



The *Sound Advice* portfolio is up 25.1 percent so far this year. This compares to 12.3 percent for the S&P 500. We have an average gain in the *Sound Advice* Model Portfolio of 44.8 percent based on the prices at which each stock or mutual fund was recommended. In this Issue, we update all of our current recommendations. We begin with our “No-Brainer”, the reverse ETFs that will benefit strongly from a rise in yields on long-term Treasury bonds.

We then update all of our other recommended positions in alphabetical order. See the table on page 7 for buy limits and other information on each recommendation.

The strength in the housing market is significant. As you will see from our discussion on pages 10 and 11, we are now seeing the beginning of the end of the foreclosure crisis and the dampening effect it has had on our economy.

Markets in the west and especially California are particularly strong where more than 25 percent of the nation's foreclosed homes once were. Investors have been buying distressed homes to the extent that there is now very little supply of foreclosed homes.

Even in the face of the fiscal cliff and a recession in the Eurozone, the US economy can still recover if its banking system and real estate markets are not dragging it down. The fiscal cliff will pass and Europe has no choice but to work it out.

As further confirmation of an economic recovery, we are seeing significant increases in the leading indicators, especially those that make up our Diffusion Index of Leading Indicators.

**-Gray Emerson Cardiff**

## Housing Recovery: For Real?

The avalanche of home foreclosures that began in 2007 compromised the assets of the US banking system and undermined the entire US economy. At such climatic times, the nation's real estate markets and the economy become tethered together, and a sustainable recovery in the economy is not possible without the sale of the bulk of the foreclosed real estate overhanging the market.

We have seen this before in the Savings and Loan Crisis of 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 already-depressed real estate markets. Although the crash was most severe in Texas and other energy belt areas, the damage undermined the whole US economy. However, once the inventory of real estate was sold off, the economy was able to recover once it was unfettered by the overhang.

Real estate prices not only recovered from the 1980s debacle, they boomed for decades. During a real estate crash, financing dries up which freezes building. The supply shrinks for the most desirable new homes in good locations, which lays a foundation for a strong price recovery. As the housing recovery unfolds, consumer confidence grows, and consumer spending increases, which accounts for two-thirds of the economy. That is the cycle, and today is no different.

Home prices increased again in August, marking the seventh consecutive monthly increase. Such a string of increases has not happened since early 2006, when the housing boom was in full force.

The August FHFA house price index was 4.7% above its year-ago level, the largest yearly increase since August 2006. This reading follows a 3.7% year-over-year increase in July and a 3.8% increase in June (see the chart).

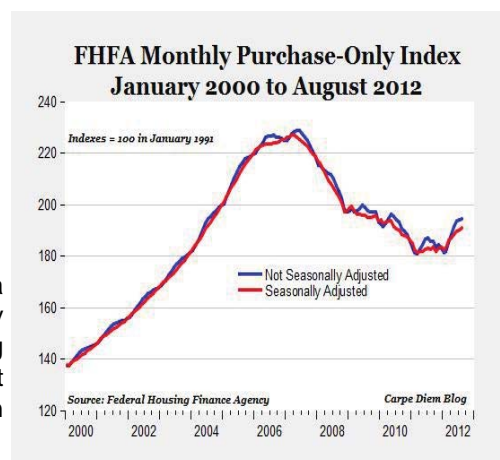
The S&P/Case-Shiller index, which is a three-month moving average of property values in 20 cities, is also showing strong and persistent gains. It was up 2 percent in August after climbing 1.2 percent in July.

As we point out in our Foreclosure Watch on pages 10 and 11, new default notices were down 11 percent nationally in September. New default notices are the first step in the foreclosure process, and thus a leading indicator. In California, where 25 percent of the foreclosures once were, new default notices have been down dramatically during the most recent three consecutive months. The biggest complaint we hear from investors in the west is that there is now only a small supply of foreclosed homes in which to invest.

Consumer confidence is also clearly on the rise. In September, The Thomson Reuters/University of Michigan, the sentiment gauge for consumer confidence, climbed to its highest level since September 2007 which was before the recession began.

### Our “No-Brainers”

A recovery of the nation's real estate market and economy bodes well for our ‘No-Brainer’ ETFs which are designed to profit greatly from an increase in long-term Treasury Bond yields.



Over please ...

If you are risk averse, you can choose the **Proshares Short 20 Plus year Treasury (TBF-NTSE)**, which uses no leverage.

For 2:1 leverage, you can invest in **Proshares Ultrashort Lehman 20 Plus year Treasury (TBT-NTSE)**. This ETF recently had a reverse split of 1 to 4. The shares are trading at four times the price and you now have one-fourth the number of shares.

The most responsive ETF, the **Direxion Daily 20 Plus Year Bear 3 Shares (TMV-NYSE)**.

You can manage your risk by the amount you invest. You can also invest in stages, buying at different times and averaging your cost basis. We do not see much room for long-term rates to go lower. The greatest and most explosive movement will be upward, and the profit potential is enormous with these ETFs.

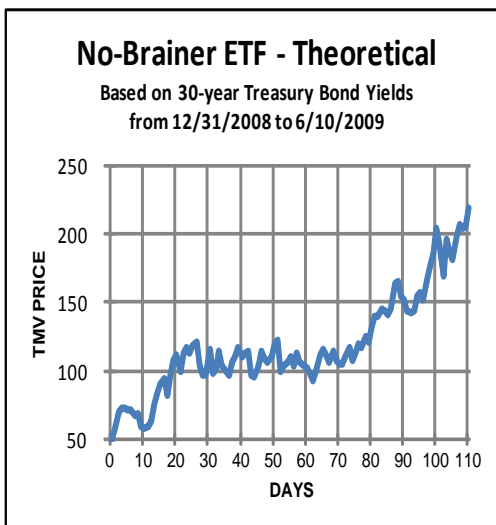
To exemplify, we look back at the period from December 31, 2008, when 30-year Treasuries were yielding 2.69 percent. By June 10, 2009, yields had climbed to 4.75 percent. These ETFs did not exist back then. (They were created in April 2009.) To see how they would have behaved, we can use the daily history of percentage changes in 30-year Treasury bond yields. Starting with a price of \$50 a share for TMV, we can apply three times the reverse of the daily changes (because TMV uses 3:1 leverage). Based on this history, TMV would climb from \$50 to \$219.55 per share – more than 4 times – in 110 days. See the chart.

Regardless of the outcome of the elections, QE3 is still in force. It is an open-ended commitment to buy \$40 billion of mortgage backed securities every month (packages of home loans created by Fannie Mae and Freddie Mac), along with about \$45 billion in monthly exchanges of shorter-term debt for longer-term debt. This commitment has been promised to continue until the employment situation improves “substantially” even after the economy begins to recover.

To make these massive purchases, the Federal Reserve creates the money to do so – it basically prints the money.

Moreover, our national debt has grown alarmingly in recent

years. It is close to \$15 trillion when external debt is included – debt owed to creditors outside the country. Our national debt is now close to 100 percent of our GDP.



It's difficult to imagine that the Federal Reserve will be able to smoothly drain the trillions of dollars worth of new money and credit it has pumped into the U.S. economy.

In the aftermath of any recession, interest rates always rise. It is as simple as that. This will be especially true for yields on long-term Treasury bonds because their yields carry the highest premium for the uncertainties of inflation for the upcoming decades.

With the additional national debt and need to sell that much more in Treasury bonds to finance that debt, yields on long-term Treasuries are likely to climb significantly higher than 4.75 percent. The move upward in long-term bond yields is bound to be breath-taking.

## Portfolio Updates

Here are updates on the rest of our recommendations, in alphabetical order. See the table on page 7 for buy limits and other information on each recommendation.

**Agrium (AGU)** is up 57 percent this year, extending our profit to 778 percent. We originally recommended this stock and continue to hold it because it is the largest farm products retailer in North America, and because it is a wholesaler to the rest of the world. In order for emerging markets to meet their needs for food, they will either have to import foodstuffs from the more advanced countries or, better for the fertilizer industry, use fertilizer to improve their crop yields. Either way means more use of fertilizers.

Last year's Midwest drought led to lower crop output during most of 2012 which means fertilizer demand for the next planting season will rise rapidly. Its strong revenue growth rate, which averaged 30 percent annually over the last five years, is bound to continue.

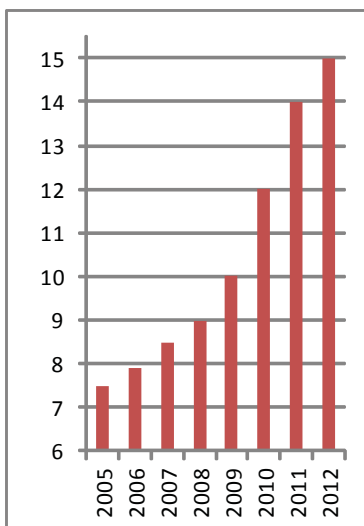
AGU recently completed its “Dutch Auction” whereby the company offered to buy back up to 9,473,684 of the outstanding shares at a price range of \$95 to \$107 per share. The company started buying shares offered at the low end of the range and paid an average of \$103 per share for 8.7 million shares.

AGU also recently announced it will be doubling its dividend to \$2.00 annually and switch to paying it quarterly.

**AMN Healthcare (AHS)** is up 124 percent this year. We have a 87 percent gain and expect considerably more.

AMN Healthcare provides temporary healthcare staffing services to the healthcare industry, ranging from nurses to physicians. The rationale for buying AMN Healthcare is a two-fer. AHS is not just an

## US National Debt



Gray Cardiff's Sound Advice is published monthly by S.A. Newsletters, LLC. Editor-in-Chief: Gray Emerson Cardiff. Managing 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. ©2012 S.A. Newsletters, LLC. When securities are initially recommended herein, the editors, affiliates, and associates of the editors do not have positions in such securities and are required to wait at least seven days from the date Sound Advice is mailed before placing orders for them. After the initial recommendation, editors and staff members may own stock of any or all of the companies discussed herein.

opportunity to invest in healthcare, which is traditionally a non-cyclical industry, but it is also a chance to buy into a healthcare business that will benefit from a recovery in the economy.

On October 17, Staff Care, an AHS company was selected to be the single-source provider for temporary physician staffing by Novation, the healthcare industry's supply chain and contracting company for the members of VHA Inc., UHC, Children's Hospital Association, and Provista.

**Associated Estates Realty Corp (AEC)** reported third quarter funds from operations (FFO) that were 18.5 percent higher than one year ago. Net operating income from the properties held over the past year increased 6.0 percent and physical occupancy was 97.3 percent, an increase from 94.8 percent.

AEC is the most undervalued apartment REIT in the sector. It was once a low-income apartment REIT, but that is no longer the case. AEC has disposed of its older properties, most of which were sold during real estate's more buoyant years, and has replaced them with class- A apartment properties. During the third quarter AEC added three more class-A apartment properties to the portfolio, two in North Carolina and one in Dallas, Texas.

The equity of its apartment portfolio translates into a stock value that is nearly double the current stock price. It pays a nice yield as well. We have a small profit, and expect much more ahead.

**Boston Scientific (BSX)** is a classic turnaround story. It has had flat earnings this year due to lower demand for surgeries that require the company's devices produced by its cardiology and cardiac rhythm management segments. However, a brighter day is ahead from innovations and acquisitions.

Its Subcutaneous Implantable Defibrillator (S-ICD) which is implanted under the skin without touching the heart or blood vessels, recently received approval from the FDA. These are currently being used widely in Europe, and there are vast new markets in India and China. BSX expects to see significant revenues from their IDCs beginning in 2016.

Other BSX innovations include its Epic Vascular Self-Expanding Stent System, designed to open blocked arteries.

The company's oncology product line continues to be strong. It recently launched two well-received products: the Renegade HI-FLO Fathom microcatheter and guidewire system, and the Interlock - 35 Fibered IDC Occlusion System for peripheral embolization.

We do not have a profit in BSX, but expect to within the next 12 months. That's not just our opinion -- BSX is buying back its own stock in an aggressive share-repurchase program. This alone will boost earnings, not to mention the introduction of new innovative products. Gains from the current price should be substantial.

**CGM Real Estate Fund (CGMRX)** is up 6 percent this year, extending our profit to 50 percent. We got back into it again after the 2008-09 crash in REIT prices.

CGMRX is as good as it gets for a REIT fund. CGMRX put on quite a fireworks show between 2003 and 2007 (+89.7%, +35.5%, +27%, +29%, +34.4%). We made a 145% profit during that period.

Ken Heebner, has run the fund since its inception in 1995.

He is known as "The Mad Bomber" because he has never been considered cautious. He either outperforms or underperforms significantly, and this fund can be volatile, but Heebner's good years are really good. We watch his portfolio choices closely, so that we can judge whether the holdings make sense to us.

**Chesapeake Energy (CHK)** is up 21 percent since it was included in the portfolio earlier this year and expect a great deal more.

We added it because it has natural gas assets worth in excess of \$27 a share. The shares were cheap for three reasons: low natural gas prices, poor corporate governance, and a cash shortfall.

Since then, natural gas prices have climbed 50 percent, and Carl Icahn bought a stake and has been instrumental in removing the founder, Aubrey McClendon, as chairman of the board and replacing several other board members. The spotlight is on the board to maximize shareholder value.

CHK has also made progress on selling assets to straighten out his cash squeeze. So far in 2012, CHK has divested itself of approximately \$12 billion of assets. CHK has also reduced its executive compensation.

### **CNG in A BOX**

Along with GE, CHK announced the launch of "CNG in A BOX" which is an easy-to-use high-speed filling station for vehicles running on compressed natural gas (CNG). Currently there are only approximately 1,000 natural gas filling stations around the country, as opposed to more than 160,000 existing gas stations. The "CNG in A BOX" are all-inclusive natural gas pumping stations designed to be installed in existing gas stations.

The proliferation of CNG pumping stations makes vehicles running on CNG that much more attractive. In mid-October, Chrysler announced a CNG option for its Ram line of pickup trucks. Honda currently sells CNG vehicles. Ford is planning the introduction of its F-series truck with a CNG option. GM will also have its CNG version of the Chevy Silverado truck.

As CNG stations become more available, CNG cars will become more practical. The expanding use of CNG in autos will go a long way in establishing US intendance on foreign oil.

### **The Utica Shale**

The natural gas and oil assets of CHK are extensive and offer a tremendous upside. CHK has quietly acquired more than one million acres in the Utica Shale including 87 wells, which is a larger holding than any other energy company.

The U.S. Geological Survey (USGS) estimates the Utica Shale contains about 38 trillion cubic feet of undiscovered natural gas, 940 million barrels of oil, and nine million barrels of natural gas liquids like ethane and propane. The Utica Shale extends over six states, from West Virginia to Ohio, across Pennsylvania and into to New York.

The Utica Shale and Marcellus Shale (the largest known shale formation in the US) are located in the same place. The Utica Shale lies approximately 2000 feet below the Marcellus Shale.

In Ohio, the Utica Shale slopes up closer to the surface, allowing for cheaper drilling and production. CHK stands best to gain from this area of the Utica Shale.

CHK is also a play on the yawning gap between the energy equivalents of oil and natural gas. In comparison to oil, an equal amount of energy in the form of natural gas costs less than 20 cents on the dollar.

During the last three months, insiders have purchased 1.5 million shares of CHK.

**CommonWealth REIT (CWH)** announced the “dividend adjustment” management has been warning about for the last two months. The quarterly dividend was reduced to \$0.25 a share from \$0.50. The price of CWH did not change significantly on the news because it was widely expected.

In keeping with its previous announcement, Management lowered its common share dividend rate “in part, because it believes that retaining more cash flow may enable the company to more aggressively lease space and increase occupancy at its properties in the current market conditions.”

Funds from operations FFO had been well in excess of the previous dividend, which is the normal guide and source of funds for dividends. However, in its warning, management referred to the previous dividend as being above 100 percent of the company’s cash available for distribution (CAD). Unlike FFO, cash available for distribution includes capital expenditures (which include tenant improvements, leasing costs, building improvements, and development activities.) Normally, capital expenditures are amortized over a number of years which is why they are not included in the FFO calculation.

Based on the second quarter’s CAD (the most recent figures available) the dividend could have been reduced to \$0.37 a share (instead of \$0.25) in order to have CAD cover the dividend. Therefore, CAD is now in excess of the new dividend.

We believe this news defines a buying opportunity. The uncertainty over the dividend is over. The new dividend is now well-covered and solid, and the comparatively high 7 percent yield puts a floor under the stock price. The cash retained from the reduced dividend should translate into improvements in property operations.

The equity in the underlying real estate portfolio works out to be \$33 per share, even using a 9 percent capitalization rate which is conservative these days. Share prices have considerable upside from here and should start to move when growth in FFO begins to materialize.

**Comcast (CMCSA)** is up 58 percent this year, extending our profit to 107 percent. This is considered the best managed cable company. Earnings are growing nicely. Third quarter earnings were just reported and was up 15 percent, benefitting from advertising on the Olympics.

CMCSA is also an indirect play on the real estate recovery. The housing recession has had a dampening effect as foreclosures and the accompanying financial stress has reduced customers. New signs of life in the housing market will be a strong benefit.

**Fidelity Select Natural Gas Fund (FSNGX)** is a diversified play on the yawning gap between the energy equivalents of oil and natural gas. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. (This value is approximate because various grades of oil have

slightly different heating values.) So if a barrel of oil is say, \$100, that is the cost of 5.8 million BTUs of energy.

On the other hand, the market price for natural gas is close to \$3.00 for one million BTUs. To buy 5.8 million BTUs will cost \$17.40 (5.8x\$3.00). So the same amount of energy is available for approximately 17.40 cents on the dollar -- if it is in the form of natural gas.

As the chart shows, this is not a normal situation. 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. Note the current yawning gap between the costs of these two forms of equivalent amounts of energy. For 5.8 million BTUs, it costs approximately \$100 if it is in the form of oil, but only \$17.40 in the form of natural gas.

So the question becomes whether or not we should expect today’s disparity to be a more or less permanent situation, or is it an anomaly? If the gap is going to close anytime soon, there is money to be made because the price of natural gas is certain to rise from its historic low, and the industry is going to become more active.

One explanation for the disparity is the fact that the market for oil is a world market, where the market for natural gas is not. Oil is transportable which makes its price subject to the world’s supply and demand balance. Natural gas is not as readily transportable around the world because it first must be liquefied by maintaining its temperature at -260°f. Therefore, natural gas is more of a continental market.

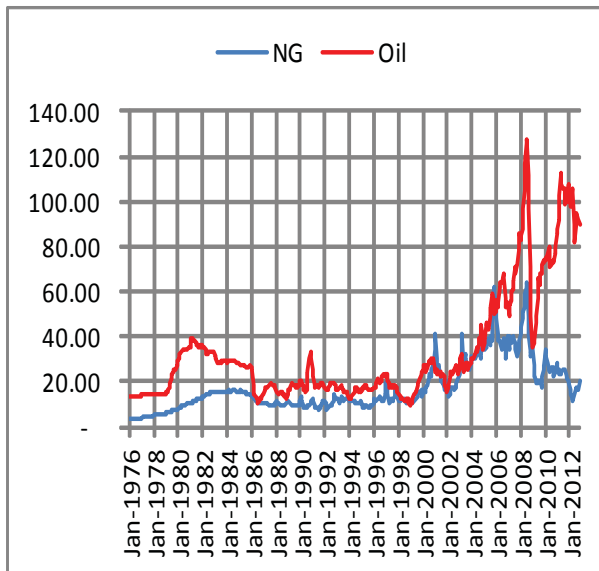
Still, energy is energy. To the extent one form can be substituted for another, the price per BTU should be approximately the same.

There is an extensive infrastructure of pipelines across the US to deliver natural gas, certainly within every metro area. Fifty-five percent of all US homes are heated with natural gas. That still leaves nearly half that are not, and the conversion is relatively simple and inexpensive. When it comes to generating power, 31% is generated by natural gas in the US, but the rest is not. Natural gas has 30% less harmful emissions than those that come from oil, and 45% less than those from coal. And Japan’s unfortunate nuclear accident has cast a pall over developing more sources of nuclear energy for the foreseeable future.

The US is self-sufficient in natural gas with only 9 percent imported from Canada. At 17.4 cents on the dollar versus oil, natural gas is bound to have a growing role in America’s energy needs as well as independence from importing oil.

This is the only mutual fund that concentrates on the natural gas industry. It is one of Fidelity’s stable of tightly focused sector funds. The fund

**The Cost of Energy Equivalents of Oil and Natural Gas**



has a relatively new manager, Ryan Oldham, who has been at the helm since mid-2010, and who is no stranger to energy. He worked as an analyst for Canadian energy companies and global exploration and development firms.

This fund is well positioned to benefit from an expanding natural gas industry, and should bring strong profits in the months ahead.

**Hambrecht & Quist Life Sciences Fund (HQL)** is up 30 percent this year, extending our profit to 52 percent. This is a closed-end fund (CEF), which means it trades not at its Net Asset Value (NAV) but at whatever price the market sets, which can create a discount or a premium to NAV. HQL is currently trading at a discount to its NAV. This fund has done well since the 2008 crash, posting double digit returns every year.

We think HQL is a superior way to gain exposure to biotech on a diversified basis, which is a volatile sector. However, the most explosive profits in the entire healthcare industry can be found here. This mutual fund has climbed inexorably most of the year, and should continue to do so.

The Fund began purchasing up to 12% of its own shares on the open market beginning in July. The share repurchase program is intended to increase the Fund's net asset value per share and to reduce the 4 percent discount the stock currently has from the net asset value.

**Leucadia (LUK)** is essentially unchanged for the year, leaving us with a small 10 percent profit. This is a holding company with a portfolio in excess of \$9 billion of assets that is as focused as the wide-ranging eyes of its two principals, Ian Cumming and Joseph Steinberg, who have been compared to Warren Buffett in their success at identifying lucrative investments that can be purchased substantially below their intrinsic value. In fact, Buffet continues to team up with the Leucadia team on joint venture investments.

Skillful investing has produced double digit growth rates in its assets since 1979. After a bad year in 2008, assets have since grown by 150 percent according to Morningstar. The nature of their most recent investments in start-up biotech and energy companies offer a very large profit potential while affording relatively low risk. Several holdings are directly partnered with Warren Buffett.

We think that Leucadia is valued well below the market prices of its disparate parts.

**Masco (MAS)** is up 44 percent this year, extending our profit to 104 percent. MAS manufactures a wide range of products for home construction and remodeling --everything from kitchen cabinets and faucets to windows and paint.

Not surprisingly the shares got hammered during the downturn. Management had been through tough times before, and began cutting costs even before the housing sector went into free-fall.

We added MAS to the portfolio in October 2011 at \$7.49, when it was languishing in the doldrums. Masco is moving to consolidate debt, close unprofitable plants, formulate and implement new systems, streamline global supply chains and cut personnel to cut costs. MAS expects to save \$150 million of gross cost reduction

before inflation with these policies.

MAS is an excellent way to ride the recovery in the housing market.

**Maxim Integrated Products (MXIM)** is up 6 percent for the year, extending our profit to 39 percent. We expect more. Even if MXIM's price ratios merely rise to the valuations of its average years, the share price should easily double from here.

MXIM is in excellent financial health with \$1.0 billion of cash and plenty of cash flow to support operations, as well as pay its quarterly dividend of \$0.22 per share – for an annual yield of more than 3 percent of the current share price.

Maxim's reputation is built on its top-notch engineering, especially in analog circuits. Though it's easy to think that digital has vanquished analog circuits, analog circuits are essential for receiving inputs from the non-digital world in which we live. After a signal has been processed, usually through a digital circuit, the signal has to be retransmitted into an analog format that we can interpret. A cell phone is a perfect example. After receiving a digital signal, it must be transformed into an analog format so that we can hear it.

The expertise to develop these analog chips is not easily duplicated and takes years to develop, which is an entry barrier for new competition. The designs don't require cutting-edge production techniques, so these chips have long and profitable product lives.

On the data center front, MXIM recently introduced its new transmitter chipset (40G) which supplies 4 times the bandwidth with very little electrical power. This is an important development because electrical power is the most critical constraint in data centers – those floors of computer servers that supply the "Cloud" we are all going to in droves for data and applications.

MXIM recently won notoriety for its solid state battery that harvests ambient energy. The device captures low-level energy forms, such as from photovoltaic cells, vibrations captured by a piezoelectric element, and heat captured

by a thermoelectric generator. This device can eliminate the need to run expensive power cables to remote locations or reduce the frequency of battery replacements.

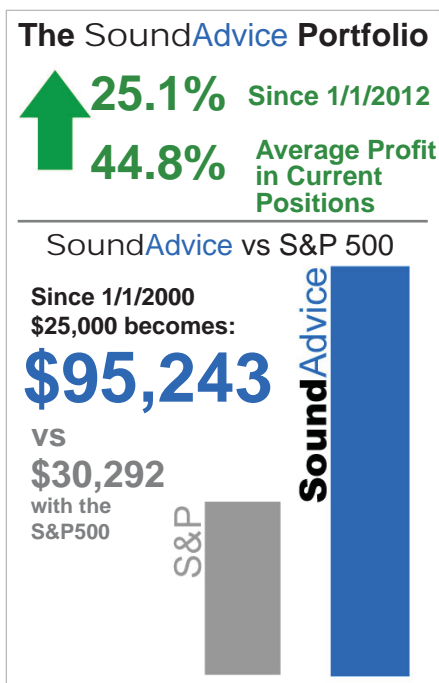
**Paychex (PAYX)** is up 8 percent this year, extending our profit to 21 percent, but there is a larger profit ahead with a recovery in the economy.

PAYX just increased its dividend and announced a share buy-back program of \$350 million of the common stock through May 31, 2014.

This is a classic "buying straw hats in winter" opportunity that offers considerable potential for capital appreciation, along with safety, and a nice yield of close to 4 percent.

Its core business is payroll services for small to medium sized companies. Accordingly, its revenues and earnings directly mirror the employment situation. Downside is limited because the balance sheet is pristine with no long-term debt exposure.

**Pfizer (PFE)** is still cheap because the patent expired on its blockbuster drug, Lipitor, and earnings have been dropping



sharply as a result. However, there are many new, potential blockbusters in the pipeline across several therapeutic areas.

Two potential blockbusters stand out of the late-stage pipeline: *Eliquis* is a treatment for stroke prevention, and *Tofacitinib* is a treatment for rheumatoid arthritis.

Another drug, Xalkori is proving to extend the lives of lung-cancer patients, without their disease worsening, for twice as long as the standard therapies.

PFE is buying back its own shares. We agree with that decision. We have a profit of 47 percent and expect more.

**Retail Opportunities Investment Corp (ROIC)** is up 6 percent this year, extending our profit to 17 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, with no debt and no problems. It is a simple model: buy distressed retail properties with high-quality demographics, refurbish them, and then lease them at a premium.

ROIC's shopping centers have high occupancy. Funds from operations (FFO) more than cover the dividend. As new properties are added, along with tenant upgrades, FFO should continue to rise, along with the dividend and price of this REIT.

**Stryker (SYK)** is up 6 percent this year, extending our profit to 27 percent. SYK is best known for its orthopedic devices: artificial knees and hips, but it's much more. SYK provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, and neuro-technological and spine products.

More profits are assured by accelerating demand for joint replacements on aging baby boomers. Moreover, as life expectancy continues to increase, more and more hip, knee, and spinal procedures will be needed as baby boomers age.

Investor concern centers on the reluctance by hospitals to make capital investments and patients who postpone procedures. These are both cyclical issues, and will reverse once the economy improves. Stryker's balance sheet with piddling debt and robust cash flow permits the company to acquire businesses that either deepen its existing strengths or add complementary lines. Management has been buying back shares and has steadily increased its dividend.

**Symantec (SYMC)** recently reported better than expected earnings that were 15 percent higher than one year ago. Revenue has now increased 4 consecutive quarters.

SYMC is the dominant supplier of software for computer security and protection against viruses and other nuisances. New markets are opening up for SYMC as the world moves to smart phones and other mobile devices, and as hackers search for security holes. SYMC's flagship brand, Norton, should see strong growth in the mobile phone and tablet markets.

Recent acquisitions of Nukona, Inc, a provider of mobile application management, and Odyssey Software, a leading provider of mobile device management, enable SYMC to offer mobile apps that protect against hackers by authenticating users and encrypting sensitive files. SYMC is also collaborating with Red Hat to deliver solutions that help customers deploy agile private and hybrid clouds, as well as create resilient data centers.

Growth is assured from the expanding use in cloud computing along with the commensurate need for security software.

**Tellabs (TLAB)** designs and manufactures hardware for the telecommunications industry, which in a world of exploding demand for wireless communications should be a bonanza of a business. However, Tellabs has been slow to move its product lines as telecom service migrates into wireless.

Now that the explosion of smart phones, tablet computers and wireless communication is testing the limits of telecom infrastructure, Tellabs should be able to gain a significant portion of that market.

Even if it should fail to complete the transition in its products, it remains an attractive takeover candidate. Consider that Tellabs' balance sheet holds \$2.91 per share in cash and cash equivalents (short-term government debt or commercial paper) with no long-term debt. Other assets and liabilities on the balance sheet offset each other. Subtract that \$2.91 from the current share price and you are buying the entire business for very little.

We also believe that an acquirer would be happy to get the company for next to nothing if only to capture its client base. At its current price, the shares trade cheaply. If we look back over the last 23 years and calculate valuations at the shares' highs and lows each year, we can get a sense of how much or little investors have been willing to pay for Tellabs.

Price-to-Sales over the last 23 years, which includes the bubble years when the ratio ran as high as the low teens, has had an average historical low of 2. Currently Price-to-Sales stands at 1.07. Price to Cash Flow over the same period has averaged at its high 33.8 and at its low 14.2. Currently P/CF is 11.7. As for Price/Book Value, historically it has run as high as 12 (2000); its average high has been 5.3 and its historical low average has been 2.8. Currently it's 0.9. We think there is very little downside risk and loads of upside.

**Tetra Tech (TTEK)** is up 21 percent this year, extending our profit to 70 percent, and we see more profits ahead.

TTEK is a leading company in water technologies. It designs complex and intricate plans that are used by local and national governments to meet future water needs, including desalinization.

TTEK has a healthy balance sheet, and water and environmental remediation are definitely growth industries.

In October, TTEK was awarded a \$108 million contract to provide technical support for the U.S. Environmental Protection Agency (EPA) Office of Water's Assessment and Watershed Protection Division in its efforts to monitor water quality conditions. This watershed protection program is one of the principal technical support focuses of the EPA.

Other recent contracts include remediating NASA's Kennedy Space Center and Cape Canaveral Air Force Station, along with environmental remediation services at U.S. Navy, Marine Corps, and other Department of Defense locations primarily in California and the southwestern United States.

The biggest potential business lies outside the United States in countries like China and India, where environmental concerns have been at best an afterthought. Only now are their governments starting to recognize the consequences. As governments around the world make this a priority, Tetra Tech should be a prime beneficiary.

**USAA Precious Metals & Minerals Fund (USAGX)** is down slightly this year. We have a profit of 20 percent.

USAGX will benefit from the Federal Reserve's bold QE-3 program which promises to make massive purchases of Treasuries and

<b>Income With Growth</b>	<b>Symbol</b>	<b>Exchange</b>	<b>Price</b>	<b>Yield</b>	<b>Limit</b>	<b>Action</b>
Associated Estates Realty Corp	AEC	NYSE/Nasdaq	\$ 14.99	4.80%	\$ 17.00	BUY
CommonWealth REIT	CWH	NYSE	\$ 13.71	7.29%	\$ 20.00	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 12.62	3.17%	\$ 13.00	BUY
<b>Diversified Growth</b>						
CGM Realty Fund	CGMRX	800-343-5678	\$ 28.45	0.91%	\$ -	BUY
Comcast	CMCSA	NASDAQ	\$ 37.53	1.73%	\$ 39.00	BUY
Leucadia National Corp.	LUK	NYSE	\$ 22.70	1.10%	\$ 25.00	BUY
Masco	MAS	NYSE	\$ 15.09	1.99%	\$ 16.00	BUY
Paychex	PAYX	NASDAQ	\$ 32.42	3.95%	\$ 37.00	BUY
Pfizer	PFE	NYSE	\$ 24.87	3.54%	\$ 27.00	BUY
Stryker Corp.	SYK	NYSE	\$ 52.60	1.62%	\$ 58.00	BUY
Xerox	XRX	NYSE	\$ 6.44	2.64%	\$ 8.00	BUY
<b>Energy/Natural Resources</b>						
Agrium	AGU	NYSE/TSE	\$ 105.54	1.90%	\$ 108.00	BUY
Chesapeake Energy Corp	CHK	NYSE	\$ 20.26	1.73%	\$ 23.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 30.89	0.18%	\$ -	BUY
Tetra Tech	TTEK	NASDAQ	\$ 25.93	0.00%	\$ 29.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$ 30.30	0.27%	\$ -	BUY
<b>Aggressive Growth</b>						
AMN Healthcare	AHS	NYSE	\$ 9.92	0.00%	\$ 11.50	BUY
Boston Scientific	BSX	NYSE	\$ 5.14	0.00%	\$ 6.50	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 53.46	0.00%	\$ -	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 29.17	0.00%	\$ -	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 62.50	0.00%	\$ -	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$ 14.91	7.24%	\$ 17.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$ 27.53	3.20%	\$ 30.00	BUY
Symantec	SYMC	NASDAQ	\$ 18.19	0.00%	\$ 20.00	BUY
Tellabs	TLAB	NASDAQ	\$ 2.92	2.74%	\$ 4.00	BUY

ROWS IN **BOLD** INDICATE A CHANGE IN ACTION OR LIMIT

Prices are as of 10/31/2012. See our website for live pricing and buy limits.

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

Yields on funds do not include distributions of capital gains. Note that all fund distributions fluctuate annually.

mortgage-backed securities well into the economic recovery. However, in order to make these purchases, the Federal Reserve creates the money to do so – it basically prints the money. Of course, all these extra dollars will raise inflationary expectations and cause the value of U.S. currency to decline. Precious metals will be a direct beneficiary.

USAGX is the best diversified way to invest in precious metals. It regularly ranks among the top-performing funds. Morningstar also rates it highly.

The fund's management has been effective over the years in shifting the weight of investments to and from large-cap and small cap companies. After the market bottomed in 2008, investments in battered small-cap mining companies brought in strong gains during the boom in mergers and acquisitions that followed. Then, after the run-up and those acquisitions became fully-valued, management moved out of those and into large-cap companies which held up better during the 2011

downturn. Now, management is moving back into small-caps again, where bargains are better.

Dan Denbow, the co-manager of the fund since 2008, has replaced manager Mark Johnson, who recently retired after managing the fund for the past 17 years. We expect Mr. Denbow will carry on the management style. But we will be watching just to be sure.

**Xerox (XRX)** is transforming from a seller of printers and copiers, which have thin profit margins and are highly dependent on economic conditions, to a company providing services on those machines. The revenue from services is more profitable and less cyclical. Half of XRX's revenues now come from services.

Earnings are expected to be in the range of \$1.08 per share this year. At close to 7 times earnings, and 30 percent below book value, these shares are really cheap, and any kind of recovery will bring a high capital gain.

## 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 \$8,294,118 in stocks and to \$1,289,362 in houses.

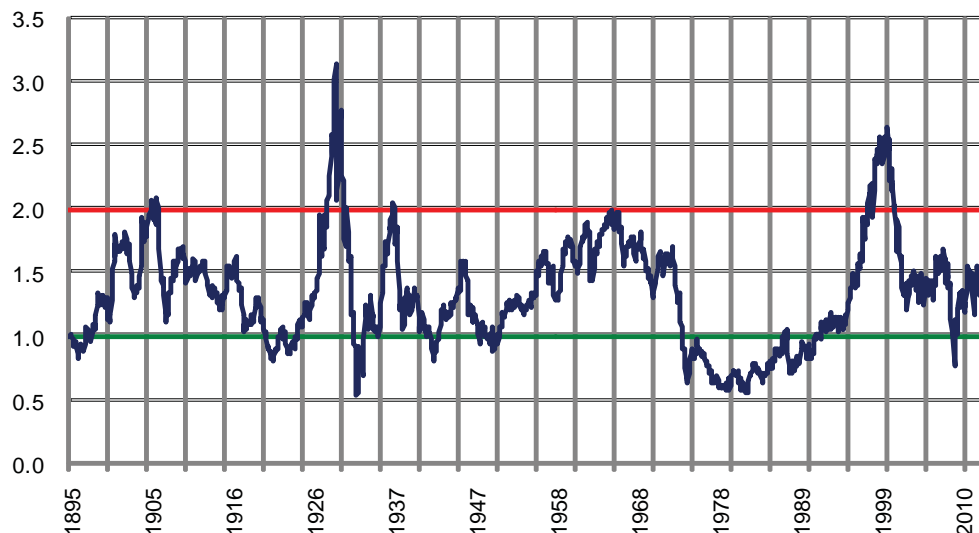
But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the SoundAdvice Risk Indicator he would have made \$329,657,110, or 39.7 times more money—the 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 1.38. This reading reveals that stock prices are below 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 renew your subscription.)



## Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

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

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

**The SoundAdvice Diffusion Index of Lagging Indicators** gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading which reveals that the economy is about to put upward pressures on interest rates. This index hit 100% in March 2012 (reported in April - very close to the peak of the market) telling us to move to a cautious approach.

Our next signal will come from a zero reading from our Diffusion Index of Leading Indicators. The latest reading is 66.7 percent.

Each month we project into future months the current readings for our hand-picked individual leading economic indicators that go into our Diffusion Index of Leading Indicators. We do this to see if a zero reading will be recorded assuming the readings stayed the same. However, due to significant increases in all of the leading indicators, we will not see a new signal (zero reading) in the months ahead unless the leading indicators (and the economy) show significant renewed weakness.

### 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 declined an average of 0.9 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%		-1.0%

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.)

The rising swell of home foreclosures began in 2007 as a symptom of faltering real estate markets across the country. But as the swell 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. We cannot have a sustainable recovery in the economy without the removal of the bulk of foreclosed homes 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 not only to invest in real estate for pennies on the dollar at the right time, but also in other investments as well as those that benefit from a recovering economy.

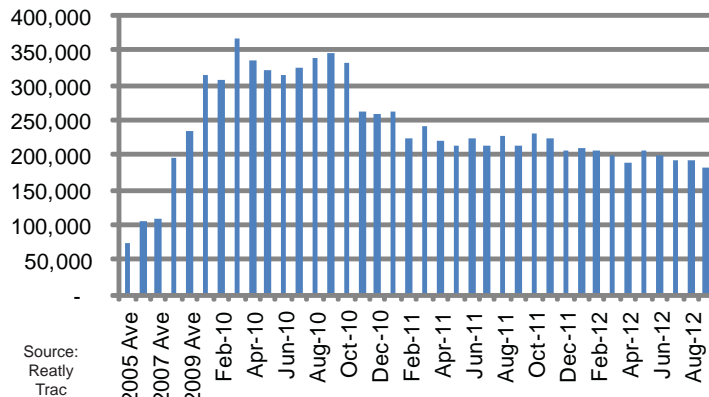
**The Key Indicator**

The secret is to focus on foreclosure rates. Realty Trac in Irvine, California has an extensive database. You can access foreclosure information on local markets from their website [www.realtytrac.com](http://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.

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 real estate recovery can then begin as well as in 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.

The following chart shows US foreclosure rates. In 2005,

**US Foreclosure Rates - Monthly Averages**



foreclosure rates averaged 74,892 properties per month. In 2006 and 2007, foreclosures were slightly above 100,000 per month. However, by January 2010, foreclosures climbed to over 300,000 per month, and foreclosures continued at over 300,000 each month through October.

We saw the beginnings of a decline in the 2010 fourth quarter. At first, the decline was due largely to a freeze in foreclosures by several major lenders. The downtrend continued as Federal and state foreclosure prevention efforts allowed distressed homeowners to stave off foreclosures. Foreclosure rates have been downtrending in recent months, with a 7% drop in September.

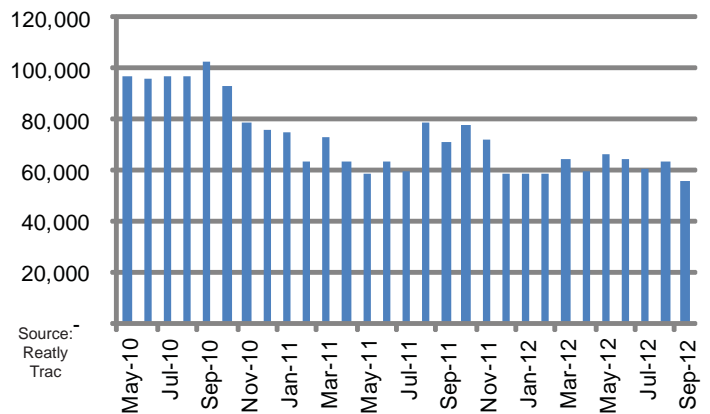
**Dissecting the Foreclosure Process**

It's important to keep in mind that the foreclosure process is comprised of three distinct stages: 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. The sheer number of foreclosures is actually the aggregate of the number of properties in each of these three stages.

We can get an early glimpse of a change in trends by focusing on changes in the first step of the foreclosure process: new default filings. After all, a significant change in the first step of the foreclosure process must ultimately lead to a significant change in the aggregate number.

The following chart shows new default filings in the US by month since May 2010. Through October 2010, new default notices were hovering around 100,000 per month. In October 2010 they began declining but remained stubbornly high until September 2012 when new default filings dropped 11 percent.

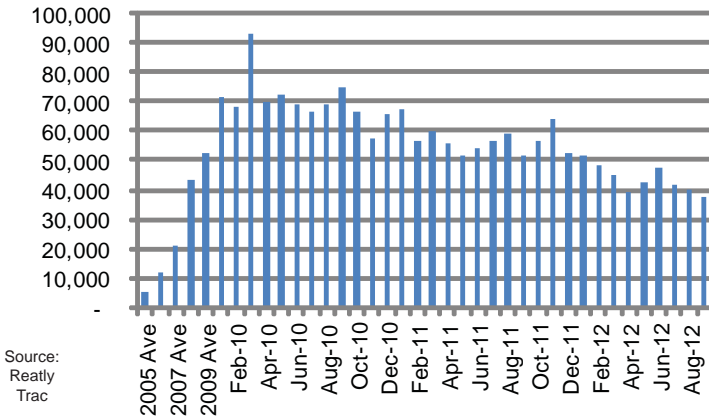
**US New Default Notices**



One fourth of the nation's foreclosures have been in California for the last few years. The following chart shows all stages of the foreclosure process in California (including auctions and bank repossessions).

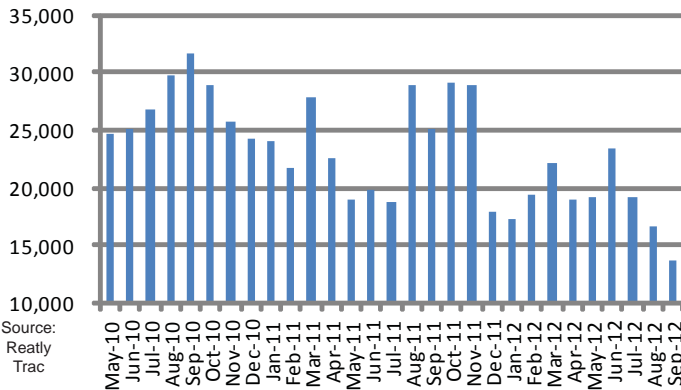
In 2005, California foreclosures averaged 5,138 properties per month. Foreclosures doubled in 2006, and again in 2007, and again in 2008. By 2010, foreclosures were close to 70,000 each month, with a spike of 93,000 in March. Foreclosure rates remained high in 2011 and began declining during the last several months.

California Foreclosures - Monthly Averages



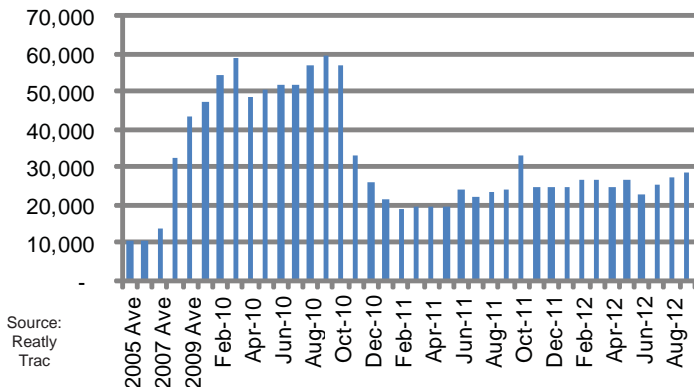
The following chart shows new default notices in California. After declining somewhat earlier this year, new default notices dropped sharply in the last three months: July (-18%), August (-13%), and September (-18%).

California New Default Filings

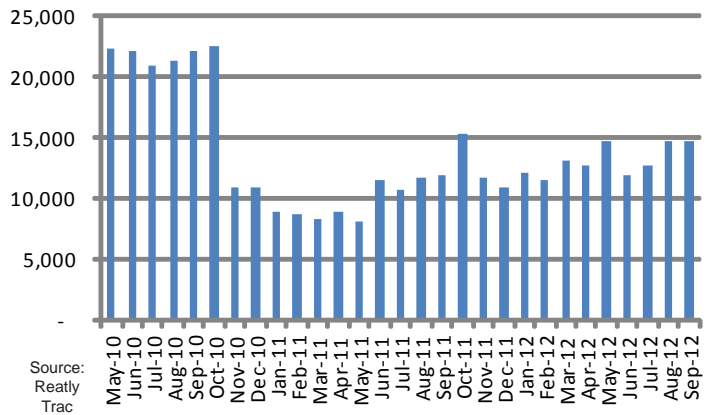


Florida is the next highest foreclosure state with 11 percent of the nation's foreclosures. See the chart below. Foreclosure rates climbed from 10,000 per month in 2005 and 2006 to 47,000 in January 2010, and stayed in the 50-60,000 range through October. After dropping sharply in late 2010 and early 2011, foreclosures have since remained above 20,000 per month.

Florida Foreclosures - Monthly Averages



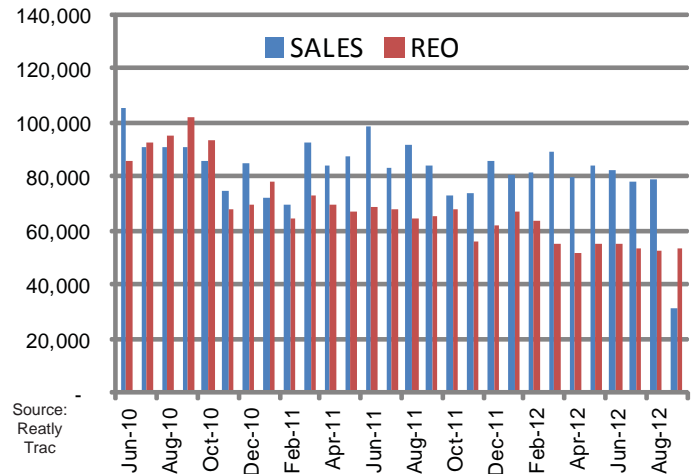
Florida New Default Filings



The chart above shows new default notices in Florida which dropped sharply in late 2010 and early 2011. However, there has been no progress in 2012.

The Inventory

At the other end of the foreclosure process is what the banks have not been able to sell. This inventory is called "real estate owned", or REO for short. Each month more REO is added to the inventory. However, each month there are a number of properties sold from the inventory. Below is a chart of the REO (in red) and sales (in blue) since June, 2010.



On balance, there have been 385,315 more properties sold than have been added to the REO inventory, or 25.2% of the current inventory of 1,526,691 foreclosure properties listed for sale.

Conclusions

The latest readings for September show significant declines nationally in both foreclosure rates as well as new default filings. California's declining foreclosure rates and steep drops in new default filings bodes well for 25% of the inventory. Although we would like to see more declines in Florida, we consider the significant drops nationally and in California to signal the beginning of the end of the foreclosure crisis. The strong data on home prices discussed earlier is also encouraging because the inventory overhanging the market is being sold off.

We will be tracking foreclosure metrics closely both nationally and in key states in these pages of SoundAdvice for further confirmation. Stay tuned.

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



First Class Presort  
US Postage  
PAID  
Permit #162  
Danville, CA

Address Service Requested

Enclosed: The November Issue of SoundAdvice

---

---

**Save 56% to 68% on your renewal to SoundAdvice**  
**Renew online: go to [www.soundadvice-newsletter.com](http://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)