its stock to CHK shareholders as a tax-free distribution. As a separate company, Seventy Seven Energy's main customer

would be CHK which provided 90 percent of its \$2.2 billion of revenue in 2013. We will advise on whether to keep the stock if and when the spin-off occurs.

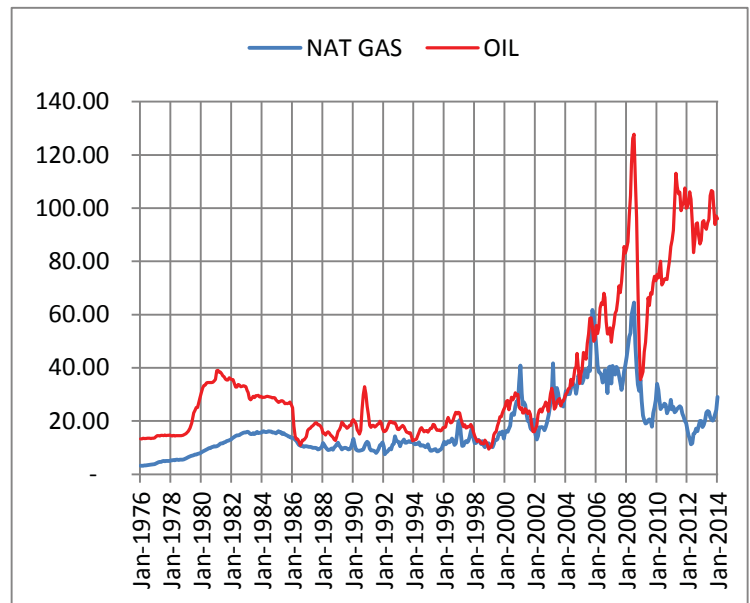
Fidelity Select Natural Gas Fund (FSNGX) is up 5 percent this year, extending our gain to 25 percent. This fund concentrates on the natural gas industry, and it is a diversified play on the gap between the energy equivalents of oil and natural gas.

Our primary reason for recommending this fund is simply that natural gas provides energy vastly cheaper than other sources of energy, which translates into an inexorably vibrant and expanding natural gas industry.

One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. With one barrel of oil at \$95, that is the cost of 5.8 million BTUs of energy. On the other hand, with a market price for natural gas at \$5.00 for one million BTUs, 5.8 million BTUs will cost \$29 (5.8x5). So the same amount of energy is available for 30 cents on the dollar -- if it is in the form of natural gas.

To illustrate the point, we continue to display the historic relationship between the costs of these two forms of energy in the chart below because it demonstrates that today's disparity is not a normal situation.

The Cost of Energy Equivalents of Oil and Natural Gas



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. Note that for most of the time (36 years), the two forms of energy are closely aligned. This stands to reason. After all, energy is energy, and it should cost approximately the same regardless of the form in which it comes. However, that is not the case today.

The US is self-sufficient in natural gas with only 9 percent imported from Canada. At pennies on the dollar versus oil, natural gas is bound to have a growing role in America's

energy needs as well as creating independence from importing oil. This fund is well positioned to benefit from an expanding natural gas industry.

Freeport-McMoRan Copper & Gold (FCX) was originally added to the portfolio in late August at \$30.42 per share. It didn't stay there long and rose above \$37. In February it had settled back to \$31.08 and we recommended it as a timely investment. FCX is up 16 percent since we originally recommended it.

Copper is woven into the fabric of every developed economy, and its price moves dramatically in tandem with expansions and contractions. We made a 643 percent gain during the last expansion, from March 2003 until December 2006, on Phelps Dodge, the largest copper producer back then. In March 2007, FCX purchased Phelps Dodge and became the world's largest copper producer in North America. As the world's economies continued to expand into 2008, so did FCX.

Since the Phelps Dodge transaction, FCX has added substantially to its copper reserves and continues to have opportunities to add reserves because of its large resource base and ongoing exploration program.

FCX is particularly opportune now because the US, along with most of the developed world, is emerging from recessions. During the last decade, China's expansion exerted a voracious demand, accounting for 40 percent of the world's demand for refined copper. The expansion of the Chinese economy is not likely to be at the double-digit growth rates of the past decade. It is a much larger economy now which by its sheer size cannot grow at the high rates of small emerging economies.

Regardless of China's growth rate, there is a large and defined source of future Chinese demand for copper. In a 5-year plan announced in 2013, the Chinese Energy Department is calling for developing 14 large "energy bases" where power plants and petrochemical facilities will be combined with coal mines. The power generated from these plants will be sent over a massive network of long-distance power lines called the "West-East Electricity Transfer Project." The capacity of the electrical power projected to be transferred by 2020 is the equivalent to the production of 60 Hoover Dams. Of course, nothing has anything close to the conductivity of refined copper, and by necessity, copper is the material needed.

Although China's growth has put it on the map as an economic force, the US GDP at \$15 trillion is double China's \$7.2 trillion and will be the most powerful force in the demand for copper. Japan's expansion of its \$5.9 trillion GDP will also be significant. Europe, with its GDP of \$12.6 trillion, is also emerging from its recession, and any growth from the world's second largest GDP will be a tremendous source of demand for copper.

In 2013, in an effort to diversify, FCX purchased oil and gas producing operations in California, Texas, Louisiana, and the Gulf of Mexico. These assets have significant exploration potential, and the current revenue from these assets now amounts to 25 percent of FCX's revenues. FCX became more of a natural resource company in 2013, with its dominant source of revenue still coming from copper, with a little help from gold, and a significant amount of help from oil and gas.

At the current price, the stock is trading close to 10 times

2014 projected earnings of \$3.15 per share. The dividend was recently increased, for the fourth time since 2009, and is now a well-covered \$1.25 a share, for close to a 4 percent yield.

Hambrecht & Quist Life Sciences Fund (HQL) is up 9.7 percent this year, extending our profit to 146 percent. In February, HQL declared another stock distribution of \$0.42 per share, which is comprised of capital gains.

We have been recommending this Fund because the most explosive profits in the entire healthcare industry can be found in biotech companies, and this fund is an excellent way to participate in a promising future on a diversified basis. There are bound to be home runs among its holdings, and all of the Fund's holdings that have promising drugs and treatments. These include: Medivation's *Xtandi* for use in prostate cancer, Amarin's *Vascepa* for use in hypertriglyceridemia, Ironwood Pharmaceuticals/Forest Laboratories' *Linzess* for use in irritable bowel syndrome, Biogen's *Tecfidera* for use in Multiple Sclerosis, and Celgene's *Pomalyst* for use in Chronic Myeloid Leukemia.

Positive clinical data for key products have been reported by Celgene's *Abraxane* for pancreatic cancer, Gilead's *Sofosbuvir* for Hepatitis C, and Vertex Pharmaceuticals for multiple drugs for Cystic Fibrosis.

Celldex's principal product demonstrated a survival benefit in the metastatic breast cancer setting.

MEI Pharma demonstrated an impressive response rate in patients with myelodysplastic syndrome when its product was combined with Celgene's *Vidaza*.

Oncogenex Pharmaceuticals began a pivotal trial in non-small cell lung cancer patients.

Endocyte, Inc. is in for approval (in concert with Merck) for its ovarian cancer drug in the EU.

ICON Energy Fund Class S (ICENX) is up slightly this year, adding to a small profit of 3 percent. We added it to the portfolio last year because the demand for energy accelerates with an economic expansion, and we expect to see stellar gains as the economic recovery gains traction. It takes energy to make everything, and especially large amounts to make the most vital materials and substances, such as chemicals, plastics, and to run data centers. The best time to invest is when the economy is coming out of a slump, before demand increases.

Aside from the cyclical timing, above average investment returns can be earned over the long run. Over the last 10 years, the Energy Equity Index has produced superior investment return to that of the S&P 500. That performance is because energy is in the fabric of the economy.

In addition, there is always the possibility of geopolitical disturbances threatening supplies and driving up energy prices. An expansion of the Russian-Ukrainian conflict could lead to disruption of oil transportation out of Russia.

Most energy mutual funds have not been able to match the performance of the Energy Equity Index. However, this fund not only beat the Energy Equity Index resoundingly, it has turned in the best performance – by far – of all energy funds.

Pfizer (PFE) is up 4.3 percent this year, extending our profit to 96 percent. We added PFE to the portfolio when it became dirt cheap as the expiration date approached on its blockbuster drug, *Lipitor*. However, its future was brighter due to the arsenal of new pharmaceutical products with more than 80 drugs in the development stage and 90 in the discovery stage.

Pfizer is making significant progress on several potential blockbusters for the treatment of cancer, heart disease, and immunology. The brightest spot is from sales of its oncology drugs which Pfizer is counting on to replace several blockbusters whose patents have expired or will be in the next few years, including *Lipitor* in 2011; *Viagra* in most major markets in Europe in June of 2013; *Celebrex* in 2014; *Zyvox* in 2015; and *Lyrica* in 2018.

PFE's potential blockbuster treatment for advanced breast cancer, *Palbociclib*, has successfully passed the phase 2 trial by delaying the progression of symptoms. PFE is discussing results with the FDA and other authorities in order to get the drug to those who need it as fast as possible. *Palbociclib* could produce \$3 billion in annual sales.

In March, PFE announced a second phase 3 study confirmed that its treatment for lung cancer, *Xalkori*, significantly prolonged survival.

Other introductions of oncology drugs include *Inlyta* for kidney cancer *Bosulif* for chronic myelogenous leukemia, *Inlyta* for late-stage kidney cancer, as well as *Xalkori* for metastatic non-small cell lung cancer.

Beyond oncology, the blood thinner *Eliquis*, which is split with Bristol-Myers, is expected to be a significant contributor to PFE's bottom line.

PFE recently started final stage trials of *Bococizumab*, a cardiovascular drug to treat those for whom statins are not effective.

PFE's largest revenue producer in 2013, was *Lyrica* for nerve pain. *Prevnar*, a vaccine against pneumococcal bacteria, was also a large revenue producer in 2013. Other Significant drugs in production include *Xeljanz* for which is promising for treating rheumatoid arthritis in patients who are allergic to Methotrexate.

PFE recently announced a \$5 billion share buy-back program along with an 8.3 percent dividend increase to \$0.26 quarterly for more than a 3 percent yield.

Stryker (SYK) is up 9 percent this year, extending our profit to 99 percent.

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

more hip, knee, and spinal procedures will be needed.

Stryker's cash-rich balance sheet with \$5 billion of cash and marketable securities, and robust cash flow, gives SYK multiple avenues for continued growth through acquisitions.

In late March, SYK purchased Patient Safety Technologies which owned the Safety-Sponge(R) System and SurgiCount 360TM compliance software aimed at preventing leaving foreign objects in the operating room (and in the patient).

This follows SYK's acquisition of Pivot Medical, a privately held business with an array of innovative instruments and implants to restore hip mobility with minimal incisions through hip arthroscopy, the fastest growing procedure in Sports Medicine.

Another significant recent acquisition was MAKO Surgical, which puts SYK in a leading position for robotic-assisted surgery and the potential for break-through innovations.

SYK's 2013 purchase of Trauson Products, offers another important source of growth. Trauson is China's largest manufacturer of orthopedic implants where 194 million people are now over the age of 60, and whose numbers are climbing rapidly (expected to double by 2050). This demographic bulge is also gaining wealth, so the number of potential candidates is mushrooming. In addition to giving SYK access to the Chinese market, Trauson also broadens SYK's customer base. Trauson devices are generally purchased by lower-

income hospitals that cannot afford Stryker's more expensive products. With the diversity of products, SYK can serve both China's developing and developed areas.

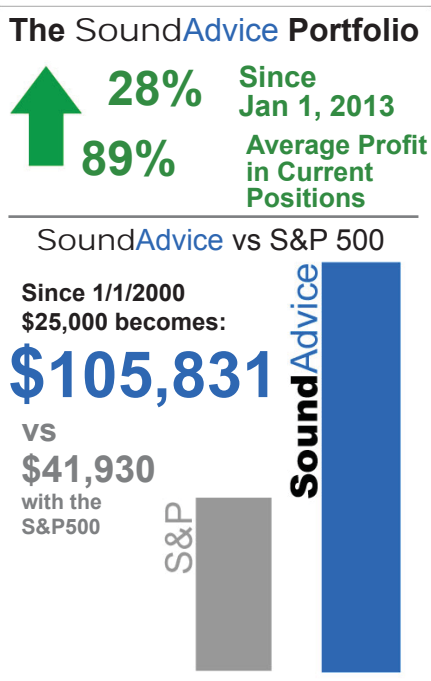
Symantec (SYMC) is down 14 percent this year, trimming our profit to 23 percent. SYMC is the dominant supplier of software for computer security and protection against viruses and other nuisances through its leading flagship brand, Norton. If there ever was a more certain growth industry, protection from cyber espionage is it.

In March, SYMC terminated its president and chief executive officer, Steve Bennett, on the basis that a more effective leader was needed. The stock dropped close to 10 percent on the announcement and then recovered most of the loss.

Chairman Daniel Schulman said, "We remain committed to our previously announced greater-than 5% organic revenue growth and better-than 30% non-GAAP operating margin targets by FY17. Our priority is now to identify a leader who can leverage our company's assets and leadership team to drive the next stage of Symantec's product innovation and growth..."

We continue to recommend SYMC. There is opportunity for growth in demand for cloud-based security systems, a product that SYMC is well-positioned to provide.

Tetra Tech (TTEK) is up 5 percent this year, extending our



Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Associated Estates Realty Corp	AEC	NYSE	\$ 17.01	4.47%	\$ 18.50	BUY
CommonWealth REIT	CWH	NYSE	\$ 26.35	3.80%	\$ 27.00	BUY
Hersha Hospitality Trust	HT	NYSE	\$ 5.83	4.12%	\$ 6.50	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 15.01	4.00%	\$ 16.00	BUY
Third Avenue Real Estate Value Investor	TVRVX	800-443-1021	\$ 30.31	2.18%	\$ 33.00	BUY
Diversified Growth						
Pfizer	PFE	NYSE	\$ 31.95	3.26%	\$ 33.00	BUY
Stryker Corp.	SYK	NYSE	\$ 81.88	1.29%	\$ 82.00	BUY
Third Avenue Small-Cap Value Investor Fund	TVSVX	800-443-1021	\$ 27.80	0.00%	\$ 32.00	BUY
Xerox	XRX	NYSE	\$ 11.44	2.19%	\$ 12.00	BUY
Energy/Natural Resources						
Agrium	AGU	NYSE	\$ 97.52	3.08%	\$ 100.00	BUY
Chesapeake Energy Corp	CHK	NYSE	\$ 26.13	1.34%	\$ 28.50	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 40.28	0.82%	\$ 42.00	BUY
Freeport-McMoRan	FCX	NYSE	\$ 32.92	3.80%	\$ 36.00	BUY
ICON Energy Fund Class S	ICENX	800-828-4881	\$ 22.89	3.23%	\$ 25.00	BUY
Tetra Tech	TTEK	NASDAQ	\$ 29.50	0.00%	\$ 29.00	HOLD
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$ 14.90	0.13%	\$ 18.00	BUY
Aggressive Growth						
AMN Healthcare	AHS	NYSE	\$ 14.21	0.00%	\$ 12.00	HOLD
Boston Scientific	BSX	NYSE	\$ 13.62	0.00%	\$ 13.50	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 58.46	0.00%	\$ 62.00	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 30.65	0.00%	\$ 32.00	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 68.76	0.00%	\$ 71.00	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$ 22.43	0.00%	\$ 25.00	BUY
Symantec	SYMC	NASDAQ	\$ 20.18	2.97%	\$ 21.00	BUY

Prices are as of 4/1/2014. See our website for live pricing and buy limits. Yields on funds may include capital gain distributions.

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

profit to 92 percent. TTEK is a leading company in water technologies and environmental remediation with a healthy balance sheet and a backlog of approximately \$2 billion in signed contracts to clean up military bases across the US.

There is plenty to clean up domestically, and the greatest growth potential continues to be outside the United States, especially in China and India, where environmental concerns have been an afterthought. As these and other governments around the world make this a priority, Tetra Tech should be a prime beneficiary. Late in 2013, the board of directors authorized a \$100 million common stock repurchase program.

USAA Precious Metals & Minerals Fund (USAGX) is up 17 percent this year, our best gainer so far for 2014. When the economic recovery gets more traction, the money created in recent years will be sloshing through the economy, putting upward pressure on the prices of commodities including precious metals. This fund will also benefit from inflation when the economy begins to overheat. USAGX is the best diversified way to invest in precious metals. It is the top-performing fund, and has constantly out-performed precious metal equities for ten years.

Xerox (XRX) is down 6 percent this year, trimming our profit to 35 percent. We have been recommending XRX because it has been transforming from purely a seller of printers and copiers to a company providing services on those machines along with developing information technology (I.T.) services. In 2013, the strongest growth came from the expansion into I.T. services, especially in the healthcare industry where technology is needed to reduce costs.

In order to spur more growth profits from its services business, XRX appointed a new executive, Robert Zapfel, a veteran of IBM who will be in charge of implementing a five-prong growth strategy. XRX announced it expects to see 2014 earnings to increase to between \$1.10 and \$1.16. The company expects to spend more than \$500 million in 2014 on new acquisitions to expand I.T. services. XRX also intends to spend another \$500 million to buy back some of its stock. Beyond 2014, XRX plans to repurchase another \$1.0 billion of its stock.

At close to 10 times earnings, XRX is at a steep discount to the overall market and cheap in comparison to its competitors like IBM and Canon. XRX raised the next quarterly dividend by 8.7% to \$0.0625 per share (\$0.25 annually).

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

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

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

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

We can, therefore, label this new tool the SoundAdvice "Risk Indicator," since it will allow us to locate the point at which prices are so high when compared to competing markets that they have come loose from their moorings

and are on the verge of declining or underperforming the other market.

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

The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$10.9 million in stocks and to \$1.39 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 \$433 million, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the SoundAdvice Risk Indicator would have provided.

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

The SoundAdvice Risk Indicator

The latest reading for the Sound Advice Risk Indicator is 1.72. This reading reveals that stock prices are above average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

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



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

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

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

The SoundAdvice Diffusion Index of Leading Indicators: As far back as February and March 2009 we were projecting that our Diffusion Index of leading indicators soon would hit zero and mark an important buying opportunity. We made that projection by assuming that the leading indicators would not improve in the current economic environment. In fact that signal arrived in March, very close to the bottom, officially giving us an "Aggressive" signal. The market subsequently climbed 61 percent.

An "Aggressive" signal coming at a time when the Risk Indicator was below 1.0 revealed that Supercycle 5 came to an end, and that Supercycle 6 was born. Our next signal will come from a zero reading from our Diffusion Index of Leading Indicators. The latest reading is 33.3 percent.

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

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

This index hit 100% in 2012 when the economy began to turn around, and marked the low-point of the long term Treasury bond yields. This indicator was instrumental in recommending our "No-Brainer" ETFs designed to profit from rising Treasury bond yields.

Although operated under the "Caution" signal, we earned a 25.74 percent investment return in 2013. We have continued to be bullish about stocks because of Federal Reserve's expansive monetary policy and its Quantitative Easing program which has been distorting the natural business cycle this time.

Track Record of the SoundAdvice Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 climbed an average of 34.4 percent. During "Caution" signals, the S&P 500 increased an average of 1.5 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Ave +/-	34.4%		1.5%

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

SoundAdvice
140 Town & Country Dr.
Suite E
Danville, CA 94526



Enclosed: The April Issue of SoundAdvice

Save 56% to 68% on your renewal to SoundAdvice
Renew online: go to www.soundadvice-newsletter.com
or fax or mail in the renewal coupon below.

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

- BEST DEAL! 24 Month Renewal for only \$125 - A 68% savings! Plus, you will receive:**




The latest edition of *The Science of Making Money in Turbulent Markets*. A \$59.95 Value...**YOURS FREE**. This is the book that explains all of the SoundAdvice indicators, including the Diffusion Indexes and the famous Risk Indicator, and exactly how they work so that you can update them yourself.

The Sound Advice Special Situations A \$29.95 Value...**YOURS FREE**. Here is a complete update of each stock and mutual fund in the SoundAdvice model portfolio. This will give you a chance to review your investments alongside our recommendations, to make sure your money is working the hardest it can for your future.



- GREAT DEAL: 12 Month Renewal for only \$85 - a 56% savings! Plus, you will receive the latest edition of *The Science of Making Money in Turbulent Markets*. A \$59.95 Value...**YOURS FREE**.**

 **With either plan, you will receive: *Our #1 Investment of the Year*. A \$29.95 Value ... **YOURS FREE**. If you could make only one investment, this is it. Time is of the essence. You should invest right now.**

E-mail: _____ To receive your Printer-Friendly Issues and updates between Issues)

- Send me my Issues by regular mail. Add \$50 to cover printing and postage costs (\$25 for a 12-month renewal).

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

- Enclosed please find my check payable to: SoundAdvice

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

Expiration Date: _____ Security Code _____ (the 3-4 Digit Number on the back of your credit card)

- Yes! Add 3 months to my choice above. I Qualify for the Early Bird Special.**

(cut along dotted line)