



Last Monday's *Wall Street Journal* placed two stories close together: Buffett's annual letter to shareholders that mentioned his search for a way to invest Berkshire's cash hoard and another that J.P. Morgan is negotiating to buy a 10% stake in Twitter for \$400 million, valuing a company that was almost invisible four years ago at \$4 billion. Frankly, there's nothing new about Buffett's quest for ways to invest the huge cash float Berkshire holds and, for all the hoopla surrounding Twitter, its story is also old news with only the names changed.

The fabulous expectations surrounding companies like Twitter, Zynga, Groupon and, of course, Facebook generate breathless analysts' expectations that eventually each will be worth \$100 billion (Merck and Pepsi, for instance, are \$100 billion market cap companies) because their revenues are rising so fast. Why would J.P. Morgan or Goldman be striving to find a way to get in, if not on the ground floor, at least not too far above street level? As Willie Sutton, the famous bank robber supposedly said when asked why he robbed banks: "That's where they keep the money." It's not that Morgan or Goldman has an abiding vision of the future of social networking. Instead, they anticipate a quick score. This brings me back to the late 1990s when Wall Street couldn't roll out IPOs fast enough to meet investors' hunger for names like Pets.com (bankrupt) Global Crossing (out of bankruptcy but private) and InfoSpace (from \$1300 a share to \$8). We already have examples of social networking shooting stars now exhausted like Friendster, the pioneer, MySpace, which News Corp bought for a fortune and doesn't know what to do with.

Buffett observed "Money will always flow toward opportunity" but there are opportunities such as Berkshire's acquisition of Burlington Northern and the sorts of businesses he's after now, which are built on tangible assets tied to a recovering economy, and then there are opportunities like Twitter, which are built on a fascinating social insight that could be supplanted tomorrow by an even more compelling social network. *Sound Advice's* preference is always toward durable businesses, not trendy businesses regardless of the short-term attraction or the ultra-longshot odds of hitting it big. Check back in a decade. Let's see whether Zynga, Twitter, Groupon and even Facebook realize that \$100 billion potential.

-Gray Emerson Cardiff

24 Months Ago

This Wednesday, March 9th, marked the second anniversary of the end of the bear market that began in October 2007. Over these past 24 months, the market as represented by the Wilshire 5000 has recouped its entire loss, while the Nasdaq is 15% higher. *Sound Advice* was fortunate enough to outdo that. If the market has experienced one of the most explosive recoveries in history, the same can't be said for investors, most of whom missed the recovery. For those, like a subscriber who eloquently lamented to us on the last weekend of that bear market that regardless of what he had bought—investments he considered bargains at the time—he really had been "buying a loss," the bear had been too much. This subscriber's despair compelled him to liquidate every security he owned.

Reading the letter, we truly felt his pain, and wondered whether the issue we had just sent to the printer with the cover story "Approaching A Buy Signal" could convince anyone that this was the moment not to be selling but to be buying. We noted that effectively our buy signal from the Diffusion Index of Leading Indicators was about to flash, though one component, the spread between short and long-term Treasuries needed another month or two to fall into place. It was not a matter of whether, it was a question of how soon. You know what happened next.

But most investors failed to get in then or since. Lately, that mentality has reversed and money grudgingly has begun to flow out of bonds and into stocks, which frankly makes us a bit nervous. Our indicators remain positive for continued higher prices, but unsettling events in North Africa and the Mideast that spiked oil prices and shuddered markets around the world can make us question such optimism. Then along comes something that makes us less anxious: a book.

James Glassman, who co-authored one of the dumbest and certainly the worst timed investment books, *Dow 36,000*, has come out with a new book. Why should a book buoy me? *Dow 36,000* debuted in October 1999, which left six months before the market came unglued, and urged everyone to buy stocks rather than bonds, the maximumly wrong orientation. Glassman claimed there was no difference in risk between stocks and bonds, and that the Dow could more than triple in as little as the next five years. Glassman's new book is titled *Safety Net*, a refreshing change from *Dow 36,000's* Icarus-approach to the market.

So what does Glassman advise today? The world is too risky to invest exclusively or even primarily in stocks. You need to ratchet down your expectations. Buy bonds. In the *Wall Street Journal* in what passes for a mea culpa for his first book's errors that conveniently ignores the book's most egregious assumptions, Glassman presents a version of "The New Normal" that posits lower growth in the U.S. and a less stable globe. Glassman has a knack for predicting what consensus already "knows." He's an anti-Cassandra. If he's true to form again, it's time to sell bonds and go long stocks.



Sector Funds in the *Sound Advice* Portfolio

Most fund investors make the mistake of buying based exclusively on recent performance, which is another way of saying that they are buying high and hoping that the trend can continue. Even when fund buyers avoid the momentum game, rarely do they pay attention to what the fund owns, and even more rarely do they keep tabs on what their fund's manager is doing with the portfolio.

Frankly, such negligence is understandable because the requisite data, though readily available in SEC filings, can be tedious to aggregate and compare. Looking at solid reference sources like *Morningstar* shows what a fund currently owns, suggests whether the positions are new, shrinking or increasing but fails to provide the detail that can be gleaned only from SEC filings. Thus, for most investors funds tend to be black boxes, and, we must confess, we tend in our month-to-month comments to cite performance figures for funds rather than dissecting portfolio changes. At least once a year, we try to remedy that. This month we'll cover five sector funds. Next month, we'll cover other diversified positions.

The CGM Realty Fund (CGMRX) as tracked by Morningstar has the best 10 (20.53%) and 5-year (9.56%) performance records, but sits well back in the pack over the last three years.

Nonetheless, since inclusion in *Sound Advice* in December 2008, the fund has doubled, which compares nicely to the S&P's 50% rise or the Wilshire 5000's 59%. Anyone who considers owning shares has to understand that the primary manager, Kenneth Heebner, differs from the manager profile we tend to favor: rather than stoic and long-term (e.g. **Dodge & Cox**) CGM funds can morph abruptly as Heebner follows his instincts. He also insists on concentrating his portfolio.

Thus, in the most recent SEC filing (September 20, 2010) CGMRX holds only 23 positions, of which the top 10 account for 58% of the portfolio. Finally, Heebner at times interprets in an extraordinarily broad manner what compromises "real estate." For instance, during the 2001-2008 period, he larded the portfolio first with homebuilders, a natural adjunct to real estate, which is what most REIT funds hold, and, after disposing of these highly successful positions, he began buying mining companies and fertilizer manufacturers, arguing that because they derived their revenues from the earth, they qualified as "real estate." Though such divergences from what we thought constituted "real estate" resulted in our yanking our recommendation, we came back to the fund after Heebner started to prune non-commercial real estate shares from the portfolio.

If we compare the most recently reported holdings with the CGMRX portfolio as it stood just three months earlier, we see that he had sold off what had been his single largest position, Digital Realty (7.2%), which owns server hotels and

other properties leased to telecom and Internet companies. Heebner made no significant changes in the fund's exposure to storage, retail and office/industrial. But he took proceeds from what he did sell and poured most of it into apartment REITs. Of the \$635.5 million the fund has put into the shares of companies absent from the June 2010 portfolio, 48.9% went into residential REITs. Take a look at the January issue to see why we think Heebner nailed a very lucrative sector and likely is still riding it.

As if to remind us he is free to do what he wants, Heebner again is flirting with natural resources, adding two new mining positions, Cliffs Natural Resources (1.4% of the portfolio) and Freeport-McMoran (5.1%). In short, putting money into any Heebner fund requires both trust that he can renew his track record. It helps to be indifferent to rapid changes of fortune, since even when successful Heebner funds are volatile. Indeed, the worst thing an investor can do is to put money with a manager whose style he can't abide, since that guarantees that the investor will buy in and bail out at precisely the wrong times. To own this fund, you have to buy into Heebner's method, which now and again results in titanic falls that over time have been more than made up for by sizzling gains.

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PowerShares Water Resources Fund

Exchange Traded funds such as **PowerShares Water Resources Fund (PHO—NYSE)**, unlike mutual funds, are obligated to reflect a specific underlying index, which might seem to limit an ETF manager. However, indexes are born to be changed, and unlike an ETF based on the S&P 500 that changes only when the S&P 500 changes, managed indexes such as the Palisades Water Index, on which PHO is based, can evolve as often as the index adviser sees fit. That said, indexes for managed ETFs do not flit from one profile to another.

Despite the fund's name, it is not purely a water fund. Indeed, the name is more aspirational than descriptive, since there are few publicly traded companies, other than water utilities, that derive all or even the lion's share of their revenues from water resources. PHO's share price tends to move in tandem with the shares of industrial companies, though it remains the best way to gain exposure to water-related companies.

Just look at the industry breakdown from the last report (as of October 31, 2010) of the ETF's holdings: the largest sector is Machinery-diversified (19.7%), followed by Miscellaneous Manufacturing (17.2%), Engineering & Construction (15.2%), Environmental Control (11.9%), Water (11.8%) and Electronics (11.7%).

When we first recommended PHO, the fund included a number of mega-cap companies like General Electric and

Siemens, which do have a water component. But that aspect was so small in relation to these companies' revenues that they bordered on trivial.

Palisades Water Index as of February 14th had as its largest four positions: Lindsay Corp, URS Corp. Veolia Environment and Valmont Industries. Lindsay's primary business is fabrication and sales of irrigation systems, which fits the water theme and Veolia Environment focuses almost entirely on water-related projects, but URS Corp is an engineering and construction company that among other things designs and builds water-related infrastructure but is far more involved in roads, energy and projects with the Department of Defense. For FY 2010 URS had \$8.9 billion in sales, of which \$1.7 billion came from infrastructure, which included far more than just water-related projects. Valmont gets 20% of its revenues from irrigation pipe with the bulk coming from making high-power line towers and light poles.

At the moment, water projects, which depend on either real estate development and/or public infrastructure spending, both of which are stagnant, are perceived as dead in the water. We think that sooner rather than later funds will begin flowing to this sector because of deferred capital expenditures and recognition of how serious the global water crisis is. PHO is an excellent place to be waiting for that tide to return.

Hambrecht & Quist Life Sciences Fund

Investing in biotechnology demonstrates extraordinary profits when an obscure company with a wonder drug gets FDA approval or is acquired by a larger firm, but biotech investments, particularly those that are on the verge of success but then stumble, can create abrupt and devastating losses. Indeed, spectacular losses are far more common than successes.

While we're comfortable evaluating specific businesses, biotech, frankly, is beyond our expertise. When we believe that biotech has lost market interest and offers opportunities, our custom has been always to be diversified and to rely on the expertise of a particular closed-end fund: **The Hambrecht & Quist Life Sciences Fund (HQL—NYSE)**. This is our third time with HQL and each has been rewarding.

Since reintroducing HQL in the December 2009 issue, it's up 30.6% versus 14.9% for the Dow, 18.1% for the S&P 500 and 25% for the Nasdaq. As for its exact peers, HQL has outperformed biotech ETFs like BBH and IBB. In the December 2009 report to shareholders (as of September 31, 2009), Daniel Omstead, the fund manager, described the previous 12 months as "a difficult period," even after the recovery in share price and NAV during the preceding six months.

That difficult stretch set the table for better times. Since then, HQL's discount from Net Asset Value (an excellent measure of investor attitudes toward a closed-end fund's assets) had dropped from 19.7% to 8.4% and occurred despite anxiety over what healthcare reform will mean and in the face of slowed demand for medical services in a still weak economy. Furthermore, biotech and device manufacturers have had to

contend with a noticeable slowing on the part of the FDA in approval of new treatments. On a more positive note, mergers and acquisitions are pushing some shares higher, and augur well for more to come.

In the most recent SEC filing as of September 30, 2010, Omstead observes that over the previous 12 months the best performers had come not from cutting-edge biotech outfits but from two generic drug companies: Akorn and **Perrigo**, the latter of which *Sound Advice*'s portfolio also benefitted from directly. It's hardly surprising that generics, which become attractive during a recession, had a good year. Neither had been among the fund's top 10 positions 12 months before and only Akorn, at 2.2% of the portfolio is now in the top 10. Perrigo, which like Akorn continued to run since the end of Q3, would have made the top 10, but Omstead cut his position.

When introducing new positions, Omstead tends toward modest beginnings. But not always, among the 18 new companies' common shares, half represent 1% or more (Incyte, a maker of small molecule drugs, starts at 2.6%) of the portfolio's dollar value. As for shares no longer in the portfolio (there were 15 deletions or 23% if the 2009 portfolio), most had been small but some were significant such as Biogen (4.2% of the portfolio), a biotech developer of drugs, and United Therapeutics (3%).

We expect that HQL has further to run, though the shrinking discount from NAV signals that investors have rediscovered this closed-end fund. To justify continuing to hold HQL, we'll need to see a significant rise in the NAV. Were the discount to shrink further, we'd have to sell.

Columbia Seligman Premium Technology Growth Fund

Technology investing over the last two decades has been a feast or famine experience. Feast during the 1990s. Famine from 2000 to 2003 and again in the 2008-2009 meltdown. During the most recent recovery that dates back to March 2009 the Nasdaq, which is heavily populated by tech stocks has led the other benchmarks, up 116% versus 101% for the Wilshire 5000. Though we love the home run quality of owning tech—except when it doesn't work and the index strikes out, repeatedly, in September we settled on what we consider the most prudent way for conservative investors to participate in technology: the **Columbia Seligman Premium Technology Growth Fund (STK—NYSE)**, a closed-end fund, that enjoys an admirable pedigree but also has a conservative twist that provides some cushion from the Nasdaq's often rough ride. The fund is structured to pay a regular distribution set at .4625 cents per quarter. On that basis, at our original price (\$17.99), the yield worked out to 10.3% (not including any capital gain distributions). At its current price (\$19.97), the yield is 9.3%.

The fund has performed as advertised. As of March 1st STK on a total return basis is up 20.8% while the Nasdaq has advanced 26.6%. We're satisfied with the performance.

How does a fund built on Nasdaq shares, which normally pay no or trivial dividends, generate a high yield? The fund sells options on the QQQQ, an ETF based on the largest

cap Nasdaq stocks. In a slowly rising, flat or falling market these options won't be exercised, which lets the fund pocket the premiums speculative buyers pay. However, in a steadily rising, and especially in a sharply rising market, calls get exercised, and STK ends up paying out more than it had received in premiums. We've seen some of that over the last few months.

If we look at changes in the portfolio between the most recent SEC filing (as of September 30, 2010) and the previous filing (March 31, 2010), which encompassed a rocky period for the market, we note that of the 50 positions in the March portfolio, six months later 18 (36%) had been dropped and 21 new positions had been added. There also were dramatic changes in several continuing positions. Thus, Analog Devices had increased from 51,400 shares to 214,860 shares (+318%) and Google had more than doubled to 22,100 shares. Nonetheless, the overall shape of the portfolio remained fairly constant. Even if some positions shifted, most sectors into which the fund was distributed moved only slightly.

To get a broader sense of how the fund managers viewed the near future, consider the options contracts that they wrote: as both March and September drew to a close, the Nasdaq had been on the rise. However, between the two SEC filings, investors had negotiated a rough stretch that in July and again in late August defined the lows for the year. In March, with the market rising after a dip in January, the fund wrote eight puts and two calls (for \$2.2 million in premiums), meaning that it was betting against the market falling sharply (a put gives the buyer the right to sell shares at a contracted price and obligates the writer to pay that price). Some of those puts got exercised and hurt STK's performance. However, the largest put for Apple, which accounted for \$444,556 in premiums, never got exercised as Apple bobbed ever higher. In September, with the market recovering but still chastened by the previous months' decline, the fund wrote four puts and five calls (for \$3.06 million in premiums), a more balanced but hardly a bullish view of what the Nasdaq would do over the next few months. None of the puts was exercised, though the Nasdaq 100 calls undoubtedly were either exercised or covered by the fund.

STK is structured as a closed-end fund, which means we should pay attention to the discount or premium to its Net Asset Value. Because of its income aspect, the fund often trades at a small premium to NAV. But at the moment, At it trades at a slim 4.4% discount.

Fidelity Select Natural Gas Fund

The **Fidelity Select Natural Gas Fund (FSNGX)** has been a relative disappointment due in part to weakness of natural gas pricing but also because the fund's holdings underperformed. Compared to the First Trust ISE-Revere Natural Gas Index ETF (FCG—NYSE), FSNGX has trailed since its introduction in September 2009. It's almost enough to make us replace the fund except for two considerations: first, as our December selection of EnCana suggests, we

think that natural gas is too cheap to last at current prices and second, the fund has a new manager, whom we're putting on a short leash as we evaluate what the new manager, Ryan Oldham, who took over from his predecessor, James McElligott in June 2010, does. Oldham is no stranger to energy. He's worked as an analyst on Canadian energy companies and global exploration and development firms.

Oldham has not been shy about imposing his opinions. In some cases, Oldham accelerated changes that McElligott had begun, but it's been more of a good old fashioned cleaning house. Most obvious, the portfolio has slimmed from 88 positions in May 2010 to 48, and the details are more telling. Of the 48 positions, only 17 are carryovers from the May 2010 portfolio, and of those the weightings have changed dramatically. Thus, Chesapeake Energy, which had been the largest position (10%) has virtually vanished from 4.1 million shares to 500, while Apache Corp, which was barely visible (0.12%) in May had become the largest position (13%). The difference between the two? Other than Apache being about double its size, Chesapeake is perhaps the sector's most aggressive mid-sized (\$24 billion in market cap) exploration and development company, using borrowed money to grow its reserves. Apache does both land-based and marine exploration and development that historically has purchased older reserves and then extracted more than the previous owners had thought possible. Valuations strongly favor Apache. In short, Oldham replaced a speculative, highly leveraged holding for a more settled and less leveraged position. Devon Energy, which barely registered in May at 2200 shares (0.02%), by December had jumped to 672,446 (5.7%). What is Devon's appeal? Like Apache, it's a strong balance sheet company with a disciplined focus that relatively is cheaper than its peers.

This move toward more stable, less aggressive positions is reflected in increased exposure to public utilities (as opposed to independent, non-regulated sellers, which Oldham purged), which totaled less than 1% before he took the reins, but by the end of the year accounted for 17.2% of assets. It's a hedge against prolonged cheap natural gas prices.

Finally, Oldham won a few points with us for tuning out the babble surrounding the BP Oil debacle in the Gulf of Mexico that started on April 2010 but was still unsettled as he took over. At that time, neither BP (3% as of 12/31) nor Anadarko (10.5%), which was a 25% passive partner to BP, were held by FSNGX and **Transocean** (2%), which was 1% of the inherited portfolio. He clearly decided that the herd's pessimism was overdone and acted on it. We're impressed he would make that big a contrarian commitment as he began his stewardship.

If the increase in public utilities and a preference for more conservative exploration and development companies like Devon and Apache suggest Oldham is risk averse, his willingness to put money in companies with headline risk suggests he's willing to take calculated risks when the reward is sufficient, which encourages us to give him enough time to prove himself.

Portfolio Updates

Though the *Sound Advice* portfolio with dividends is up 1.2% since the February letter was priced (2/4), it's been a rollercoaster with the Dow up 0.6%, the S&P 0.8%, the Nasdaq 0.6% and the pan-market Wilshire 5000 1%, all significantly below where they stood on February 18th when world markets decided that though earlier events in Tunisia and Egypt were significant politically, rebellion in Libya, which accounts for 2% of the world's oil production, was materially significant to the global economy. Oil prices escalated quickly, and despite stronger macroeconomic results for job creation, business expansion and consumer confidence, the prospect of \$4 gasoline put continued progress at risk. *Sound Advice* remains positive about the eventual recovery of the U.S. and global economies even in the face of an oil shock.

AHM Healthcare Services, the February recommendation, won't release results until March 8th, but the shares are acting as if they had been released and were wonderful. Since we priced the February issue, the shares are up 22.4%. There are telltale clues that suggest good news really might be coming. Consider that hospital chains, like Tenet, are reporting very strong results for the quarter, which means that more patients are coming through the door, a plus for AHM's temporary nurse, doctor, pharmacist and support worker business. The better job creation numbers also support a positive view. But if you aren't comfortable with volatility, this might not be a stock for you. As a truly small small-cap stock (\$300 million is commonly considered the lower boundary for small caps and AHS is just under that) AHS can move rapidly. But it's a two way street. What happens on March 8th (we close the issue on March 4th) will provide a test.

Energy companies have been at the heart of the market during the last week as unrest and flat out revolutions have roiled North Africa and the Mideast. The primary focus has been oil companies, since natural gas (NG), aside from liquefied NG shipped over long distances, is a very local business and, aside from countries like Italy and France which rely on NG from places like Libya, disruptions of NG production from Libya are mostly irrelevant. Oil, however, which Libya exports over long distances feeds into that pricing. When even Libya's 2% of global production diminishes, the reverberations, both on the spot market but particularly on the futures market, can be profound. We also can't ignore the possibility that Saudi Arabia, which has a significant minority Shia population that is unhappy, might see its own unrest, which would make the to-date jump in oil prices look like a rounding error. Rising energy prices pose a threat not just to the general economy but also to other commodities, which are yoked to economic growth. Finally, the dollar, in which energy and other commodities are priced, has taken a beating lately, in part because of U.S. budgetary anxiety but also because the Euro has risen on expectations of rate increases by the European Central Bank, has weakened and provided an accelerant for oil and some support for metals. Gold and silver also have

been on a tear as investors sought safety. **USAA Precious Metals & Minerals Fund** rose 4.9%, though the **ProShares UltraShort 20+ Treasury ETF**, which moves inversely to the price of longer-duration Treasuries, fell 5.4% as money sought security in something we believe, at least in terms of price, is not all that secure.

Transocean has had a mixed run. Since the last letter, RIG is 6.2% higher despite reporting poor results for the previous quarter. The company continues to deal with the aftermath of the Deepwater Horizon explosion in the Gulf of Mexico. For example, the moratorium on drilling in the Gulf of Mexico limits revenues and has engendered disputes with customers over how to determine costs for drilling equipment that has been contracted for but can't be deployed. Also, RIG has undertaken more intense testing program for its blowout preventers, the last protection against an uncontrolled underwater oil spill. That process cuts into operating time. There are continuing legal and insurance costs associated with the Deepwater disaster. Finally, RIG wrote off the value of its fleet as it has had to stack rigs, especially shallow and mid-water rigs, as demand has slipped. On the plus side, management announced that it expects to pay out the dividend that Swiss courts had blocked after the Deepwater Horizon sank.

EnCana, the Canadian natural gas exploration and development company, hit the market with a double-whammy: first, it announced that PetroChina, whose negotiations we'd been following, will pay \$5.4 billion to develop shale natural gas reserves in western Canada. In addition, the money will pay for a pipeline, storage and a liquefied natural gas exporting facility. On the news ECA jumped 6%, but gave most of it back as natural gas prices slid during the oil crisis. Since the last letter, ECA is up 0.8%. For EnCana (and other natural gas producers) the continued penetration by Asian buyers is significant but just as important is the development of export capacity, since the amount of natural gas trapped in shale that can now be accessed through fracking has created an oversupply that had depressed the share prices for natural gas companies. Five years ago, the industry was gearing up to import liquefied natural gas. Now the flow's direction has switched. As we titled our December recommendation for EnCana, "Buying into Oversupply," there was and remains opportunity for increasing revenues and share prices.

Fidelity Select Natural Gas Fund did better than ECA, adding 4.7%. It's not that ECA is a dog compared to other NG companies. Rather FSNGX holds many exploration and development companies that have significant exposure to oil, which buoyed the fund this week. See our remarks about FSNGX on page 4. Agrium has been all over the map as fertilizer stocks, which were white-hot as the market tried to digest what rising demand for food in a world with crop problems meant and then fell apart as investors worried what China's

throttling back of growth and geo-political chaos might mean for demand. Since the last letter, AGU is up 5.3%.

Plum Creek Timber, the forest product REIT, added 1%. The new housing market, which is a major customer for wood, remains difficult. As our tracking of foreclosures and defaults in each issue shows, there is really no significant improvement in the overhang of properties repossessed by banks. Until those homes find buyers, the prospects for new construction is poor. Frankly, no one knows when the market will improve even as the volume of sales increases, the prices at which transactions are being made decline. PCL remains a reasonable place to wait out this painful process with a significant dividend (4.1%). Natural resource stocks were a mixed bag.

Anglo American was up 0.2% as concerns about demand from China and a global slowdown due to higher energy prices hit the industrial metals miners. USAA Precious Metals & Minerals Fund, however, enjoyed a rebound, adding 4.9% as gold pierced its historical high (unadjusted for inflation).

Leucadia, which is often priced along with miners because several of its biggest holdings are in mining, slid 2.7% as several factors combined to hurt the shares. The CEO of Fortescue, the Australian iron mining company in which LUK holds a significant stake, had been thought exonerated from charges of misleading investors about contracts with Chinese companies to import its iron-ore. But last month, an appellate court reinstated the charges, which crushed the company's shares. Another Leucadia investment in development of a coal gasification facility in Indiana also lately has run into problems. Also, shares in Inmet, the Canadian copper company in which LUK holds an 18% interest, are off 19% after absorbing two blows: first, its merger with Lundin has run into competing bids and second, the Panamanian government intends to repeal a recently passed law that made possible Inmet's development of a new copper mine that is considered crucial to its growth.

REITs had a mixed run. **Associated Estates**, the apartment REIT, advanced 4.9% but **Commonwealth REIT**, the old **HRPT Properties Trust**, which holds office buildings and light industrial properties, lost 0.8%, dropping sharply after earnings came in a penny short at 88 cents and Stifel Nicholas switched its rating from Buy to Sell. CWH's 7.5% dividend is among the highest available from property REITs with reasonable balance sheets and we expect the shares to recover from Stifel's blow. **CGM Real Estate Fund** slipped 0.3%, most likely because Heebner's exposure to mining shares restrained performance this month.

Healthcare was good. **Boston Scientific** is up 7.7% as value investors again seem willing to own BSX. **Pfizer** added 1.7% and **Johnson & Johnson**, thanks to its 54 cent dividend, is up 1.3%. We are concerned about JNJ, which continues to fumble along. It's as if John Wayne suddenly forgot how to ride a horse. But UnitedHealth, the HMO, loitering earlier in the month, jumped after other HMOs reported excellent results. UNH finished 4.6% higher.

Hambrecht & Quist Life Sciences Fund has been doing

well, but this month is up just 0.3% after factoring in the 25 cent distribution. The discount from NAV has slipped to under 9%, and we'll need to see an increase in NAV to make us comfortable with continuing to hold these shares.

Stryker, the orthopedic device and hospital equipment maker, is the healthcare standout, up 8.8%. Hospitals are seeing more visits, though admissions for other than out-patient care continue to lag. Bad news for competitors might have helped SYK. The FDA is scrutinizing all-metal hip replacements for material failure and negative outcomes. Stryker does not make all-metal hip replacements.

Wal Mart got clobbered by quarterly results, which showed sliding same-store U.S. sales, but it was fear that escalating gas prices will force its primarily blue-collar customers to cut back on other purchases that really sunk the shares. WMT fell 7.1%. Management did announce a 21% increase in the dividend to \$1.46 for a 2.8% yield.

Telecom New Zealand, which along with the entire New Zealand economy, was shaken by a massive earthquake on February 22nd that shattered much of Christchurch, the capital of South Island, fell 6.9%. Some of the loss is attributed to selling panic and some can be explained by the sharp drop in the value of the NZ dollar, the result of lost revenues and expected borrowing by the NZ government to pay for rebuilding. We respond, as investors, to events like the earthquake as a wary buyer, since rebuilding shattered infrastructure often benefits an economy. As someone living in an earthquake prone part of the country, we shudder. As for the fallen currency, we expect that will recover in time. The focus should be on longer-range issues, the most important of which is NZT's intention to split into two segments: a wholesale business now done under the name Chorus, and a retail services division. This division is essential for NZT to participate in the government's ultrafast broadband initiative that will rewire the country to bring high speed connectivity both to cities and rural areas. The government insists that NZT, which at one time enjoyed a state monopoly on all telecom services, would not have a dominant position that could quash competition. We're working on the assumption it will go through and that NZT will enjoy significant benefits.

Media stocks are doing nicely. **TimeWarner** added 4.4% and continues to build on excellent quarterly results built around its cable channels (it spun off its cable transmission business last year), which accounted for 70% of operating profits. TWX is upping the dividend 11% and busy buying back shares. **Comcast** also is higher, up 9.8%, benefitting from the same trends: better margins, improved advertising revenue and in the case of its services, migration of customers from single services to the triple-play package (cable, phone and Internet). Management also announced a 19% increase in its annual dividend (to 45 cents a share) and a \$2.1 billion stock buyback to be completed by the end of 2011. Acquisition of NBC Universal, completed recently, is already bringing in sales from its cable division, but Comcast sees significant potential in the network TV brand, which has languished.

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
Associated Estates Realty Corp	AEC	NYSE/Nasdaq	\$16.06	4.23%	\$17.00	BUY
CommonWealth REIT***	CWH	NYSE	\$26.77	7.47%	\$30.00	BUY
Telecom New Zealand	NZT	NYSE	\$7.92	9.07%	\$9.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$96.58	0.23%	\$100.00	BUY
CarMax	KMX	NYSE	\$35.15	0.00%	\$38.00	BUY
CGM Realty Fund	CGMRX	800-343-5678	\$27.68	2.23%	N/A	BUY
Comcast	CMCSA	NASDAQ	\$25.55	1.28%	\$28.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$37.07	1.34%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$114.35	1.08%	N/A	BUY
Fastenal	FAST	NASDAQ	\$61.85	2.30%	\$65.00	BUY
Gabelli Global Telecom Fund	GABTX	800-422-3554	\$21.03	1.71%	N/A	BUY
Honeywell	HON	NYSE	\$56.51	2.34%	\$62.00	BUY
International Speedway Corp.	ISCA	NASDAQ	\$27.99	0.57%	\$32.00	BUY
Johnson & Johnson	JNJ	NYSE	\$61.06	3.54%	\$68.00	BUY
Leucadia National Corp.	LUK	NYSE	\$32.40	0.77%	\$38.00	BUY
Mattel	MAT	NASDAQ	\$25.52	3.61%	\$29.00	BUY
Microsoft	MSFT	NASDAQ	\$25.95	2.47%	\$31.00	BUY
Molson Coors Brewing	TAP	NYSE	\$44.24	2.17%	\$54.00	BUY
Paychex	PAYX	NASDAQ	\$33.30	3.72%	\$40.00	BUY
Pfizer	PFE	NYSE	\$19.66	3.66%	\$21.00	BUY
Stryker Corp.	SYK	NYSE	\$63.67	0.94%	\$70.00	BUY
Superior Industries	SUP	NYSE	\$19.87	3.22%	\$24.00	BUY
Tetra Tech	TTEK	NASDAQ	\$23.11	0.00%	\$30.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$52.26	1.85%	N/A	BUY
Time Warner	TWX	NYSE	\$37.25	2.52%	\$40.00	BUY
United Parcel	UPS	NYSE	\$72.44	2.87%	\$79.00	BUY
UnitedHealth Group	UNH	NYSE	\$44.45	1.12%	\$49.00	BUY
Wal-Mart Stores	WMT	NYSE	\$52.07	2.32%	\$60.00	BUY
Xerox	XRX	NYSE	\$10.49	1.64%	\$14.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUKY.PK	PINK SHEETS	\$26.75	0.00%	\$30.00	BUY
EnCana	ECA	NYSE/TSE	\$32.31	2.48%	\$37.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$28.05	0.15%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$40.89	4.11%	\$42.00	BUY
PowerShares Water Resources ETF	PHO	NYSE	\$19.65	0.52%	\$21.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$41.11	11.20%	N/A	BUY
Aggressive Growth						
AMN Healthcare	AHS	NYSE	\$7.54	0.00%	\$8.50	BUY
AOL Inc.	AOL	NYSE	\$21.94	0.00%	N/A	SELL
Boston Scientific	BSX	NYSE	\$7.53	0.00%	\$8.50	BUY
Davis Financial Fund	DFIBX	800-279-0279	\$22.46	0.00%	N/A	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$11.47	6.71%	\$12.67	BUY
Maxim Integrated	MXIM	NASDAQ	\$27.51	3.05%	\$29.00	BUY
Seligman Premium Growth Fund	STK	NYSE	\$19.97	9.27%	\$22.00	BUY
Symantec	SYMC	NASDAQ	\$17.72	0.00%	\$20.00	BUY
Third Avenue Focused Credit Fd	TFCVX	800-443-1021	\$11.65	7.17%	N/A	BUY
Transocean	RIG	NYSE	\$84.95	0.00%	\$90.00	BUY
UltraShort 20+ Treasury ProShares	TBT	NYSE	\$38.68	0.00%	N/A	BUY

* Prices as of Friday, March 4, 2011

** Yield represents all distributions during previous 12 months divided by current share price. Note that all fund distributions fluctuate annually.

*** Name and Ticker changed from HRPT (HRP--NYSE)

BUY, HOLD, SELL OR LIMIT IN BOLD INDICATES A CHANGE IN ACTION OR LIMIT

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

The rising tide of home foreclosures began in 2007 as a symptom of faltering real estate markets across the country. But as the rising tide turned into a tidal wave, falling real estate prices have compromised the assets of the US banking system and the fabric of the US and worldwide economies. Indeed, the state of the nation's real estate markets and the economy have become one and the same. Clearly, the recession cannot be fully put behind us and a recovery kick into full gear until the inventory of foreclosed homes stops overhanging the market.

We have seen all this before. It was back in the 1980s. After years of loose and questionable lending practices, regulators were forced to liquidate hundreds of savings and loans and dump their foreclosed real estate onto an already-depressed real estate market. As values dropped, the downward spiral continued until most of the real estate was sold at steep discounts. The crash was worse in some parts of the country, but the damage to the whole US economy was substantial. Does this sound familiar?

We have the same situation today. It's like the old good news/bad news jokes, except this is no laughing matter. The bad news is that today's crash has been damaging, to both real estate prices and the national economy.

The good news is that we have the tools to determine when the bad news will be over. This will give us a tremendous opportunity to not only invest in real estate for pennies on the dollar at the right time, but also in other investments as well that benefit from a recovering economy.

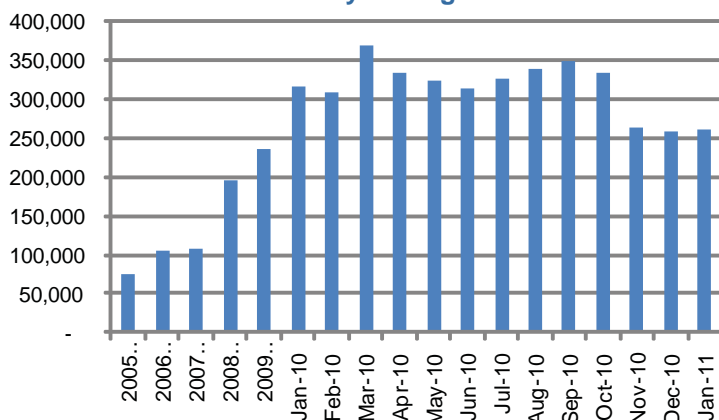
The Key Indicator

The secret is to focus on foreclosure rates. Fortunately, Realty Trac in Irvine California has an extensive data base. You can access foreclosure information on local markets from their website www.realtytrac.com. We use some of their data here to gauge the state of the nation and its real estate, and plan to continue to do so in future issues of **SoundAdvice**.

Take a look at the chart below on US foreclosure rates.

In 2005, foreclosure rates averaged 74,892 properties per month. In 2006 and 2007, foreclosures were slightly above 100,000 per month. However, by the time January

US Foreclosure Rates
Monthly Averages



Source: Realty Trac

2010 rolled around, foreclosures climbed to over 300,000 per month, and foreclosures continued to persist over 300,000 each month through October.

What we are looking for is a significant decline in the number of foreclosures. When this happens, the bulk of the overhanging inventory of foreclosed properties will have been digested, and the recovery can then begin in real estate as well as the economy. In the late 1980s, this was the best indicator for knowing when the recovery was near. As foreclosure rates dropped, the ensuing recovery began. For nearly two decades, fortunes were made from real estate purchased for pennies on the dollar during the S&L Crises of the 1980s.

We saw the beginnings of a decline in the fourth quarter with a 21 percent drop in November followed by a 1.8 percent decline in December. However, there was a foreclosure freeze in October by Bank of America that began on October 8th which continued through most of the month on 102,000 foreclosure actions. JP Morgan Chase also had a freeze on 56,000 actions. The GMAC unit of Ally Financial also had a freeze.

That freeze had lingering effects in November and December due to the lead time involved in gearing up again. In addition, the seasonal trend in recent years is for November and December to decline. So the majority of the decline during November and December was due to seasonal factors and by the foreclosure freeze.

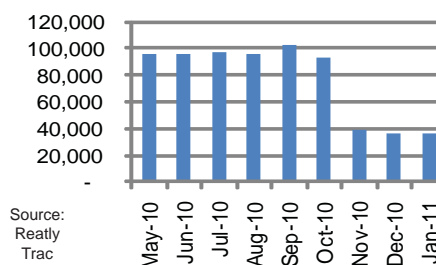
In January, the latest data available, foreclosures increased by 1.4 percent, putting an end to the decline.

While foreclosure rates are a leading indicator, we believe that some of the data that goes into compiling the foreclosure rates has even better predictive value. This is because the number of foreclosures is measured by adding up the properties in each of the three stages of the foreclosure process: new default filings by lenders; then auctions as lenders attempt to sell these properties; and finally, bank repossessions of those properties not sold through auctions. Because the first stage, new default filings, is the first step in the foreclosure process, it should therefore be an early indicator of a change in trends.

This chart shows new US default filings by month since May 2010.

October showed a 9 percent decline followed by a whopping 58 percent decline in November, and a 7 percent decline in December. These were much larger declines than for foreclosures as a whole, which could be expected from a leading indicator. Again, seasonal factors and the freeze were major factors. New default filings were virtually unchanged in January. We will be keeping a close eye on new default filings in the months directly ahead.

US New Default Notices



Source: Realty Trac

Where are the Foreclosures?

While the foreclosure crisis is a nationwide problem, the bulk of foreclosed properties are not evenly scattered across the country. The table below shows where 70 percent of the foreclosed properties were in January.

Foreclosure Activity - January 2011

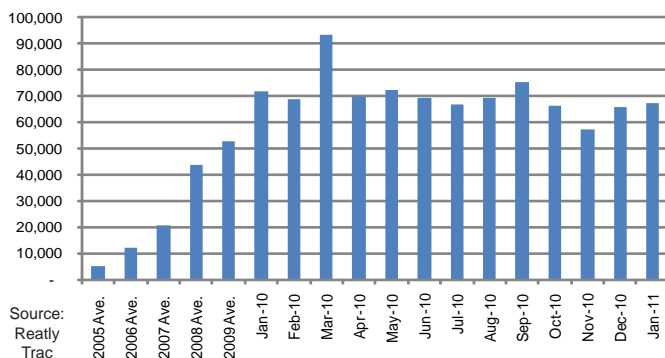
	Number of Properties	Percent of Total	One in every	Monthly Change
US	261,331	100.0%	497	1.4%
CA	67,072	25.7%	200	1.8%
FL	21,671	8.3%	409	-15.5%
MI	16,716	6.4%	272	4.1%
AZ	15,575	6.0%	175	14.9%
TX	14,897	5.7%	653	33.5%
IL	13,664	5.2%	402	-2.7%
GA	12,772	4.9%	318	15.7%
NV	12,263	4.7%	93	-9.0%
OH	8,924	3.4%	571	-15.2%

Nevada (NV) has earned a reputation as the foreclosure capital. That is because it has the highest number of foreclosures in relation to the number of houses there. The table shows that 1 of every 93 houses was foreclosed upon in January, which is the highest concentration of foreclosures in the nation. While that may be important to a homeowner or real estate investor in Nevada, other states are a larger burden on the national economy, notably California.

More than a quarter of all foreclosures were in California. We need to keep an eye on California. Any changes in foreclosure trends there could lead to a significant change in the trend for the national economy as a whole. Take a look at the chart of California Foreclosures - Monthly Averages.

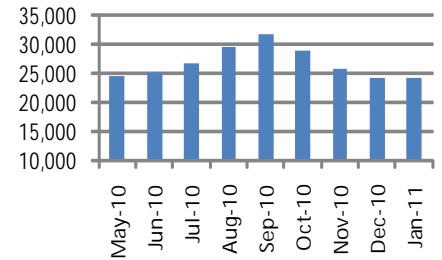
In 2005, foreclosures averaged 5,138 properties in California. Foreclosures doubled in 2006, and again in 2007, and again in 2008. By 2010, foreclosures were close to 70,000 each month, with a spike of 93,000 in March. After dropping 12 percent in October and another 14 percent in November, California foreclosures increased 15 percent in December and another 2 percent in January, which is not an encouraging sign.

California Foreclosures - Monthly Averages



However, new default notices in California declined by 6 percent in December and by 0.9 percent in January, which is somewhat encouraging.

California New Default Notices

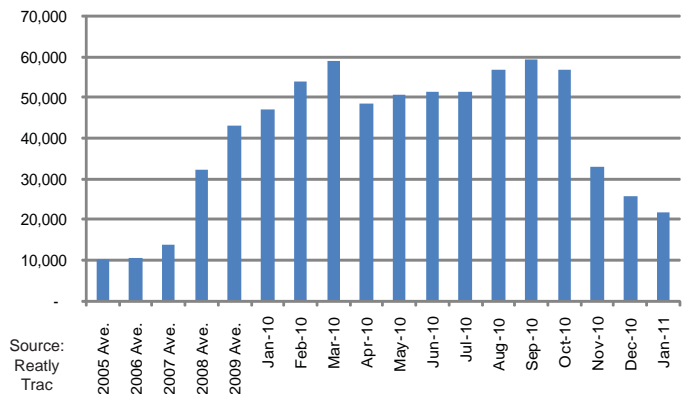


Florida Turnaround

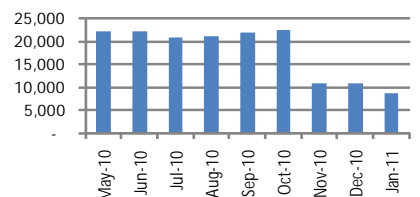
Florida foreclosures climbed from 10,000 per month in 2005 and 2006 to 47,000 in January 2010, and stayed in the 50-60,000 range through October. Then the rate dropped sharply by 42 percent in November, again by 22 percent in December, and then again by 15.5 percent in January.

Last October, Florida accounted for 17.1 percent of all foreclosures. In January it accounted for 8.3 percent. Foreclosures in Florida dropped by 62 percent from October to January.

Florida Foreclosures - Monthly Averages



Florida New Default Notices



New default notices in Florida dropped off sharply during the last three months, leading the way to the decline.

Conclusions

The downtrend in Florida is encouraging. However, we continue to see increases in California, Michigan, Arizona, Texas, Georgia, as well as the nation as a whole. The mixed results reveal that the foreclosure crisis is still ongoing.

We will be tracking these foreclosure metrics closely in these pages of **SoundAdvice** to be among the first to know when the end of the foreclosure crisis is at hand. That will mean you can make enormous profits in real estate, as well as other investments that benefit from a robust economic recovery. Stay tuned.

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 a "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 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 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 \$7,770,176 in stocks and to \$1,226,569 in houses.

But though an investment begun 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 Risk Indicator he would have made \$308,832,600, 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 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. A recent example was during the 1998-2000 stock market mania, when most investors were chasing high-tech stocks, our *Sound Advice* portfolio was buying the REITs. Most investors got killed with 75 percent-90 percent losses during the ensuing decline. However, Real Estate Investment Trust shares during the same period soared 25 percent, and had locked in nearly double-digit dividends. When the bear market ended in late 2002 and tech stocks recaptured some of their losses, REITs rolled to mind-boggling highs as speculation drove them to excess that climaxed in 2007.

The SoundAdvice Risk Indicator

The latest reading for the **Sound Advice** Risk Indicator is 1.41. This reading reveals that stocks are slightly above their average relative 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 renew your subscription.)



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

To construct our 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 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 Diffusion Index of Leading Indicators: As far back as February and March 2009 we were projecting that our Diffusion Index of leading indicators would hit zero in March, 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.

An "Aggressive" signal coming at a time when the Risk Indicator is close to 1.0 reveals that Supercycle 5 has come to an end, and that Supercycle 6 is born. The current reading is 25 percent, which does not change our market perspective. That will change only with a signal from the Lagging Indicators.

The 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 reveals a strengthening economy and inflationary pressures ahead. Our next signal will come from this Index. This Diffusion Index currently stands at 16.7 percent.

Track Record of the 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 produces an annual average return of 23.4 percent. During "Caution" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased at an annual rate of only 1.62 percent during caution periods.

Aggressive	S&P	Caution	S&P
Sep-74	68.12	Apr-76	101.90
Nov-79	100.00	Oct-83	167.65
Dec-84	164.48	Jun-85	188.89
Jul-86	240.18	Aug-87	329.36
Mar-88	265.74	Jun-88	270.68
Mar-89	280.00	May-89	313.93
Oct-89	347.40	Mar-93	449.74
Feb-97	798.38	Dec-98	1,141.00
Oct-00	1,429.40	Dec-00	1,320.28
Jun-03	974.50	May-05	1,191.50
Jul-06	1,276.66	Mar-08	1,325.43
Apr-09	865.33		

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 subscription, and you will also receive an updated copy when you renew your subscription.)

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