



The *Sound Advice* portfolio is up 13.3 percent for the first half of the year, assuming an equal amount was invested in each position on December 31, 2012. This return compares to 12.6 percent for the S&P 500. If we look back to the beginning of last year, the portfolio is up 38.7 percent as compared to 27.7 percent for the S&P 500. We have an average gain of 54.9 percent based on the prices at which each stock, ETF, or mutual fund was originally recommended.

**-Gray Emerson Cardiff**

## The Bernanke Bombshell

Bond prices dropped sharply in mid-June, sending yields upward, just after Mr. Bernanke said that the Federal Reserve may begin scaling back its \$85 billion monthly bond purchases later this year as long as the economy continues to improve. What seemed like an obvious statement turned into a bombshell.

At the time of our May 1, 2013, Issue titled "No-Brainer Buying Opportunity", the yield on 10-year Treasury bonds was 1.61%. The Bernanke reaction sent that yield to 2.67 percent. The yield on 30-year Treasury bond jumped over 3.6 percent from just under 2.86 percent on May 1.

Although we have been expecting bond yield to rise, as they always do after a recession, even we were surprised at the market's sharp reaction and how much bond yields rose in a matter of days. As evidenced by statements from other Federal Reserve members aimed at calming the markets after the Bernanke bombshell, it became obvious that Fed members were also surprised at the bond market reaction.

Following Bernanke's statement were more signs of economic strength.

Consumer confidence climbed in June to the highest level in more than five years to 81.4 percent, which far exceeded expectations. The measure of consumer expectations for the next six months also climbed strongly to 89.5 percent.

Consumer spending accounts for 70 percent of the US gross domestic product (GDP) and is the primary driver of the US economy. The confidence of consumers comes from their sense of wealth. Primary sources of consumer wealth come from

houses and stocks. Crashes in the real estate and financial markets were the heart of the 2008-09 melt-down and recession, and they need to be at the heart of the recovery.

Increases in new-home sales and durable goods orders also exceeded expectations. The S&P/Case-Shiller property index jumped 12.1 percent from a year ago, the largest increase since 2006, and the volume of home purchases increased 2.1 percent, the most since July 2008. Demand for durable goods (meant to last at least three years) increased a robust 3.6 percent for a second month in a row.

Our Diffusion Index of Leading Economic Indicators (page 11) read 100 percent again which means that all of the most sensitive leading indicators we track were above their respective levels from six months ago. Even the Diffusion Index of Lagging Economic Indicators read 100 percent. Dual readings like this for several months only occur when the economy is recovering significantly.

The increases in 30-year Treasury bond yields jump-started our No-Brainer ETFs.

The most responsive ETF, **Direxion Daily 20 Plus Year Bear 3 Shares (TMV)** which uses 3:1 leverage, climbed from \$49.16 on May 1 to \$69.70, or 41 percent.

The **Proshares Ultrashort Lehman 20 Plus Year Treasury (TBT-NYSE)**, which uses 2:1 leverage, climbed from \$58.81 to \$76.13, or 29 percent.

The **Proshares Short 20 Plus Year Treasury (TBF-NYSE)** which uses no leverage, climbed from \$29.46 to \$32.20, or 9.3 percent.

Bernanke's statement is the best possible news for our No-Brainer ETFs. Although the economy was clearly recovering, and bond yields had already begun to rise, the Fed is promising to continue stimulating the economy until the recovery is firmly entrenched. By the Fed's definition, that means until the unemployment rate is around 7 percent. This means the rise in bond yields is not over. More likely, it is just getting started.

Keep in mind that the recent rise in bond yields occurred while the Federal Reserve is continuing its massive bond-buying program. The Treasury bond market is far greater than the Fed's coffers. The June jump in bond yields caused speculation that the Fed may have lost control.

Also keep in mind that the Federal Reserve's inventory of Treasury securities has expanded to \$3.35 trillion. This compares to \$879 billion six years ago in May, 2007. As we have been reporting, recent Federal Reserve meetings have been consumed with debates regarding the risks on continuing the massive quantitative easing bond-buying program for fear it will fuel future inflation and is causing asset bubbles.

A larger concern is about how the Federal Reserve is going to unwind its position without disrupting the financial markets. As the Federal Reserve begins to taper its massive purchases, and then unwind its holdings, interest rates and bond yields are certain to rise considerably more.

The jump-start in our No-Brainer ETFs since May 1 gives us a glimpse of the profit potential they have. We have refreshed our hypothetical models.

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

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

The price action of these ETFs is based on the changes in long-term treasury bonds, specifically BlackRock's iShares 20+ Year Treasury Bond ETF (symbol TLT) which holds a portfolio exclusively of long-term Treasury bonds with an average maturity length of 27.54 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. Fees, costs, and interest expenses will trim the price increases slightly. Conversely, an increase in TLT will cause our No-Brainers to drop in the same fashion.

To construct our models, we start with a projection of an increase in 30-year Treasury bond yield. We begin with today's yield of 3.50 percent, and project a 220 basis point rise using the same pattern that occurred from December 18, 2008 to June 10, 2009, which would bring the 30-year Treasury bond yield to 5.70. This projection is shown on the top chart.

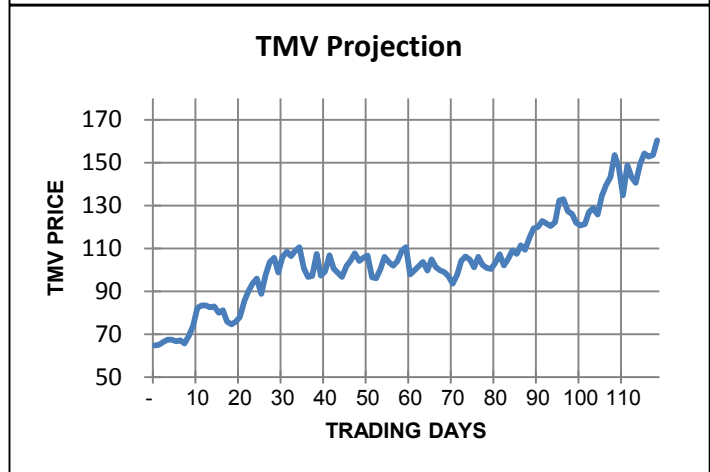
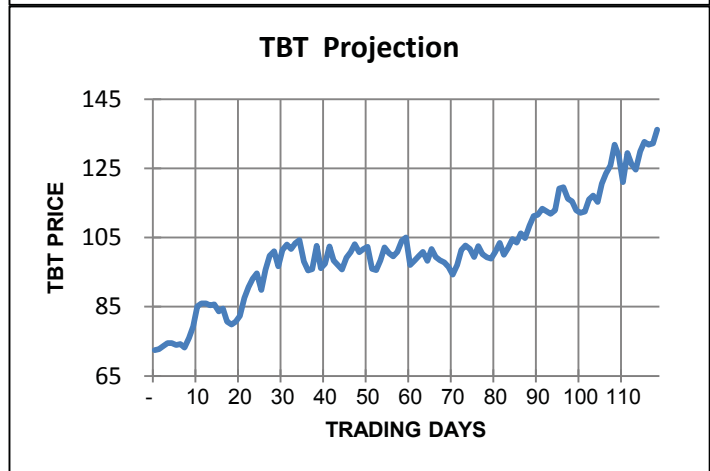
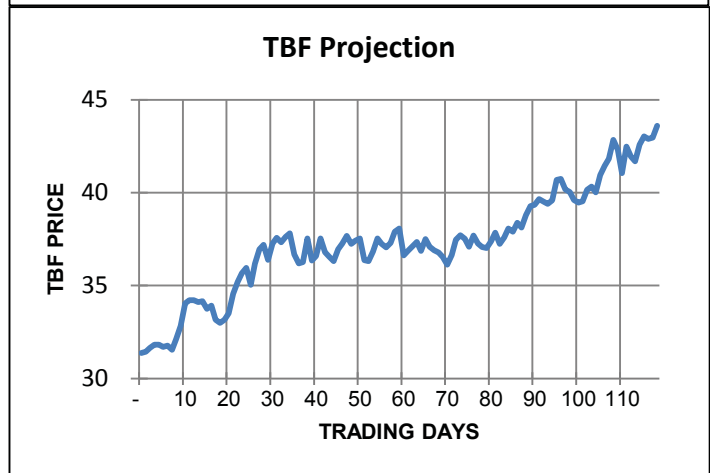
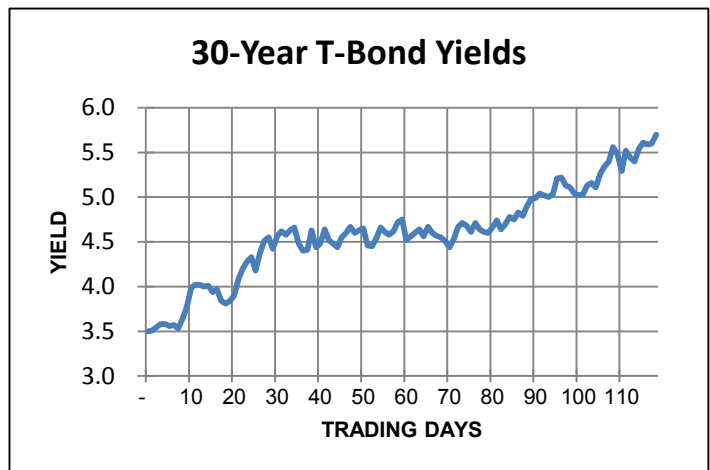
To project the impact on each of our No-Brainer ETFs from the 220 basis point rise, we determine the price of TLT on each day as if TLT's yield matched each day's 30-year Treasury bond yield. We then take the percentage changes in the price of TLT each day, and apply the reverse of these percentage changes to the prices of our No-Brainer ETFs, in accordance with the leverage each one uses.

Here is what would happen to each ETF with the 220 basis point rise shown in the top chart.

TBF (1:1 leverage) would climb from \$31.38 to \$43.6, for a 39 percent gain (see the second chart).

TBT (2:1 leverage) would climb from \$72.43 to \$136, for an 88 percent gain (see the third chart).

TMV (3:1 leverage) would climb from \$64.72 to \$160, for a 147 percent gain (see the fourth chart).



## The History of 30-Year Treasury Bond Yields



This graph shows the yields of 30-year Treasury bonds since 1977. As you can see, yields are still close to historic lows.

Source: Yahoo! Finance

### The Historical Perspective

We have included the graph showing the history of long-term Treasury bonds since 1977 to offer the historical perspective. As you can see, today's yields are still historically low. Also note that yields have been considerably higher than 5.8 percent most of the time. There is no reason the rise in long-term Treasury bond yields should stop at 5.8 percent. The case can easily be made that it won't, and that the rise in bond yields this time will be breath-taking.

These ETFs (especially the most highly-leveraged) are not for an indefinite "buy and hold" investment strategy. Excess volatility in bond yields over an extended period will cause erosion in the prices of these ETFs. More importantly, they will drop when bond yields decline, and are only for periods when bond yields are certain to rise substantially. However, these ETFs are worth a substantial investment right now for the immediate future because the profit potential is so great.

Clearly, the greatest and most explosive movement in long-term Treasury bond yields will be upward. Bond yields are still near historic lows, the economy is recovering which always pushes interest rates and bond yields upward, the Federal Reserve will start tapering its bond-buying soon, and then it will start unloading its historically large inventory. The rise in bond yields has already begun because, in its usual fashion, the market is beginning to anticipate these events. It's not a question of whether they will continue to climb, it is only a question of how much and how fast.

### Portfolio Updates

The uptrend in bond yields is good news and bad news for stocks. The good news is that the economic stimulus will propel the economic recovery which will boost earnings, and thus stock values. The bad news is the specter of rising interest rates. These cross-currents are bound to add to volatility, but on balance, the good news should outweigh the bad as long as the economy continues to recover and inflation remains at bay.

The rise in bond yields caused REITs to pull back, including AEC, CGMRX, and ROIC. Although the bulk of financing used by most REITs is at fixed interest rates, the prospect of high mortgage rates is a negative for future refinancing or credit lines. However, further economic growth out-weighs this negative because the increase in rental income more than offsets any increase in interest expenses. In addition, mortgage rates are still historically low and can advance significantly before reaching historically normal levels. Accordingly, the dip in REIT prices are presenting a buying opportunity.

Here are updates on the rest of our recommendations in alphabetical order. The table on page 7 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 down 13 percent this year, which has reduced our profit to 632 percent. This is the largest farm

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products retailer in North America and a wholesaler to the world.

In early June, to take advantage of low bond yields, AGU issued \$500 million 3.5% of debentures due June 1, 2023, and \$500 million of 4.9% debentures due June 1, 2043. Agrium intends to use the proceeds to fund anticipated capital expenditures and reduce short-term credit facilities.

This year's stock price weakness can be explained by the weakness in potash prices, which have been suffering because supply has been running ahead of demand. Another drought, like the one in 2012, would change the excess supply situation because potash contains potassium compounds and potassium-bearing materials which are effective in protecting against arid conditions. However, barring another drought, potash supplies are likely to be in excess for the next few years.

Although AGU sells potash, it also sells the other common fertilizer components – nitrogen and phosphate. In addition, AGU's retail segment provides counter-cyclical revenue from non-fertilizer products, including fungicides and pesticides, along with a variety of services.

There is no question fertilizers boost crop yields, and the yield of most crops is boosted from more than one nutrient. For example, nitrogen pairs particularly well with potash. Nitrogen-based fertilizers have been experiencing high margins because supplies of nitrogen are tight.

Arable land continues to disappear which requires a higher crop yields through the use of fertilizers. Growth is certain as an expanding worldwide population growing per-capita income exerts demand for crops.

AGU should earn \$10 this year with future growth ahead from a broad array of agricultural products and services. At less than 10 times earnings, this is a good value.

**AMN Healthcare (AHS)** is up 23.8 percent this year, extending our profit to 170 percent.

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

As the stock advanced, ultimately climbing close to \$16 a share, expanding the P/E over 25, we recommended holding off on purchases. The stock price has declined from its peak recently but is still above our upper buy limit. We continue to recommend holding for now and waiting for a pull-back to buy more.

**Associated Estates Realty Corp (AEC)** is unchanged this year after the dip in REITs. There was no significant news in

June. Last month we noted AEC has been reducing debt and diversifying into California, both of which were good moves.

This continues to be the most undervalued apartment REIT in the sector. The equity of its apartment portfolio translates into a stock value of \$27 per share. So the stock is still trading at a steep discount. It pays a nice yield as well.

**Boston Scientific (BSX)** is up 62 percent this year. Growth prospects have become more favorable from numerous new products as well as those currently in clinical trials. One of the most significant is *Watchman*, a device that decreases the chances of a blood clot in patients with erratic heartbeats. The *Watchman* is approved in Europe and in for FDA approval for use in the US.

In June, patients with Parkinson's disease using BSX's Vercise DBS System showed a significant improvement in motor scores. The system incorporates multiple independent current controls which selectively stimulate targeted areas in the deep in the brain.

It was also reported in June that BSX's Lotus device, which is inserted into the heart to fix a damaged aortic valve, was safely implanted without any severe leakage. The device improved blood flow through the repaired valve without complications and reduces the need for the traumatic, chest-opening surgery. Only one of the 60 patients developed a complication while 79 percent had little or no leakage.

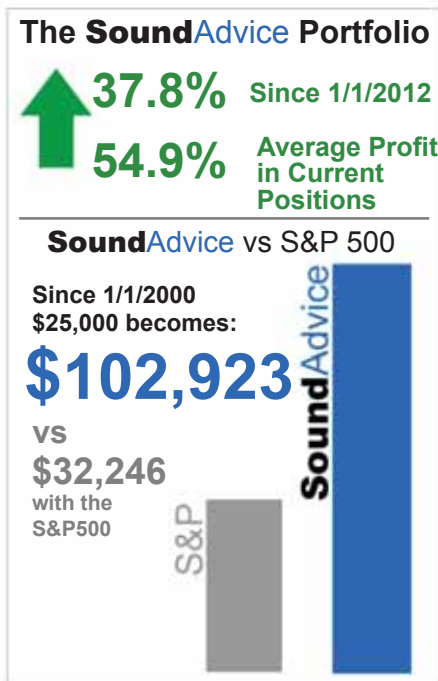
Researcher Ian Meredith, director of Monash Heart at Monash Medical Centre in Melbourne stated "This is a game-changer because all the first generation devices aren't repositionable when fully deployed ... There comes a point in the procedure where you have to let the valve go. With Lotus, you have almost obliterated the likelihood of regurgitation and at the same time given extreme control to the operator to get the valve positioned in exactly the right place."

BSX has begun getting approval for use in Europe, and will begin the studies needed for US approval of Lotus sometime next year.

BSX's medical products are well suited for an aging population in the US as well as emerging markets around the world, especially in India, China, Brazil, and Russia. Emerging markets only accounted for 4 percent of revenue in 2012, so there is considerable room for growth.

**CGM Real Estate Fund (CGMRX)** is up slightly this year, after the dip in REITs, leaving our profit at 58 percent. We believe that this fund is poised for considerably more gains ahead as the economy recovers.

Most of the time, above average investment returns can be earned in REITs. By far, CGMRX has been the best performer of REIT funds over the last ten years. (See the February 1st Issue of *Sound Advice* for the complete rundown of all



REIT Funds.) CGMRX has produced an annual return of 15.28 percent over the last ten years through June 27. By comparison, the S&P 500 produced an annual return of close to 8 percent over the same period.

Unlike the other mutual funds we recommend, CGMRX is not cleared through brokerage firms. You will need to call the fund directly to invest at 800-343-5678.

**Chesapeake Energy (CHK)** is up 22 percent this year giving us a gain of 24 percent since we added it to the portfolio.

CHK is the second largest producer of natural gas. We added it to the portfolio last year because it was greatly undervalued. Natural gas prices were historically low at the time, close to \$2.00 for one million BTUs. In addition the company had poor corporate governance, and was suffering from a severe cash squeeze. Natural gas prices have nearly doubled since our recommendation. Carl Icahn has been instrumental in removing the founder, Aubrey McClendon, as chairman of the board and replacing several other board members. CHK has sold most of the targeted divestments to straighten out its cash squeeze. Over the last four quarters, revenue has increased 14.2% on average year-over-year.

As a sign of the change in corporate culture, and the company's annual meeting in June, shareholders rejected a proposal to "declassify the board" that would have eliminated the current provision where the three-year terms of the eight directors are staggered. The proposal would have made it possible to replace the entire board of directors in one step.

Doug Lawler officially took over as CEO in June, after spending his entire career at Anadarko Petroleum and its predecessor Kerr-McGee. Lawler said "I don't think there could be a more exciting time to be at Chesapeake ... There have been so many good things done by the company in the past several years. I'm excited to be a part of it, and I look forward to working with this team and building on the success they've had in the past. It's an exciting time because there are so many good things going on here."

**In June, CHK was reported to be the leading driller in Ohio's Utica Shale, and CHK expects its success to accelerate this year along with a substantial decline in its costs which have dropped 30 percent recently.**

In addition, the opening of two major processing plants in the area this year is bound to provide a big boost to production. With the addition of the new infrastructure, CHK management is confident that it will achieve its year-end target of 330 million cubic feet of gas per day from its Utica wells. If that becomes a reality, it would quadruple the average first-quarter natural gas volumes.

CHK's natural gas and oil assets are extensive, close to 15 million net acres of oil and gas assets, and offer a large upside. Morningstar's fair value estimate is \$31 a share.

**Comcast (CMCSA)** is up 12 percent this year, extending our profit to 93 percent.

CMCSA is the nation's largest cable TV provider. But it is no longer just a cable company. It also provides internet and telephone service. CMCSA now has sole ownership of NBC Universal which operates major broadcast and cable networks

(NBC, Bravo, USA), as well as film studios (Universal Pictures), digital media content, and resort theme parks. CMCSA's synergistic array of products provides a solid growth path. Earnings have increased every year since 2003, and so have dividends since they commenced in 2008.

In June, CMCSA announced the launch of the X1 Platform which uses internet technology and cloud servers on Comcast's network to create the world's first entertainment operating system. X1 integrates the largest collection of video content with social media features, interactive apps, web content into one system.

During the National Cable Show in June, CMCSA unveiled its TV remote with a voice control as part of its new X2 operating system which moves the operations from the box to the cloud where it can be smarter by learning the user's preferences.

Broadband is the fastest growing sector of CMCSA. In addition to internet and cable TV, the company is using its fast internet speeds to deliver additional bundled services, including home thermostat controls and security systems with alarms and cameras, all of which can be accessed from a smart phone or tablet. The bundled packages are often less expensive than if delivered from separate providers.

The housing recovery will also add growth to consumer demand for CMCSA products.

**Commonwealth REIT (CWH)** is up 46 percent this year. On June 21, Corvex Management LP and Related Fund Management LLC, announced that they have delivered consents from holders of over 70 percent of the outstanding shares approving their proposal to remove the entire Board of Trustees. CWH management is contesting the validity of the consent solicitation, and the matter is currently in arbitration.

Corvex and Related Companies believe CWH is worth at least \$40 a share, and \$50 with better management. We agree, and this underlying value has been the primary reason for our recommendation.

Applying a 9 percent capitalization (cap) rate to the net operating income of CWH's real estate, which is a very conservative cap rate these days, the net equity of the company's real estate translates to \$41.44 per common share. At a more typical 7 percent capitalization rate, the net equity translates to \$63.74 per share.

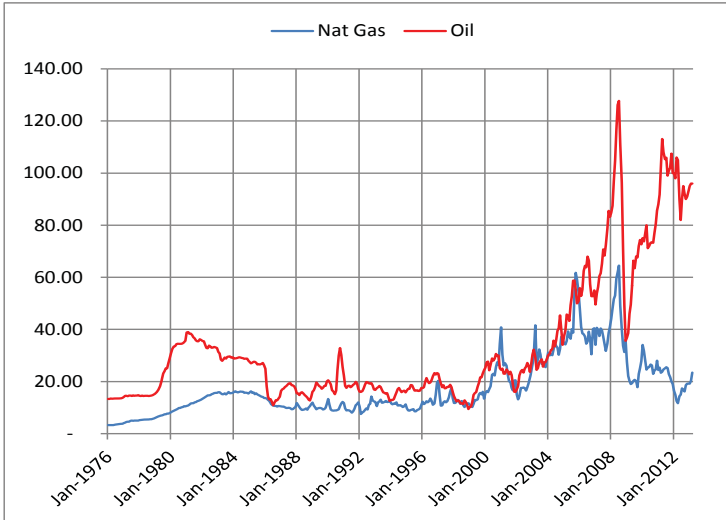
**Fidelity Select Natural Gas Fund (FSNGX)** is up 6.8 percent this year. This is the only mutual fund that concentrates on the natural gas industry, and a diversified play on the gap between the energy equivalents of oil and natural gas.

One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. So if a barrel of oil is say, \$100, that is the cost of 5.8 million BTUs of energy. On the other hand, with a market price for natural gas at \$4.00 for one million BTUs, 5.8 million BTUs will cost \$23.20 (5.8x4.00). So the same amount of energy is available for approximately 23.20 cents on the dollar -- if it is in the form of natural gas.

As the chart below 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. For 5.8 million BTUs of energy, it costs approximately \$100 if it is in the form of oil, but only \$23.20 in the form of natural gas.

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



The US is self-sufficient in natural gas with only 9 percent imported from Canada. At 23.2 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 fund is well positioned to benefit from an expanding natural gas industry.

**Hambrecht & Quist Life Sciences Fund (HQL)** is up 23 percent this year, extending our profit to 90 percent. The inexorable climb in the price of HQL has taken the price/earnings (P/E) ratio of the underlying portfolio above 25. Although these are typically young promising companies which tend to carry high multiples, we were not anxious to chase a high P/E and have had HQL on “Hold”.

However, in June, HQL dropped below our upper buy limit price, and it is now a “Buy”.

The most explosive profits in the entire healthcare industry can be found here in biotech companies. This is a volatile sector, so diversification is crucial. HQL is a superior way to gain exposure to biotech on a diversified basis.

**ICON Energy Fund Class S (ICENX)** is down slightly since we added it to the portfolio a few months ago. We added this no-load mutual fund because the demand for energy accelerates with an economic expansion. 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 produced an average above 13 percent annually through the end of June far outstripping the performance of the S&P 500. The superior performance is due to the fact that energy is in the fabric of the economy.

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. There is always the possibility of the added “bonus” of geopolitical disturbances threatening supplies and driving up energy prices.

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 energy funds. This no-load fund furnished an annual return of 14.8 percent during the last ten years through the end of June. This Fund’s performance also led the pack in shorter durations – 5 year, 3 year, and 1 year. See the April 1, 2013, Issue for a complete analysis of all no-load energy funds.

Derek Rollingson, who has managed the Fund since May 2007, emphasizes value. While the price of energy in its different forms is important, the real opportunities come from how the stock market reacts to changes within the industry: whether the market realizes the change too fast and becomes over-priced, or conversely, whether there is still opportunity to invest. This Fund focuses on the values created by changes, even by falling prices.

**Masco (MAS)** is up 17 percent this year, extending our profit to 164 percent. MAS manufactures a wide range of products for home construction and remodeling--everything from kitchen cabinets and faucets to windows and paint.

We added MAS to the portfolio at \$7.49 after the shares got hammered during the recession. However, after the share price rocketed, ultimately reaching \$22, we put the stock on “Hold”. The price/earnings ratio got too rich, climbing over to 30 times the 2013 earnings estimate of \$0.60 a share. This high price/earnings ratio is already anticipating a steep growth rate. We continue to recommend waiting for a pullback to accumulate more shares. The stock has been pulling back recently, but still above our upper buy price limit.

**Maxim Integrated Products (MXIM)** is down 5.5 percent this year, reducing our profit to 43 percent. MXIM specializes in high-performance electronic chips that convert digital signals into analog format. Such chips are in every cell phone. After receiving a digital signal, it must be transformed into an analog format so that we can hear it.

MXIM also makes integrated power management chips (PMIC) for portable devices makers to extend battery lives.

Revenues and earnings are growing sharply. Samsung’s cell phones and tablets are now contributing to 40 percent of MXIM’s revenues and 30 percent of earnings.

The Samsung Galaxy S4 smartphone went on sale the last week of April and has become the top-selling phone. In second place Samsung’s previous model, the Galaxy SIII. In third place is Apple’s iPhone.

The importance of Samsung is both a benefit and a risk. To diversify, MXIM is starting to sell integrated power management chips to other smartphone manufacturers who are aiming for growth in lower-priced handsets in emerging markets.

MXIM is in excellent financial health with more than \$1.5

Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Associated Estates Realty Corp	AEC	NYSE/Nasdaq	\$ 16.08	4.73%	\$ 18.00	BUY
Commonwealth REIT	CWH	NYSE	\$ 23.12	4.33%	\$ 25.00	HOLD
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 13.90	4.03%	\$ 15.00	BUY
Diversified Growth						
CGM Realty Fund	CGMRX	800-343-5678	\$ 29.82	1.61%	\$ 31.00	BUY
Comcast	CMCSA	NASDAQ	\$ 41.75	1.56%	\$ 42.00	BUY
Masco	MAS	NYSE	\$ 19.49	1.54%	\$ 18.00	HOLD
Paychex	PAYX	NASDAQ	\$ 36.51	3.51%	\$ 34.00	HOLD
Pfizer	PFE	NYSE	\$ 28.01	3.14%	\$ 30.00	BUY
Stryker Corp.	SYK	NYSE	\$ 64.68	1.31%	\$ 67.00	BUY
Xerox	XRX	NYSE	\$ 9.07	1.87%	\$ 10.00	BUY
Energy/Natural Resources						
Agrium	AGU	NYSE/TSE	\$ 86.96	2.30%	\$ 95.00	BUY
Chesapeake Energy Corp	CHK	NYSE	\$ 20.38	1.72%	\$ 24.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 32.96	0.17%	\$ 36.00	BUY
ICON Energy Fund Class S	ICENX	800-435-5697	\$ 21.31	0.00%	\$ 25.00	BUY
Tetra Tech	TTEK	NASDAQ	\$ 23.51	0.00%	\$ 26.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$ 12.94	3.44%	\$ 15.00	BUY
Aggressive Growth						
AMN Healthcare	AHS	NYSE	\$ 14.30	0.00%	\$ 12.00	HOLD
Boston Scientific	BSX	NYSE	\$ 9.27	0.00%	\$ 9.50	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 64.72	0.00%	\$ 75.00	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 31.38	0.00%	\$ 34.00	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 72.43	0.00%	\$ 78.00	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$ 17.87	0.00%	\$ 18.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$ 27.78	3.46%	\$ 33.00	BUY
Symantec	SYMC	NASDAQ	\$ 22.48	0.00%	\$ 25.00	BUY
Tellabs	TLAB	NASDAQ	\$ 1.98	0.00%	\$ 2.50	BUY

Prices are as of 6/28/2013. 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.

billion of cash and plenty of cash flow to support operations. The investment and resources necessary to develop MXIM's analog chips, and the years it takes to develop them, is an entry barrier for new competition. Once developed, these chips have long and profitable product lives.

**Paychex (PAYX)** is up 17.4 percent this year, extending our profit to 37 percent. This is the second-largest provider of payroll services to small to medium-sized companies serving a total of approximately 567,000 payroll clients. Accordingly, its revenues and earnings directly mirror the employment situation. There is definitely further growth ahead with a recovery in the economy. Another attractive feature is its pristine with no long-term debt exposure.

However, in its typical fashion, the market has been anticipating future growth by bidding up the stock price. The price/earnings ratio has been over 20 which is substantially

above the market and not a bargain. Accordingly, we have had PAYX on "Hold".

At the end of June, PAYX reported flat earnings which was a disappointment and the stock declined. However, it is still above our buying zone, and we recommend that you hold for now and wait to accumulate any more shares on further weakness.

**Pfizer (PFE)** is up 11.7 percent this year, extending our profit to 67 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. Pfizer is poised to launch several blockbusters in cancer, heart disease, and immunology.

The company's two most promising new products are Xeljanz for rheumatoid arthritis and Eliquis for stroke prevention.

Both were approved in late 2012 and are scheduled to be widely available later this year. Eliquis could be Pfizer's next blockbuster with sales of \$5 billion.

Pfizer is the world's largest pharmaceutical firm, with annual sales near \$60 billion. Pfizer's large size gives it economy of scale and the resources to finance the research and development of new drugs. It has more than 80 drugs in the development stage and 90 in the discovery stage.

**Zoetis (ZTS).** In case you missed our June 6<sup>th</sup> website blog, Pfizer sent out an offer to exchange your stock for Zoetis. We recommended that you REJECT the offer. We looked at this gift horse in the mouth.

PFE said a full exit from ZTS in this exchange offer will be accretive (beneficial) to its earnings per share. That can only mean it will be detrimental to those accepting the offer. PFE said if this offering did not do the job, PFE would keep trying. However, in late June, PFE exchanged all of its ZTS stock.

Zoetis receives the majority of its revenue from raising livestock for the production of food, primarily cattle, pigs, and poultry. The FDA recently issued voluntary guidelines for the use of antibiotics on animals. We believe that there is a substantial risk that the FDA will be issuing more restrictive, involuntary guidelines regarding the use of antibiotics on production animals in the future which would be highly detrimental to Zoetis.

**Retail Opportunities Investment Corp (ROIC)** is up 8.2 percent this year after the dip in REITs, extending our profit to 31 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. 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.

In June, Standard & Poor's Ratings Services has assigned an investment grade corporate credit rating to ROIC. According to the Standard & Poor's report, the rating reflects ROIC's portfolio of well-positioned, well-occupied shopping centers that are located in multiple major markets on the West Coast with high barriers to entry and above average household incomes. Additionally, Standard & Poor's noted that ROIC's leverage and coverage metrics are healthy compared to those of similarly rated peers.

CEO and President Stuart Tanz stated, "We are pleased to have earned an investment grade credit rating ... It reflects our long-standing commitment to growing our business prudently while maintaining a strong and flexible balance sheet ... Having achieved an investment grade rating from S&P, together with the previously announced rating that we were awarded from Moody's of Baa2, we are well positioned to access the investment grade unsecured debt market going forward. We believe this will enhance our competitive position in the market place as we continue to pursue opportunities to grow our portfolio."

Based on its peers (Regency Centers, Acadia Realty Trust, and Kimco Properties), ROIC should trade close to \$18 a share in today's market.

**Stryker (SYK)** is up 18 percent so far this year, extending our profit to 56 percent. SYK is best known for its orthopedic devices: 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.

Reconstructive implants account for 45 percent of SYK's revenues, and more profits are assured by accelerating demand for joint replacements on aging 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 over \$2 billion in net cash) and robust cash flow, gives SYK multiple avenues for growth through mergers and acquisitions. The stock hit a new 52-week high in May.

**Symantec (SYMC)** is up 19 percent this year, extending our profit to 34 percent. SYMC is the dominant supplier of software for computer security and protection against viruses and other nuisances through its leading flagship brand, Norton.

We added SYMC to our portfolio when it was cheap and when the company was suffering from operational inefficiency and lack of direction. In July, 2012, Steve Bennett took over as the new CEO and has streamlined operations while giving SYMC stronger direction.

SYMC is expanding its cloud computing customer base through its new product "Norton Zone" which allows users to safely access, sync, and share photos, videos and documents from any of their PC, Mac, Android, or iPhones and iPads.

Protection from cyberespionage is definitely a growth industry. There was a 42 percent surge in attacks during 2012. Mobile malware increased by 58 percent, and 32 percent of all mobile threats attempted to steal information, such as e-mail addresses and phone numbers. This year's data shows that cybercriminals aren't slowing down. They continue to devise new ways to steal information.

SYMC will be embarking on a cost-cutting program in the next couple of quarters by thinning the ranks of its layers of 30 to 40 percent of its mid-managers. The benefits of this program should be appearing later in 2013 and early 2014.

**Tellabs (TLAB)** designs and manufactures hardware and systems for the telecommunications industry. It is down slightly this year, still near its all-time low and below its net asset value.

The company's balance sheet at the end of its most recent quarter shows cash and equivalents of \$1.13 billion, which works out to \$3.14 per share. Adding in its other assets, including properties and equipment (less depreciation), but excluding the paper assets of Goodwill and Intangibles, TLAB's assets total \$1.42 billion, or \$3.95 a share. The company has no debt, but short-term liabilities total \$507 million, leaving net assets of \$912 million, or \$2.54 per share. The reason TLAB is selling below its net assets is because it

is running deficits which are likely to continue into 2014. The loss of AT&T as a customer for its Ethernet routers was a blow because 35 percent of revenues came from AT&T. While AT&T was a substantial customer, 39 of the Fortune 100 companies still use TLAB's products and systems. In June, TLAB joined forces with **WESCO International (WCC)** to distribute TLAB's popular fiber optical network systems products. This collaboration broadens TLAB's exposure to US businesses as well as government agencies because its "Optical LAN" is JITC-certified for use in government networks.

WESCO is a leading distributor with annual sales of \$6.6 billion. The Company employs approximately 9,000 people in 475 full-service branches in North America and international markets. It maintains relationships with over 18,000 suppliers and 65,000 active customers worldwide providing a local presence for customers and a global network to serve multi-location businesses and multi-national corporations.

Dan Kelly, CEO and president of Tellabs said "We're excited to add the capabilities of WESCO to the innovation of Tellabs Optical LAN, which saves customers money by reducing their capital expenses, energy consumption and space needs ... Through WESCO, many more businesses, organizations and government agencies will be able to save money by leveraging Tellabs' Optical LAN solution."

Tellabs fiber optical systems combine all of a building's communications networks into one, improving security and eliminating the need for future re-cabling. They save 80% of energy consumption over conventional copper wire Ethernet network systems in addition to saving up to 70% of the cost of ownership.

Its fiber optical systems and products accounted for 41 percent of TLAB's total revenue in 2012. Increased sales through WESCO's strong distribution network should be substantial and help offset the loss of AT&T's revenues.

TLAB has begun buying back its shares, and plans to reduce the float by 20 percent.

At a discount to its net assets, there is very little downside risk. As profitability comes into focus, the market will anticipate a brighter day ahead and bid up share prices. The profit potential is very large from the current depressed price.

**Tetra Tech (TTEK)** is up 4.2 percent this year, extending our profit to 79 percent. TTEK is a leading company in water technologies and environmental remediation with a healthy balance sheet.

In June TTEK announced that its third quarter will show a loss of up to \$0.50 a share due to a one-time charge to reflect increased restructuring costs from weakness in Eastern Canada and mining. We had TTEK on "Hold" and this announcement caused the stock to drop into our "Buy" zone. We view this news as temporary and does not change our view that TTEK will continue to see growth from cleaning up the world's environmental messes.

TTEK currently has a record backlog of approximately \$2 billion from contracts to clean up the McClellan Business Park in California (formerly the McClellan Air Force Base), and

to remediate the Naval Facilities in North Carolina, Virginia, Maryland, Connecticut, Maine, West Virginia, Africa, and Vieques, Puerto Rico.

The greatest growth potential continues to be outside the United States in China and India, where environmental concerns have been at best an afterthought. Only now are these governments starting to recognize the consequences. As these and other governments around the world make this a priority, Tetra Tech should be a prime beneficiary.

Also in June, the board of directors authorized a \$100 million common stock repurchase program.

Accordingly, we advise using the current weakness as a buying opportunity.

**USAA Precious Metals & Minerals Fund (USAGX)** is down 51 percent this year as the price of precious metals suffered. Rising interest rates (as led by rising bond yields) have strengthened the dollar which has adversely impacted all commodity prices. However, this is not a permanent situation.

When the economy gets more traction, there will be an upward pull on the prices of commodities including precious metals. USAGX is the best diversified way to invest in precious metals. It is the top-performing fund, and has constantly outperformed precious metal equities for ten years. Even after the poor markets and declines of precious metals, USAGX still provided an annualized return of 11.5 percent over the last ten years through the end of May.

**Xerox (XRX)** has climbed 33 percent this year. XRX has been transforming from a seller of printers and copiers to a company providing services on those machines as well as I.T. services in a variety of other areas. The revenue from services is more profitable and less cyclical, and it now accounts for half of XRX's revenues.

We expect growth to continue from services as well as technological advances in its color output equipment. Xerox has quietly been ushering in the next generation of new digital color-output equipment which should benefit 2014's bottom line. For example, in June, XRX introduced its new Wide Format IJP 2000 to meet the growing demand for full-color large posters and banners. It completes jobs 40 times faster than comparable wide format systems using five print heads in one single pass with instantly drying ink.

Meanwhile, XRX is continuing to buy back its own stock. After buying \$700 million in 2011 and \$1.1 billion in 2012, stock purchases will likely be within this range in 2013 and 2014.

XRX is expected to earn \$1.00 per share and at least \$1.10 next year. At less than 10 times 2013 earnings, XRX is at a steep discount to the overall market's price earnings ratio of approximately 14. XRX is still dirt cheap. Morningstar's fair value estimate of the stock is currently \$11 per share which is still only 11 times 2013 earnings. However, even \$11 is 28 percent above the current price.

## 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 \$9,229,412 in stocks and to \$1,430,723 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 \$366,831,209, 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 1.58. This reading reveals that stock prices are slightly 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 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 - 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 100 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 economy shows significant 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 0.1 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%		-0.1%

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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