



The *Hulbert Financial Digest*, the independent watchdog of the newsletter industry, recently published a study called *The Virtues of Consistency*.

The study compares the consistency of 200 newsletters for 2 consecutive 10-year periods, and determined that those with the highest consistency during the first 10-year period had more consistent and better investment performance during the following 10-year period, beating the market at least 7 out of the ten years. *Sound Advice* was among the seven newsletters that made the cut.

To assist in selecting newsletters, Hulbert concludes by saying, "What this means: While an adviser's consistency score is not the only thing worth focusing on, it does appear to be one of the data points that can help."

As a way of finding the year-by-year performance of any of the newsletters tracked by the *Hulbert Financial Digest*, you can subscribe to the *Hulbert Interactive*, which is \$99 for one year.

To compare the performance of a newsletter to the market, Hulbert uses the Wilshire 5000 rather than the S&P 500. According to Hulbert's data, since the beginning of 2000, *Sound Advice* has beaten the market 11 out of the last 14 years; under-performing the market in three of those years by 5.8 percent or less. Using the S&P 500 as the measure of the market, *Sound Advice* has beaten the market 13 out of the last 14 years; under-performing the market in one year (2011) by 4.8 percent.

Over the entire period since the beginning of 2000, our data for the *Sound Advice* track record is close to Hulbert's. We calculate the investment return to average 11.5 percent per year for *Sound Advice*. This compares to 4.6 percent annually for the Wilshire 5000 and 2.1 percent annually for the S&P 500 over the same period.

-Gray Emerson Cardiff

Behind the Curve?

In a statement released after the Federal Reserve's latest two-day policy meeting in August, Fed's officials projected the jobless rate will be falling more than previously thought, receding to 6% or 6.1% by year-end and then to the mid-5% range in 2015 and low-5% range in 2016.

Federal Reserve officials also projected the benchmark Federal Funds rate would increase (from zero currently) to 1.2% by the end of 2015 and to 2.5% by the end of 2016. Beyond that, officials said the Federal Funds rate could settle in at 3.75%.

Behind the closed doors of the Federal Reserve's meetings are growing debates regarding whether monetary policy is being too slow in returning to "normalization".

In a CNBC interview during the recent Jackson Hole meeting, the President of the St. Louis Federal Reserve, Jim Bullard, said that the debate is not whether, but when, to pull back to "normalization". When asked if he is worried about inflation and excesses in markets growing, he replied:

"Yes, I think that is a big risk of the next 2 to 3 years. The debate is how do we play this. If we go very slow and gradual, are we going to get another housing bubble and a big disaster on our hands. It's a huge issue. The answer has to be to normalize monetary policy."

Although US inflation is already at the Fed's upper target of 2 percent, Federal Reserve Chair, Janet Yellen, appears less concerned about inflation than about unemployment. Ms. Yellen and others believe the Federal Reserve can help the long-term unemployed find new jobs by keeping rates low.

Also mitigating inflation worries, and built into the Federal Reserve's forecast, is the presence of low inflation and interest rates elsewhere in the world, particularly in Europe.

Relative Value

Because capital flows around the world, low interest rates elsewhere have been acting to push bond yields low in the US. The German ten-year bond yields less than one percent, compared to 2.3 percent on the US ten-year Treasury. On the surface this difference makes the yield on US Treasuries look attractive to foreign capital. However, the US inflation rate of 2.0 percent only leaves a real return of 0.3 percent on the US 10-year Treasury bond. This spread is even more out of whack when you consider the growth prospects of these two countries. Even if things remain exactly as they are, this spread should widen.

If one thing is certain when it comes to investing, it is that things don't remain as they are for very long. This is especially true when the current situation simply doesn't make sense.

All we need to ask is: Who in their right mind would lock-in an investment returning less than one percent in real terms for a ten-year period?

The obvious answer is no one. Investing in 30-year bonds makes even less sense. Historically, investors require a real return of three percent. Capital is just being parked temporarily in long-term bonds as a safe haven, with the idea that it will move when better options come along. We need to keep in mind that low interest rates will stimulate economic activity (and inflation) in foreign economies, just as they do here. That will put upward pressure on bond yields both here and abroad, and it is a safe bet that the capital hiding in bonds will be moving on.

Not only are the spreads between US bond yields and foreign sovereign bonds too narrow right now, these spreads are bound to widen as the US economy continues to strengthen and US inflation increases. Real US bond yields (after adjusting for inflation) will diminish and make the relative value less attractive to foreign capital. This will reduce foreign demand for US Treasuries.

If the Federal Reserve stays behind the curve and continues to keep interest rates too low, inflation will increase more rapidly, and the relative value will diminish ever further. On the other hand, the Federal Reserve could stay in front of the curve by raising interest rates. Either way, bond yields will go up.

Emergency Interest Rates?

There are numerous reasons to believe that the Federal Reserve's forecast regarding rising interest rates is too slow. The first and most obvious is that the Federal Funds rate is still zero, which is an emergency level established after the economy crashed in 2008. After 5+ years of recovery, it simply does not belong there.

Second, the Federal Reserve will be soon ending its massive purchases of Treasury securities, removing close to \$1.2 trillion in annual purchases, which is comparable to the holdings of China or Japan - the largest foreign purchasers. In addition, these purchases remain on the Federal Reserve's balance sheet, in the amount of \$4 trillion -- which is more than \$3 trillion above normal. The Federal Reserve will need to unwind its excess position.

Third, as we have pointed out, the spread between US bond yields and other sovereign bond yields is too narrow, and bound to be widening, especially as US inflation heats up.

There is a substantial risk that the Federal Reserve is moving too slowly in raising interest rates from emergency

levels to normal levels. If they are "behind the curve", inflation will start heating up and bond yields will rise sharply. With inflation already at 2 percent, which is the Federal Reserve's upper target, this is more than a realistic possibility.

However, even assuming the Federal Reserve is not behind the curve, and that its interest rate forecast proves to be close to reality, our "No-Brainers" will still be immensely profitable.

Modeling the No-Brainers

The ETFs we are recommending, designed to benefit from rising long-term Treasury bond yields, differ in the amount of leverage used:

The [Direxion Daily 20 Plus Year Bear 3 Shares \(TMV\)](#) uses 3:1 leverage.

The [Proshares Ultrashort Lehman 20 Plus Year Treasury \(TBT\)](#) uses 2:1 leverage.

The [Proshares Short 20 Plus Year Treasury \(TBF\)](#) uses no leverage.

You can choose one or all of these ETFs, depending on your investment objectives and risk tolerance.

We have dubbed these ETFs as "No-Brainers" because interest rates always rise after a recession during the recovery. The upward path has never been smooth, and this time is proving to be no exception.

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

We can construct a model of these ETFs based on the Federal Reserve's forecast. To reach 1.2 percent by the end of 2015, the Federal Funds rate will need to start increasing from its current rate of zero by the end of January, 2015, and increase an average of 0.0050 percentage points (0.5

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basis points) during each trading day of the year. Continuing those daily increases during 2016 brings the Federal Funds rate to the Federal Reserve's target of 2.5 percent.

At the very least, long-term Treasury bond yields should follow the same path as the Federal Funds rate. Cases could be made for a more rapid rise in long-term bond yields because of the "shock" in the change in monetary policy. Bond yields will also rise more rapidly if it appears the Federal Reserve has moved too slowly and has let inflation get out of control (behind the curve). However, for our purposes of creating a base-line model, we will assume that long-term Treasury bond yields will move in tandem with the Federal Funds rate. That means long-term Treasury bond yields will rise from 3.07 percent today to 4.27 percent by the end of 2015, and to 5.57 percent by the end of 2016.

If we assume that the ascent in interest rates will not begin until the end of January in accordance with the Federal Reserve's forecast, we must make a further assumption regarding what will happen until then. As we illustrated last month, there is an "erosion factor" with these ETFs, and it is more pronounced with leverage. This is because these ETFs decline slightly more on downswings than they rise on an equivalent upswing in bond yields. Therefore, a negative scenario assumes that bond yields churn up and down, rising say, 5 basis points one day and declining the same amount the next. Based on history, this would be a high degree of churning and unusually detrimental.

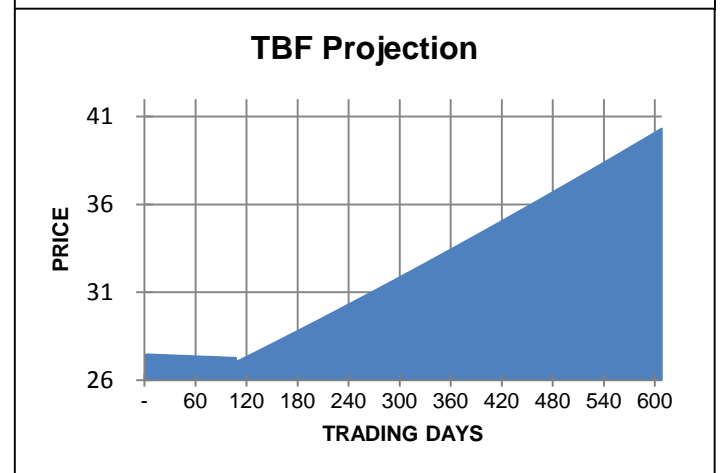
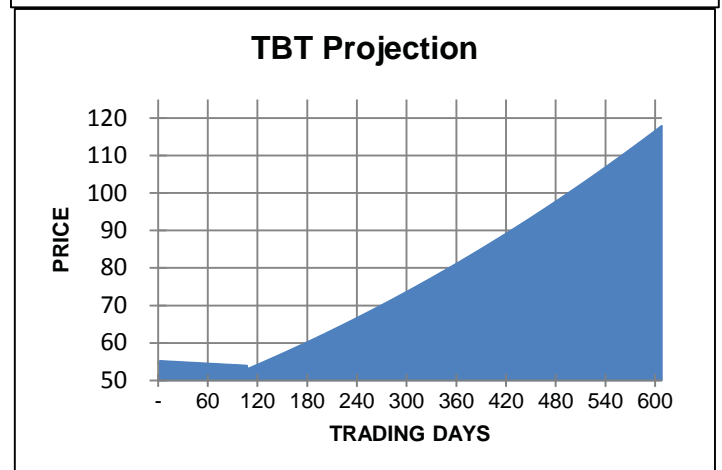
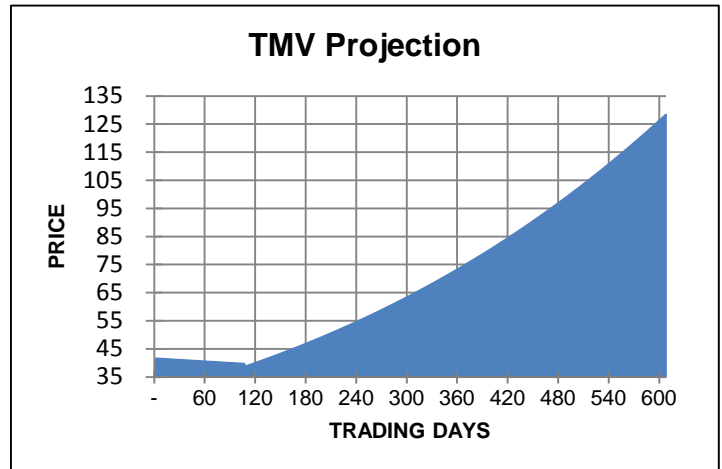
This churning would erode TMV's price the most, by 4.6 percent, because it uses the most leverage. TBT would erode 2.3 percent, and TBF would erode 0.74 percent. Then, this erosion would be followed by steady price increases in all three ETFs, along with rising interest rates.

TMV would rise to \$128 by the end of 2016, slightly more than three times its current price. The chart to the right shows the pattern, including the erosion until January.

TBT would rise to \$118 by the end of 2016, slightly more than twice its current price. The chart to the right shows the pattern.

TBF would rise to \$40.3 by the end of 2016, which is 48 percent greater than its current price. The chart to the right shows the pattern.

While these ETFs are no-brainers after a recession because interest rates always rise, the ride has been rougher than we first anticipated. The Federal Reserve's forecast is based on the most extensive resources available, but it is still a forecast. However, we believe it is conservative and provides a basis for a base-line expectation. Even though the Federal Reserve's forecast calls for a gentle increase over a long period, it would lift our No-Brainers substantially and provide handsome profits, and demonstrates the profit potential of these ETFs. Also keep in mind that nobody is



debating whether or not interest rates will rise, only about exactly when and how fast.

We should also keep in mind that the Federal Reserve projects the "normal" Federal Funds rate to "settle in at 3.75%." That brings long-term Treasury bond yields to 6.8 percent assuming a tandem rise with the Federal Funds rate, and potentially larger profits for these ETFs.

At any rate, we continue to believe it is bound to be worth the ride.

Portfolio Updates

With our Diffusion Index of Lagging Indicators hitting 100 percent recently (see page 11), we are operating with caution. That means we are being much more selective these days, and will continue to be so until we have the green light from our Diffusion Index of Leading Indicators (page 11). We have positioned the *Sound Advice* portfolio for an improving economy, along with the rising inflation and interest rates that an economic expansion fuels.

Our REITs and real estate stocks and funds should be net beneficiaries. Although interest rates will be pushing up mortgage rates, the corresponding increases in rental rates should more than compensate. These, along with our other hard-asset stocks and funds, should also benefit from the rising inflation that accompanies an improving economy.

Our energy stocks and mutual funds should continue to bring attractive profits because energy is in the fabric of the economy.

Value stocks have been among the better performers at this stage in past cycles, when an improving economy is pushing up earnings, price/earnings ratios are shrinking, and interest rates are rising. Our value-oriented approach should continue to pay off.

Having covered our No-Brainer ETFs, here are updates on the rest of our recommendations in alphabetical order. The table on page 9 details our buy limits and other information on each recommendation, and organizes them by investment objective. Also see our website for live pricing.

Agrium (AGU) is up 5.1 percent this year, extending our profit at 726 percent.

AGU has a broad mix of agricultural products and services that are poised to benefit from growing demand as arable land continues to disappear around the world and the need for higher food production per acre increases. Growth is also bolstered by an expanding worldwide population along with increasing per-capita income.

AGU has a solid dividend yield and is undervalued at close to 10 times the expected 2015 earnings of approximately \$8.75.

Associated Estates Realty Corp (AEC) is up 17 percent so far this year, extending our gain to 36 percent. What originally attracted us to AEC was the fact that it was selling at a substantial discount to the value of its net assets, and it paid a nice dividend. Although AEC has since risen in price, so has the value of its real estate portfolio. It remains a stellar value with a nice dividend.

We value the equity of AEC's apartment portfolio at approximately \$28 per share, considerably greater than the current stock price.

Boston Scientific (BSX) is up 2.7 percent so far this year, extending our profit to 30 percent. BSX's medical products are well suited for an aging population in the US. The Company's mission is to transform lives through innovative medical solutions that improve the health of patients around the world. BSX has been a global medical technology leader for three decades by providing a range of high performance solutions aimed at addressing medical needs and reducing healthcare costs.

Chesapeake Energy (CHK) is essentially unchanged this year, leaving our gain at 65 percent. CHK is the second largest producer of natural gas and pioneered the use of fracking technology to produce oil liquids and natural gas from shale. We added CHK to the portfolio because it was at a substantial discount to its net assets. The stock price was cheap because of low natural gas prices, poor corporate governance, and because it was in the midst of a financial squeeze. We could see all of these conditions were likely to be remedied, and indeed they were.

With earnings projected to be \$2.30 next year, CHK is still a reasonable value. Morningstar's fair value estimate of CHK is \$37 which is still substantially higher than the current stock price.

CommonWealth REIT (now Equity CommonWealth REIT – Ticker “EQC”) was originally introduced when it was selling for close to a 50 percent discount to its NAV. Subsequently, two large investors, Corvex and the Related Companies, woke up shareholders by sponsoring a proxy vote to remove the entire board and management.

The new management started off by changing its name to Equity Commonwealth, along with its ticker symbol to EQC.

On August 7, two days after EQC issued its 8K report to the SEC, we noted in our e-mail update that buried on page 6 of the 8K was the following statement:

“With respect to the common dividend, EQC is evaluating its options regarding the appropriate policy. EQC anticipates that the quarterly common dividend likely will be reduced from the level being paid before the prior Trustees were removed on March 25, 2014.”

If the dividend is reduced under the new management, for whatever reason, we believe it would be reminiscent of the dividend cuts under the old, ousted management, and could rattle EQC.

We also calculate from the latest financials disclosed on the August 8K that the net equity of the real estate portfolio is approximately \$28 per share, which is close to the current price of the stock.

With the price of the stock close to parity with the underlying equity, we do not see significant upside over the near term, and the potential for a dividend cut introduces new downside. The price of EQC has not changed materially

since our early August e-mail update, and we reiterate that it is prudent to sell EQC.

Fidelity Select Natural Gas Fund (FSNGX) is up 18 percent this year, extending our gain to 53 percent.

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

One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. With one barrel of oil at \$100, that is the cost of 5.8 million BTUs of energy. On the other hand, with a market price for natural gas at \$5.00 for one million BTUs, 5.8 million BTUs will cost \$29 (5.8x\$5). So the same amount of energy is available for 29 cents on the dollar -- if it is in the form of natural gas.

To illustrate the point, we continue to display the historic relationship between the costs of these two forms of energy in the chart to the right because it demonstrates that today's disparity 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.

Freeport-McMoRan Copper & Gold (FCX) was originally added to the portfolio last year at \$30.42 per share. FCX is up 23 percent since we recommended it.

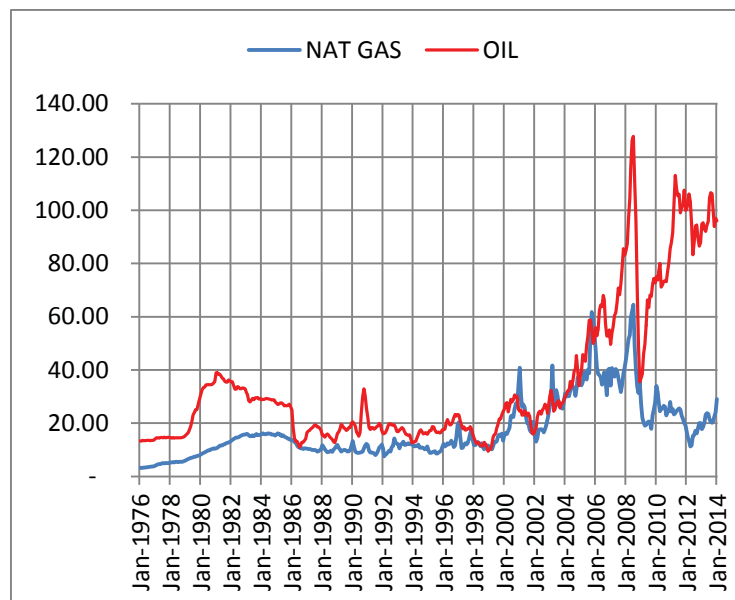
Copper is woven into the fabric of every developed economy, and its price moves dramatically in tandem with expansions and contractions. We made a 643 percent gain during the last expansion, from March 2003 until December 2006, on Phelps Dodge, the largest copper producer back then. In March 2007, FCX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

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

The 2013 acquisition of substantial oil and gas assets in California, Texas, Louisiana, and the Gulf of Mexico is an added bonus both for earnings growth and stability. Growth in earnings is ahead and the dividend yield is attractive, plus it reduces risk.

In August, FCX resumed operations from its Grasberg mine, one of the largest copper and gold mines in the world, which will lower production costs and increase export volume. This resumption, along with the commencement of

The Cost of Energy Equivalents of Oil and Natural Gas



copper production at its newly expanded Morenci operation, will be adding to earnings.

Hambrecht & Quist Life Sciences Fund (HQL) is up 13.7 percent this year, extending our profit to 63 percent.

We have been recommending this Fund because the most explosive profits in the entire healthcare industry can be found in biotech companies. Sales of the top drugs now come from biotechnology origin, a drastic change from 10 years ago. The consensus of analysts is that earnings growth in the biotech sector will exceed that of nearly all other sectors of the economy.

Exemplifying HQL's holdings is its largest, Gilead Sciences, the inventor of *Sovaldi*, a drug that actually cures Hepatitis C. With approximately 140 million people infected, *Sovaldi* promises to be the most successful drug ever. Gilead also has promising remedies for HIV and AIDS, along with products for cardiovascular needs, macular degeneration, cystic fibrosis, and influenza.

Other HQL's holdings include Celgene, Biomarin Pharmaceutical's, Pharmacyclic, Biogen Idec, Medivation, Amgen, Regeneron Pharmaceutical, Puma Biotechnology, and Sangamo BioSciences, all of which have promising products and treatments for a wide variety of dreadful diseases.

Hersha Hospitality (HT) is up 24.5 percent since our recommendation in December 2013. Our principle reasons for recommending HT were because hotel assets in general are sensitive to the business cycle and will benefit strongly from the economic recovery.

In addition, the price of the stock is depressed and selling

at a discount to its net asset value because many of its major properties have been undergoing renovations, and the income potential has not yet been realized.

Based on the most recent second quarter results reported in August, we value HT's NAV at \$7.86 per share, which is substantially higher than the current price of the stock. The NAV increased from last quarter's value of \$7.33 due primarily to the addition of two properties in May: the Parrot Key Resort in Key West, Florida, and the Hilton Garden Inn on 52nd Street in New York City. We expect to see further increases of NAV as income from new acquisitions are realized along with increased income from completed renovations.

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

ICON Energy Fund Class S (ICENX) is up 14.3 percent since we added it to the portfolio last year. Demand for energy accelerates with an economic expansion, and we expect to see solid gains as the economic recovery gains traction. It takes energy to make everything, and especially large amounts to make the most vital materials and substances, such as chemicals, plastics, and to run data centers. The best time to invest is when the economy is coming out of a slump, before demand increases.

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

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

ICON management looks for changes within the energy industry to capture value, rather than simply depending on rising prices. Management points out that it has achieved growth even during periods of declining energy prices. The track record of this fund bears this out. The most recent sanctions directly target Russia's predominantly state-owned oil company, Rosneft. The changing landscape should provide opportunities ahead to capture values.

NCR Corp (NCR), formerly known as National Cash Register, was recommended in our August 14, 2014, e-mail update. It is up slightly since then but remains under our buy limit of \$35.

The stock declined over 25 percent during the previous 12 months and looks like it has finally bottomed. We believe

NCR is a timely addition to our model portfolio.

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

The consensus is that NCR will earn from \$3.00 to \$3.10 per share this year, so the stock is currently close to 11 times earnings which is a steep discount to the market as measured by the 16+ price-to-earnings ratio (P/E) on the S&P 500.

NCR is cheap because rapid earnings growth came to a halt beginning in 2013, causing the stock to slide. The reason for the slowdown in earnings was because NCR increased its debt load to make two significant purchases, and the cost of the debt has dampened earnings growth. However, more rapid growth should resume as these new acquisitions add to earnings next year and beyond. Earnings next year are expected to climb to \$3.50 a share. At 15 times earnings, the stock would trade above \$52.

These two acquisitions were Retalix, a transaction software provider, in February 2013 for \$791 million, and Digital Insight, an online and mobile-banking solution provider, in January 2014 for \$165 billion. These acquisitions have started to add to earnings and have pushed NCR much farther along its path from a hardware provider to more of a software and services provider where profit margins are substantially higher.

Software services sales doubled from 2010 through 2013 to slightly more than 20% of total revenues. The two latest acquisitions are expected to push software-related revenues to 40% of total revenues by the end of this year.

Another catalyst for growth comes from the fact that approximately 90 percent of ATMs in the US still run on Windows XP which Microsoft just stopped supporting. That will translate into increased demand for NCR's ATMs.

NCR does not pay a dividend because it is using its capital for growth. At this price we believe it is a solid investment with limited downside risk and very good profit potential.

Pfizer (PFE) is down 1.5 percent this year, trimming our profit to 91 percent. We added PFE to the portfolio when it became dirt cheap as the expiration date approached on its blockbuster drug, *Lipitor*. However, its future was brighter due to the arsenal of new pharmaceutical products with more than 80 drugs in the development stage and 90 in the discovery stage. Among the most significant include *palbociclib* for advanced breast cancer, a meningitis B vaccine, and *Xeljanz* for inhibiting the progression of rheumatoid arthritis.

Sales on Pfizer's top are climbing, which, include *Lyrica* (for pain and fibromyalgia), and *Pprevnar* vaccines (for

pneumonia and other infections).

PFE has made a number of significant alliances to grow its pipeline. One, for example, is with ViiV Healthcare which specializes in treatments for HIV. It has sales of \$2.3 billion from 12 HIV drugs. A new HIV drug, Triumeq, was recently approved and is aimed to cure HIV-1.

During the first half of this year, Pfizer has repurchased \$2.9 billion worth of its own common stock and plans to purchase another \$2.1 billion by the end of the year, for a total of \$5 billion in 2014. In 2013, the company purchased \$16.3 billion of its own stock.

PFE has been languishing this year and it is a good value with promising growth from a wide array of drugs and treatments. Its dividend is close to 3.5 percent.

Retail Opportunities Investment Corp (ROIC) is up 9.6 percent this year, extending our profit to 60 percent. This REIT began as an IPO in October 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains.

ROIC buys distressed retail properties with high-quality demographics, refurbishes them, and then leases them at a premium. So far this year, ROIC has purchased \$358 million of shopping centers, with \$253 million occurring in the second quarter. This follows \$368 million during 2013. Second quarter funds from operations (FFO) was 16.7 percent higher than one year ago. Occupancy ended the quarter at 96.8 percent.

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

Stryker (SYK) is up 10.7 percent this year, extending our profit to 103 percent.

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

Stryker's cash-rich balance sheet with \$4 billion of cash and marketable securities, along with its robust cash flow, gives SYK multiple avenues for continued growth through acquisitions.

In August, SYK completed the acquisition of Small Bone Innovations (SBI) which has products for trauma and diseases in small bones and joints including ankles, fingers, wrists, and elbows. Its three-piece "STAR" ankle

replacement system is available in over 40 countries, strengthening SYK's product offering. This adds to other recent acquisitions including Pivot Medical which has a platform of arthroscopic implants to efficiently access the hip with minimal incision. Berchtold Holding was also acquired which has a product portfolio of surgical infrastructure equipment including surgical tables and lighting systems. The MAKO Surgical acquisition put SYK in a leading position for robotic-assisted surgery and the potential for break-through innovations. The 2013 purchase of Trauson Products, China's largest manufacturer of orthopedic implants, also offers access to the Chinese market and broadens SYK's customer base.

Symantec (SYMC) is up 4.4 percent this year, extending our profit to 49 percent. SYMC is the dominant supplier of software for computer security and protection against viruses and other nuisances through its leading flagship brand, Norton. If there ever was a more certain growth industry, protection from cyber espionage is it.

In August, SYMC reported its first quarter fiscal earnings which beat expectations for the third quarter in a row. SYMC is expected to earn \$1.84 to \$1.92 next year, and the recent string of quarterly earnings offers confidence that the expectation will be met. This puts SYMC below the average market price/earnings multiple and makes it a good value. SYMC is still undervalued based on the sum of its parts. Valuations range from \$25 to \$28 per share, a premium over the current price of the stock.

Tetra Tech (TTEK) is down 8.4 percent this year, trimming our profit to 66.4 percent. TTEK is a leading company in water technologies and environmental remediation with a healthy balance sheet with \$500 million of capital for growth in strategic markets. TTEK has a backlog of approximately \$2 billion in signed contracts to clean up military bases across the US. TTEK also provides energy efficiency and carbon management consulting which are bound to see growth under the new proposed carbon rules announced by the EPA which are aimed at reducing carbon emissions from power plants by 30 percent by 2030.

In August, TTEK was awarded a five-year, \$23 million contract from the Environmental Protection Agency (EPA) to assess and reduce waterborne risks from contaminated fish and sediments from various sources threatening drinking water supplies and recreational waters.

TTEK recently initiated its first quarterly dividend of 7 cents per share for the second quarter and is buying back \$100 million of its common stock.

Third Avenue Funds are in our portfolio because the management team looks for 4 fundamental characteristics before making investments:

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

Last October, we introduced the **Third Avenue Real Estate Value Investor Fund (TVRVX)** into our portfolio, and it has since grown 15.7 percent. It has led the pack of all real estate mutual funds during the last 3 years. This is still where the best real estate values can be found in a mutual fund. It is replete with stellar values substantially below NAV with strong growth prospects.

The **Third Avenue Small-Cap Value Investor Fund (TVSVX)** is up slightly since we introduced it earlier this year. This fund invests in companies with small capitalizations using the same value-oriented approach. Small cap stocks perform better than large cap stocks over the longer term because they are pure plays on the early stages of new industries and inventions. They have more dynamic and entrepreneurial management, and they are much more likely to be the target of an acquisition or merger which is usually profitable. Not only do small caps perform better over the long run, they generally benefit strongly from a recovering economy.

Transocean (RIG) was introduced in June. At close to 10 times earnings, RIG is trading at the low end of its trading range from the high \$30s to the upper \$50s. Even forgoing the 15 percent foreign tax withholding, the net dividend is above 6 percent.

In August, RIG reported surprisingly good earnings of \$1.61 per share, well ahead of the expected consensus estimate of \$1.12. Compared to the previous quarter, gross revenues and fleet utilization were flat, but operating and maintenance expenses were down, and cash flows from operating activities were strong at \$636 million, compared with \$136 million in the first quarter.

RIG is forming master limited partnerships (MLPs) to unlock the value of its assets. The first was In July, a \$350 MLP to which it will sell a 51% interest in three assets

located in the Gulf of Mexico; two ultra-deepwater drill ships which are leased to Chevron and one semi-submersible rig leased to British Petroleum (BP). The next MLP, called the Caledonia Offshore Drilling Company, will purchase 8 of its rigs operating in the North Sea.

The creation of these MLPs will be highly beneficial to Transocean. The cash infusion will bolster its balance sheet and provide a way for the company to sell assets at full value, much more than could be realized in the open market, while still maintaining control of these assets.

We expect a substantial recovery from this depressed stock price.

USAA Precious Metals & Minerals Fund (USAGX) is up 29.4 percent this year. When the economic recovery gets more traction, the money created in recent years will be sloshing through the economy, putting upward pressure on the prices of commodities including precious metals.

Geopolitical tensions are a positive for precious metals because they are also safe haven assets. An increase in tensions between Russia and the West are likely to be a positive force for this sector.

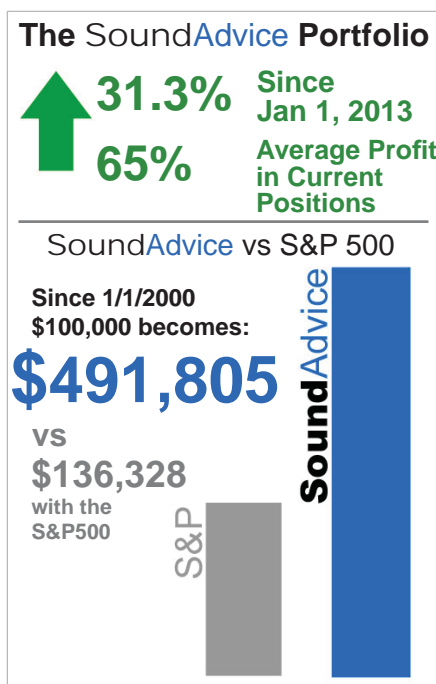
This fund will also benefit from inflation when the economy begins to overheat.

USAGX is the best diversified way to invest in precious metals. It is the top-performing fund, and has constantly out-performed precious metal equities for ten years.

Xerox (XRX) is up 14 percent this year, extending our profit to 67 percent. In August, XRX reached a new 12-month high.

We have been recommending XRX because it has been transforming from a seller of printers and copiers to a company providing business services in the form of business process outsourcing, information technology (IT) services, and document outsourcing (printing as a service). The strongest growth is coming from the expansion into IT services where services are performed under long-term contracts. Renewal rates are generally high.

During the last three years, XRX has repurchased \$816 million of its stock annually. Free cash flow continues to be strong and will be used to continue to buy back more stock in 2014 close to that average. Beyond 2014, XRX plans to repurchase another \$1.0 billion of its stock.



Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Associated Estates Realty Corp	AEC	NYSE	\$ 18.32	4.15%	\$ 19.50	BUY
CommonWealth REIT	CWH	NYSE	\$ 26.96	3.71%		SELL
Hersha Hospitality Trust	HT	NYSE	\$ 6.79	3.53%	\$ 7.86	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 15.84	3.79%	\$ 17.00	BUY
Third Avenue Real Estate Value Investor	TVRVX	800-443-1021	\$ 32.17	2.05%	\$ 33.00	BUY
Diversified Growth						
NCR Corp	NCR	NYSE	\$ 33.75	0.00%	\$ 35.00	BUY
Pfizer	PFE	NYSE	\$ 29.38	3.54%	\$ 32.00	BUY
Stryker Corp.	SYK	NYSE	\$ 82.67	1.28%	\$ 87.00	BUY
Third Avenue Small-Cap Value Investor Fund	TVSVX	800-443-1021	\$ 28.09	0.00%	\$ 32.00	BUY
Xerox	XRX	NYSE	\$ 13.76	1.82%	\$ 14.50	BUY
Energy/Natural Resources						
Agrium	AGU	NYSE	\$ 94.86	2.69%	\$ 100.00	BUY
Chesapeake Energy Corp	CHK	NYSE	\$ 26.98	1.30%	\$ 32.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 44.69	0.74%	\$ 48.00	BUY
Freeport-McMoRan	FCX	NYSE	\$ 36.16	3.46%	\$ 40.00	BUY
ICON Energy Fund Class S	ICENX	800-828-4881	\$ 24.25	3.05%	\$ 27.00	BUY
Tetra Tech	TTEK	NASDAQ	\$ 25.48	1.10%	\$ 27.50	BUY
Transocean	RIG	NYSE	\$ 38.41	6.64%	\$ 45.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$ 16.87	0.12%	\$ 18.00	BUY
Aggressive Growth						
Boston Scientific	BSX	NYSE	\$ 12.35	0.00%	\$ 14.00	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 40.65	0.00%	\$ 55.00	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 27.24	0.00%	\$ 30.00	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 54.30	0.00%	\$ 65.00	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$ 22.38	0.00%	\$ 25.00	BUY
Symantec	SYMC	NASDAQ	\$ 24.16	2.48%	\$ 25.00	BUY

Notes to the table:

Prices are as of 8/28/2014. See our website for live pricing and buy limits:

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

Yields on funds may include capital gain distributions.

* Transocean (RIG) and Agrium (AGU) yields are net of the 15 percent foreign withholding tax.

** CommonWealth REIT (CWH) changed its name to Equity CommonWealth REIT and its ticker to EQC.

General Comments:

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

If you are investing in the portfolio for the first time, we believe your performance will be enhanced by deferring purchases in positions that are not below our "Buy" limit.

If you are picking and choosing, you can focus on the sector of the portfolio that matches your investment objectives. The table above divides the portfolio into four sectors; Income with Growth, Diversified Growth, Energy and Natural Resources, and Aggressive Growth.

Alternatively, you may have a higher degree of comfort with certain industries, funds, or stocks because of past experience or your profession. In that case, you may want to invest more heavily in one sector, or in one or more individual recommendations.

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 \$11.7 million in stocks and to \$1.49 million in houses.

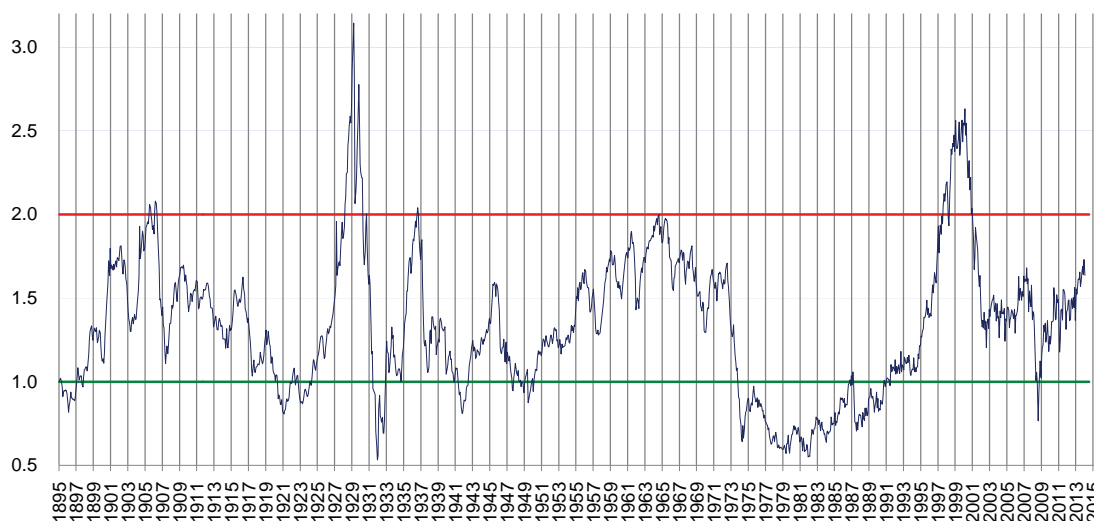
But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the SoundAdvice Risk Indicator he would have made \$467 million, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the SoundAdvice Risk Indicator would have provided.

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

The SoundAdvice Risk Indicator

The latest reading for the Sound Advice Risk Indicator is 1.71. This reading reveals that stock prices are above average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

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



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

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

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

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

An "Aggressive" signal coming at a time when the Risk Indicator was below 1.0 revealed that Supercycle 5 came to an end, and that Supercycle 6 was born. Our next signal will come from a zero reading from our Diffusion Index of Leading Indicators. The latest reading is 66.7 percent.

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

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

This index hit 100% in 2012. Although we operated under the "Caution" signal, we earned a 25.74 percent investment return in 2013. We continued to be bullish about stocks because of Federal Reserve's expansive monetary policy and its Quantitative Easing program which has been distorting the natural business cycle this time.

This index hit 100 percent for the fourth month in a row in June 2014 which tells us that the economy is now strong enough to push up inflation and long-term interest rates along with bond yields. It registered 83.3 percent in July.

Track Record of the SoundAdvice Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 climbed an average of 34.4 percent. During "Caution" signals, the S&P 500 increased an average of 2.3 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%		2.3%

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.)

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