

SoundAdvice

Advising Investors for 30+ years

March 2020 Issue

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The Coronavirus Correction

Concerns over containing the Coronavirus (COVID-19) and the potential for slowing world-wide economic growth began to hit the market in late January and spread fear into nearly all sectors in February. In our last issue at the beginning of February, we noted that “until it is clear that containment efforts are working, the market is likely to suffer in the near term.” That certainly happened.

Fears over unpredictable rates of contagion and the impact on world-wide growth will continue to affect the market adversely until containment is apparent. In recent issues, we have been warning that the market was over-valued and vulnerable to “an accident waiting to happen”. Well, here it is.

Even after the recent correction, the stock market as a whole is still very expensive, with the price/earnings (P/E) ratio over 20 based on trailing 12-month earnings of the S&P 500 stocks. This is very close to the highest P/E since the bull market began in 2009.

Our Sound Advice Risk Indicator (page 10) remains substantially above 2.0, revealing that it is a very high-risk time for stocks.

Our Sound Advice Diffusion Index of Lagging Indicators (page 11) is still giving us a Caution Signal based on the latest leading economic indicators for January. We will be watching these indicators closely for changes that may be caused by the Coronavirus.

The Portfolio

Our investing approach continues to be defensive. We continue to recommend that you keep a substantial amount of cash on the sidelines. We cannot tell you how much, because we are not familiar with your particular financial situation, but it should be substantial to you. All recommendations are summarized in the table on page 9 and sorted by investment objective categories and then in alphabetical order. This table is updated and live on our website.



Gray Cardiff, Editor

Investment returns in prior years have been calculated independently by the Hulbert Financial Group and concur with ours. From 2000 through 2019, the *Sound Advice* model portfolio averaged a 9.8% annual return versus 4.0% from the S&P 500.

Our portfolio recommendations are made regarding the money you have allocated to the stock market, and in accordance with our current cautionary mode. We believe our selections are exceptionally strong values; trading at a significant discount to the rest of the market, which should give them buoyancy in both good and bad market conditions over the longer term. To add downside protection, we continue to recommend hedging your portfolio.

ProShares UltraShort S&P 500 (SDS) essentially short-sells the market and will benefit from down-drafts in the S&P 500. It is designed to produce two times the daily fluctuations of the S&P 500 index. A decline of say, 1.0 percent in the S&P 500 will cause SDS to increase by 2.0 percent. Conversely, an increase in the S&P 500 will cause SDS to decline in the same fashion. We have been tracking SDS and confirmed that it is performing as it should, with daily premiums and discounts within 0.5 percent. It is also very liquid. Sadly, this was our best performing position during February because it was the only position that had a positive gain (up 15.7 percent).

Real Estate Selections

The Sound Advice portfolio only includes real estate stocks offering an extraordinary value now. An established method of evaluating real estate is to measure the cash yield before any debt service. In real estate parlance, this is called a capitalization (cap) rate. Like a bond yield, a lower cap rate means a higher asset

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price. Currently, a cap rate of 7 percent is considered attractive for the quality and location of the properties held by our recommended companies. By evaluating a company’s real estate portfolio using a 7 percent cap rate, we can gauge the value of its stock.

We are recommending two real estate investment trusts (REITs) in the hospitality industry. A major drag on this industry has been the proliferation of Airbnb and similar competition. However, this is changing in major metro areas. New York City is the most recent to pass a measure prohibiting transient rentals of fewer than 30 days at a time without the host being present. San Diego, Los Angeles, San Francisco, Boston, Washington DC, Philadelphia and Miami have also passed similar measures.

RLJ Lodging Trust (RLJ) reported fourth quarter financial results in late February. Funds from operations (FFO) of 41 cents per share beat expectations.

By valuing the company’s real estate portfolio at a 7 percent cap rate, RLJ is worth \$33.37 per share which is substantially higher than the current price. RLJ has a large and diversified portfolio in 25 states and the District of Columbia. The majority are located in business districts within major metropolitan areas where business travelers represent the majority of the demand. We believe the net operating income (and thus the value of the stock) is primed to improve as the company executes its mission to sell its non-core assets since the August 2017 merger with FelCor, and to renovate and upgrade significant properties. In the fourth quarter, the Company sold five hotels in Austin TX for a total sales price of \$67.6 million. In all of 2019, the Company sold 47 properties

in five separate transactions and repurchased 4.6 million shares of its common stock at an average price per share of \$17.01 for approximately \$77.8 million.

The annual dividend is \$1.32 per share. This is close to a 10 percent yield at the current stock price. Such high yield causes one to question the sustainability of the dividend. However, funds from operations (FFO) available for common shareholders in 2019 amounted to \$341 million, or \$2.07 per share. Moreover, the company ended the year with \$882 million in unrestricted cash on its balance sheet. Accordingly, the dividend appears reasonably secure. Of course, adverse events could compromise the company’s FFO and reduce the dividend coverage. Even if the dividend were reduced by 30 percent, the yield would still be 7 percent.

Hersha Hospitality (HT) is worth \$24.45 per share, substantially greater than the current price of the stock. Net operating income from the real estate portfolio is bound to increase from major renovations to hotels in Philadelphia, Boston, and New York. Of course, increases in net operating income will also increase the net asset value of the company’s portfolio along with the value of the stock.

The annual dividend is \$1.12 per share which is also close to a 10 percent yield at the current stock price. Funds from operations (FFO) available for common shareholders in 2019 amounted to \$67.6 million, or \$1.74 per share, which is in excess of the dividend. The company ended the year with \$27 million in unrestricted cash on its balance sheet, which is somewhat thin because it is less than one year’s FFO. Hersha is more vulnerable to adverse events than RLJ which could com-

Hospitality REITs Comparison Table

Company	Symbol	Recent Stock Price	Dividend Yield	Stock Market Cap Rate	Portfolio Value @ 7% Cap Rate (\$Millions)	Stock Value	Discount (-) Premium (+)
RLJ Lodging	RLJ	13.21	10.0%	13.0%	7,407	33.37	-60.4%
Hersha	HT	11.53	9.7%	8.8%	2,419	24.45	-52.8%
Service Properties	SVC	21.78	11.3%	10.3%	12,812	42.92	-57.9%
Host Hotels & Resorts	HST	16.35	5.5%	12.3%	23	27.80	-47.9%
Apple Hospitality	APLE	15.00	9.2%	10.4%	6,638	22.79	-42.7%

The table above shows the “Stock Market Cap Rate” (what the stock price is paying for the underlying real estate portfolio) for several comparable hospitality stocks. The “Stock Value” column shows the current value of the stock assuming the underlying portfolios are valued using a cap rate of 7.0 percent, which is close to the average cap rate on recent hotel transactions. The last column shows the discount or premium at which the stock is trading based on a 7.0 percent cap rate valuation of each company’s real estate portfolio.

Service Properties (formerly Hospitality Properties - HPT) is trading at a large discount. However, this company is externally managed by RMR which charges high fees and suppresses value. As long as RMR continues to externally manage HPT, we do not expect to see significant growth. **Host Hotels and Properties (HST)** is very small, with only 749 thousand shares outstanding, which may lead to excessive volatility. Growth may be limited by its small capitalization.

promise the company's FFO and reduce the dividend coverage. As in the case of RLJ, even if the dividend were reduced by 30 percent, the yield would still be 7 percent.

Hersha recently agreed to sell 4 hotels for \$144 million and will use \$97 million of the proceeds to pay down debt. Cash flow is likely to be thin this year, but improve substantially next year.

President and COO Neil Shah recapped the company's position in the fourth quarter earnings call in late February:

"Over the last few years, our portfolio has been recycled and renovated to now include young, higher growth, higher RevPAR [revenue per average room] producing assets with very low CapEx requirements and significant EBITDA ramp on the horizon. And with our stock trading more than 30% below our internal NAV, at an 8% dividend yield with one of the lowest payout ratios in the sector, we believe this is a particularly attractive entry point for investors."

Real Estate Preferred Stocks

We are recommending three preferred stocks because they are inherently defensive and are yielding above 6 percent. They have first claim to the company's cash flow for their dividends. Only after the preferred dividend is satisfied, can the remaining cash flow be used to pay the dividend on the company's common stock. Additionally, these are cumulative preferred stocks, which means that any missed preferred dividends must be paid in full first before common stock dividends could be paid.

In view of the safety of these preferred stocks, they are astonishing values in comparison to the paltry yields on long term bonds (less than 1.2 percent on 10-year Treasury bonds or 1.7 percent on 30-year bonds).

We continue to point out that most preferred stocks have a relatively small number of outstanding shares, which means the daily trading volume is thin. We recommend using limit orders that specify your purchase price (instead of market orders which can be executed at any price). There is usually a large spread between the "bid" and "ask" price. Placing your price close to the midpoint usually works, or you can place your limit lower and wait for a price dip. We also recommend being patient with your purchase. It could take a while to fill.

Our first two recommendations are those of Hersha (HT) and RLJ.

RLJ \$1.95 Series A Cumulative Convertible Preferred Shares is often quoted as RLJ.PA, but on the iPhone it is RLJ'A, and Fidelity uses RLJPRA. In any case, this is the only RLJ preferred stock.

Normally, preferred stocks have a call provision whereby the company can buy them back at a certain price (par value) at a certain date (call date). However, this preferred does not have this provision which means this stock has unusual upside potential.

The only way the company could redeem this preferred stock is if RLJ common rose to \$115.82 per share, an enormous rise in RLJ from its current price, which we are not forecasting any time in the foreseeable future. Instead, the upside potential comes from a drop in the yield on this preferred, which is highly likely.

This preferred stock pays \$1.95 annually per share (which must be paid before the common stock dividend) providing a yield above 7 percent. If the yield drops to, say 5 percent, which would still be a good value, the price of this preferred would rise substantially because there is no call provision. At a 5 percent yield, the price of this stock would be \$39 per share, a 40 percent increase. Meanwhile, the yield is excellent. It is also quite secure.

The preferred dividend in 2019 amounted to \$25 million, which was only 6.8 percent of the company's \$367 million funds from operations (FFO). A great deal would have to go wrong before this preferred dividend would be threatened. Even then it would have to be made up before dividends on the common stock could be resumed.

Hersha's Preferred D is callable on 5/31/2021, which can be exercised later at the company's option, at \$25 per share. The annual dividend is \$1.64 per share which provides a yield of 6.6 percent. Ticker symbols also vary from HT.PD, HT'D for an iPhone, and Fidelity uses HTPRD. We recommend using a limit order at or below \$25 and waiting to let the market come to you. To pay more than \$25 would reduce your overall return.

To evaluate the security of this dividend, we can perform the same analysis as we did with RLJ. Hersha has three preferred stocks which require \$24.2 million in annual distributions. This is 26.3 percent of the company's total FFO, making it less secure than RLJ's preferred. Still, substantial adverse conditions would have to occur before this preferred dividend would be threatened. Because this is also a cumulative preferred stock, all of the unpaid dividends on the preferred stocks would have to be made up before dividends on the common stock could be resumed. Moreover, this preferred stock is likely to be called on 5/31/2021, making the holding period relatively short.

RPT Realty 7.25% Series D Cumulative Convertible Perpetual Preferred pays an annual dividend of \$3.62 which provides a 6.7 percent yield. It is a convertible preferred stock, convertible into 3.7758 shares of the common stock (RPT).

RPT Realty is a real estate investment trust (REIT) currently owning 49 shopping centers across the eastern US, consisting of town center, urban-infill neighborhoods, and power center properties with national chain store tenants, market-leading supermarket tenants, as well as a strong lineup of smaller national retailers. Centers also include entertainment components, including theaters, fitness centers, and restaurants.

The company's culture and business objectives have changed as new CEO, Brian Harper, and his new executive team have been repositioning the company's portfolio of shopping centers by selling off those which are not scalable, or in less desirable locations, while expanding those in the best locations.

The value of RPT's real estate portfolio is \$2.3 billion at a 7 percent cap rate. Adding the company's other assets and subtracting its liabilities leaves an equity of \$19.77 per common share (RPT). Currently RPT is trading at 12.96 per share, a 34 percent discount to that value.

The conversion value of the common stock is close to the current price of the preferred stock, which gives the preferred stock nearly the same upside as the common stock. Interestingly, the yield on the preferred is close to the yield on the common stock, which is unusual because the preferred is a much safer investment. The preferred dividend was only 6.6 percent of the company's FFO in 2019, making it a very secure dividend because it must be paid first, and paid in full before any dividends are paid on the common stock.

Unlike most preferred stocks, this preferred stock does not have a call feature, which is why it is "Perpetual." Each share has a "liquidation preference" of \$50 per share in the event the company is liquidated due to bankruptcy, but that preference does not allow the company to call (redeem) the preferred shares. However, the company does have the right to convert the preferred shares into common shares if the common stock rises above 130 percent of the conversion price, which means the common stock would have to rise above \$17.28 per share. At that price, the conversion value would raise the price of the preferred above \$65. In the event such a conversion took place, a decision could be made at that time whether to keep the common stock or not.

The ticker symbol of this preferred stock varies depending on the device you are using or the brokerage service. It is often quoted as RPT.PD, but on the iPhone it is RPT'D, and Fidelity uses RPTPRD. In any case, this is the only RPT preferred stock for RPT Realty.

Real Estate Mutual Fund

Third Avenue Real Estate Value Investor Fund (TVRVX) is loaded with good values substantially below their net asset values (NAV) with strong growth

prospects. Management has a similar approach to ours because it is very price conscious, especially in relation to net asset value. Just as we do at Sound Advice, they eat their own cooking – they invest a substantial amount of their personal assets into their funds. In December, TVRVX paid out a distribution of \$4.4966 per share.

This fund is a global real estate fund which means it is not confined to US real estate with low cap rates. Management looks for growth more than current income by focusing on real estate operating companies which, unlike REITs, can reinvest profits back into the business. Management also searches for opportunities in different aspects of a real estate company's capital structure by investing in senior debt in addition to equity. Also, unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities.

Energy & Natural Resource Selections – Common Stocks

The concern over the impact of the Coronavirus on world-wide demand for oil, refined petroleum products, and natural gas continued to drive down the price of all energy-related companies, making them a timely investment for the longer term. However, we recommend limiting choices to those who are bound to exhibit growth even with stagnant oil prices.

Chevron (CVX) expects company-wide production to grow 3 to 4 percent during the next five years. As we point out regularly, Chevron is an integrated oil company, which means it has operations in production as well as refining. This gives CVX diversification because the company's oil and gas production (upstream) benefits from rising oil and gas prices while the refining operations (downstream) tend to benefit from lower oil prices. This diversification adds financial stability during times of volatile oil prices.

CVX has an attractive and sacrosanct dividend that provides an attractive yield. This means we can continue to expect annual increases in the dividend which is already providing an attractive yield.

Exxon Mobil (XOM) recently started investing aggressively for growth in the Permian Basin and offshore Guyana, South America. Even with stagnant oil prices, the company's increasing production prospects are strong enough to produce significant earnings growth in the next five years. The company projects overall earnings to more than double to \$7.78 per share by 2025 with the price of oil averaging \$60 per barrel.

As in the case of Chevron, Exxon is an integrated oil company, which means it has operations in both drilling and producing oil (upstream operations) as well as refining that production (downstream operations). These segments often balance each other. Of course, upstream operations benefit from higher oil prices. However,

because oil is a feedstock to downstream operations, and therefore a cost of production, downstream operations benefit from lower oil prices. This balancing effect may carry different weights at times, but generally one hedges the other and offers a safer investment.

The current dividend is \$3.48 per share, which is greater than 6 percent. Exxon and our other major oil recommendation, Chevron, are the only energy companies to maintain dividend increases over many years. Exxon's dividend has increased each year for 37 consecutive years. Exxon has a top credit rating of AAA with the strongest balance sheet in the energy sector.

Valero Energy (VLO) has a bright future in renewable diesel which reduces greenhouse gas emissions up to 80 percent because it only releases as much carbon dioxide that the animal or plant waste material originally contained. Renewable diesel does not gel at low temperatures which means it can be easily transported through pipelines. Use for sustainable aviation fuel is expected to be a primary escalating demand factor. Valero is positioned with assets that are difficult and time consuming to replace. Under the current EPA requirements for increasing renewable diesel use, Valero will be tripling its current capacity in the next few years and make renewable diesel close to 25 percent of Valero's operating profit by 2025.

The new marine fuel regulations took place in January, requiring all vessels sailing in international waters to use the more environmentally friendly low-sulfur diesel fuel which needs extensive refining and is more profitable for refiners. Over the longer term, the new fuel regulations are expected to boost annual demand for low-sulfur diesel fuel by four-fold.

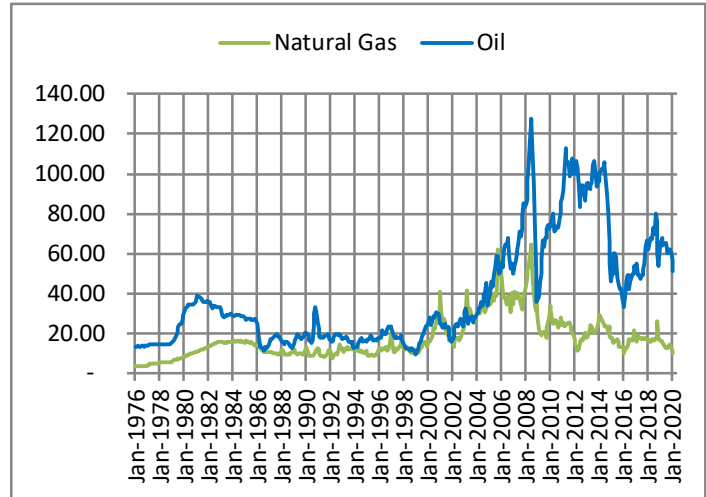
We continue to point out that Valero has the flexibility to refine substantial quantities of both US light sweet (low sulfur) as well as heavy sour crude. This bodes well under the new regulations and over the longer term. Valero also has access to the US pipeline network for delivery to its gulf coast locations. This flexibility allows the company to capture the highest margins among its competitors because it can take advantage of the temporary local gluts of crude, whether it's low or high-quality crude, or light sweet or heavy sour, and receive the best discounts for its feedstocks.

Energy & Natural Resource Selections – Mutual Funds

Adams Natural Resources (PEO) is being deleted from the portfolio because we are reducing our exposure to the oil and gas market and it is not likely to deliver growth with stagnant energy prices.

Fidelity Select Natural Gas Fund (FSNGX) is an open-end fund which means it trades at the NAV of its portfolio set at the close of the market each day. It is a diversified way to participate in the growth of the natural gas industry

The Cost of Energy Equivalents of Oil and Natural Gas



through strong companies. In December, FSNGX paid out a distribution of \$0.197 per share.

Natural gas provides the same energy as oil for pennies on the dollar, and natural gas is more environmentally friendly. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. However, with the current market price for natural gas at \$1.73 for one million BTUs, 5.8 million BTUs will cost \$10.03. Thus, with a barrel of Brent crude oil costing \$51, the same amount of energy is available for 20 cents on the dollar if it is in the form of natural gas rather than oil.

The updated chart above shows the historic relationship between the costs of these two forms of energy. The red line shows the price of a barrel of oil since the mid-1970s. The green line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. The fact that natural gas provides energy for pennies on the dollar translates into an expanding natural gas industry.

Medically-Related Selections

Both of our selections make medical devices and products which are well-suited for an aging population. They are defensive in nature because they are not largely dependent on economic conditions. They also avoid the current uncertainties over drug pricing and patent expirations facing pharmaceutical companies.

Boston Scientific (BSX) continues to be 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. The company's stream of new inventions acquisitions continues to add to promising growth prospects.

Stryker (SYK) provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products. Its orthopaedic devices for artificial knees and hips lead the industry. SYK has a very high return on equity which is propelled by its strong balance sheet and its ability to make strategic acquisitions.

The Best in Biotech ETFs

Biotechnology has become a major industry and the source of the world's top breakthrough drugs. Biotech companies offer the most explosive profits in the healthcare industry. However, stocks of individual biotech companies are often volatile. Diversification is essential and can be accomplished by investing in a diversified biotech electronically traded fund (ETF) investing exclusively in a portfolio of biotech companies. We are recommending two top performers.

ARK Genomic Revolution Multi-Sector (ARKG) is an actively managed biotech ETF investing in companies expected to benefit by incorporating technological and scientific developments and advancements stemming from mapping the human genome. Breakthroughs and advancements have cut the cost substantially of mapping the human genome which is opening up new opportunities and making this sector the cutting edge of new innovations.

Virtus LifeSci Biotech Products (BBP) is a passively managed biotech ETF that weighs the portfolio selections essentially equally, as opposed to weighing selections according to market capitalization. This is an important aspect because biotech ETFs weighing their portfolio selections essentially equally have been the best performers by far because they have larger investments in smaller biotechnology companies which are acquisition targets for large pharmaceutical companies looking for ways to revitalize their drug portfolios by scooping up smaller companies.

Financials

Today's relatively flat yield curve is unusual and not a historical norm and will not remain flat indefinitely. When more normal times return and the yield curve is no longer flat, banks will prosper. That eventual return to historical norms is why these stocks present an extraordinary value.

JP Morgan Chase (JPM) presents a good value, especially in comparison to the rest of the market. At the relatively modest P/E ratio of, say 15, JPM would be \$160 which is substantially above the current stock price.

Wells Fargo (WFC) has most if not all of the troubling recent past behind and the future can only be brighter for WFC, especially considering the stock is very cheap due to all of the recent unsettling news. At \$44 per share, the P/E is 11. This P/E is a steep discount from the rest of the market, and it is based on 2019's earnings which were depressed by a hefty litigation charge and Federal Reserve limits on asset growth.

While we wait for a brighter day, WFC has a dividend yield of 4.3 percent. This attractive income also puts a floor under the stock price.

Small Caps

Numerous studies show that small caps perform better over the long run than the market as a whole. Small Caps 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 quite profitable.

Third Avenue Small-Cap Value Investor Fund (TVSVX) invests in companies with small capitalizations using the same value-oriented approach as it does with its real estate value fund (TVRVX). Management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value, and the ability to consistently grow NAV, with an initial targeted holding period of three to five years. A patient and price conscious acquisition is a critical first step in both protecting capital and in realizing an attractive investment return. In December, TVSVX paid out a distribution of \$1.4277 per share.

Special Situations

The rest of our portfolio falls into other market sectors, with companies that are presenting extraordinary values within their respective industries. Here they are in alphabetical order.

Apple (AAPL) has been on hold while we wait for a substantial correction from recent prices we believed were lofty. Our target price has been \$262 per share. On Friday, February 28, AAPL dropped below that price during the trading day but closed above it. We arrived at that target price because the company has \$206 billion in cash in the company's coffers which amounts to \$46 per share. Subtracting this cash from our target price of \$262 means we are actually paying close to \$216 per share for the company. This puts the P/E close to 17, based on the trailing 12 months earnings of \$12.66 per share. We continue recommending holding out for our target price.

Carnival Cruise Lines (CCL) has been torpedoed on news of the Coronavirus which makes it a striking value for the longer term. CCL has long-term growth prospects because of the company's dominance in the industry, efficiencies of scale, favorable demographic trends driving a lasting increase in demand, the company's extensive share repurchase program, and last but not least, the value the stock price is currently presenting.

Prior to the Coronavirus, the company expected earnings of \$4.30 to \$4.60 a share in its 2020 fiscal year. Management recently made the following statement:

“While not currently planned, if the company had to suspend all of its operations in Asia through the end of April, this would impact its fiscal 2020 financial performance by \$0.55 to \$0.65 per share, which includes guest compensation.”

Lopping off \$0.65 from the low end of the 2020 earnings estimate would leave \$3.65. The stock is currently trading at less than 10 times those earnings. During the last 5 years, the median P/E has averaged close to 19. At the reasonably conservative standard valuation of 15 times earnings, the stock belongs in the vicinity of \$54 per share.

Intel (INTC) sold its 5G modem business assets to Apple last year but still has a much bigger business creating chips that power the infrastructure for 5G networks. Intel recently added 18 new products in this segment.

Intel has the size, diversity, and industry dominance, to make a relatively safe investment in a high-growth, and often high-risk business. Intel can leverage new technology into its existing large platform without introducing unacceptable risks.

Intel has been buying back massive amounts of its stock over the last three years, including \$3.5 billion in the fourth quarter, reducing the number of outstanding shares by more than 9 percent. The company also raised the annual dividend from \$1.20 to \$1.32 per share. INTC is still trading at a relatively modest P/E based on the company's guidance of \$5.00 per share in 2020.

International Business Machines (IBM) has pulled back to an incredible value. The \$6.00 per share dividend provides an attractive yield and puts a floor under the price of the stock.

The company expects to earn at least \$13 per share in 2020. The current P/E of close to 10 anticipates practically no appreciable growth. Any prospect of growth should propel the stock from here, and there are strong prospects brewing.

The Red Hat acquisition has launched IBM into the enormous and growing hybrid data center market, allowing customers to modernize legacy cloud services so that they can work on both private cloud platforms as well as economical and scalable public platforms including IBM Cloud, Amazon AWS, Microsoft Azure, Google Cloud, and even Alibaba. IBM is capitalizing on OpenShift by combining it with the company's artificial intelligence (AI) platform, it calls “Watson”, which can “think” like a human. IBM recently began offering technology consulting services to cope with the strong demand for the platform.

NCR Corp (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. NCR is trading close to 10 times earnings, far below the rest of the market.

ETFs for Rising Bond Yields

Concerns over the Coronavirus have driven down bond yields as investors panicked in a flight to safety. There are several longer-term factors that are bound to make this reaction temporary.

A significant source of upward pressure on interest rates is the sheer size and growth of the US federal deficit. A \$1 trillion deficit looks likely which means additional sales of Treasury bonds will be necessary, adding upward pressure on yields.

Inflation is widely reported by changes in the consumer price index (CPI) which covers both goods and services, but this index is becoming outdated because too much emphasis is placed on goods rather than services. The services sector has become far greater throughout the world and now represents a majority of the world's GDP. In the US, the services sector represents 80 percent of GDP, and in this sector, inflation has been running higher than widely perceived. One of the Commerce Department's economic indicators is the Change in the CPI for Services, which over the last seven months has been logging in annual increases ranging from a low of 2.4 to a high of 3.2 percent. The latest reading for January was 3.1 percent.

Even if inflation subsides, today's low yields of 1.7 percent on long-term treasury bonds are not sustainable because they offer nothing in real terms (after adjusting for inflation).

We can see that historically since 1980, investors have demanded a real return of 3.1% on long-term treasury bonds. That means 30-year treasury bonds should be yielding close to 6 percent with today's inflation rate in the vicinity of 3 percent.

If we only look at recent history, since 2000, which has been a low inflationary period, investors have demanded a lower real return of 1.9 percent. This would still put the yield on long-term treasury bond yields close to 5 percent.

The following table shows the historical relationship between 30-year Treasury bond yields and inflation as measured by the consumer price index (CPI).

Years	30 Yr Note (Avg. Yield)	CPI Annual Increase	Real Rate
1980-84	12.0	7.6	4.4
1985-89	8.4	3.6	4.8
1990-94	7.7	3.7	4.0
1995-99	6.3	2.4	3.9
2000-04	5.7	2.6	3.1
2005-09	4.5	2.6	1.9
2010-14	3.6	2.0	1.6
2015-18	2.9	1.9	0.9
Average			3.1

Accordingly, even in a low inflationary environment, the yields on long-term treasuries are far too low and belong much higher.

Our recommended ETFs will prosper from rising yields on long-term (25 to 30 year) Treasury bonds. These ETFs differ in the amount of leverage used. You can choose among them depending on your investment objectives and risk tolerance.

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.

The price action of these ETFs is based on the changes in long-term Treasury bond indexes, only in the opposite direction, and then multiplied by the leverage each ETF uses. For example, a decline of say, 1.0

percent in their respective benchmark bond indexes will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent.

The table below shows the impact on the prices of our selected ETFs at the end of 2020 at various long-term Treasury bond yields. The first row shows today's ETF prices with long-term Treasury bonds yielding 1.7 percent. Note that the price of these ETFs would rise dramatically as Treasury bond yields rise.

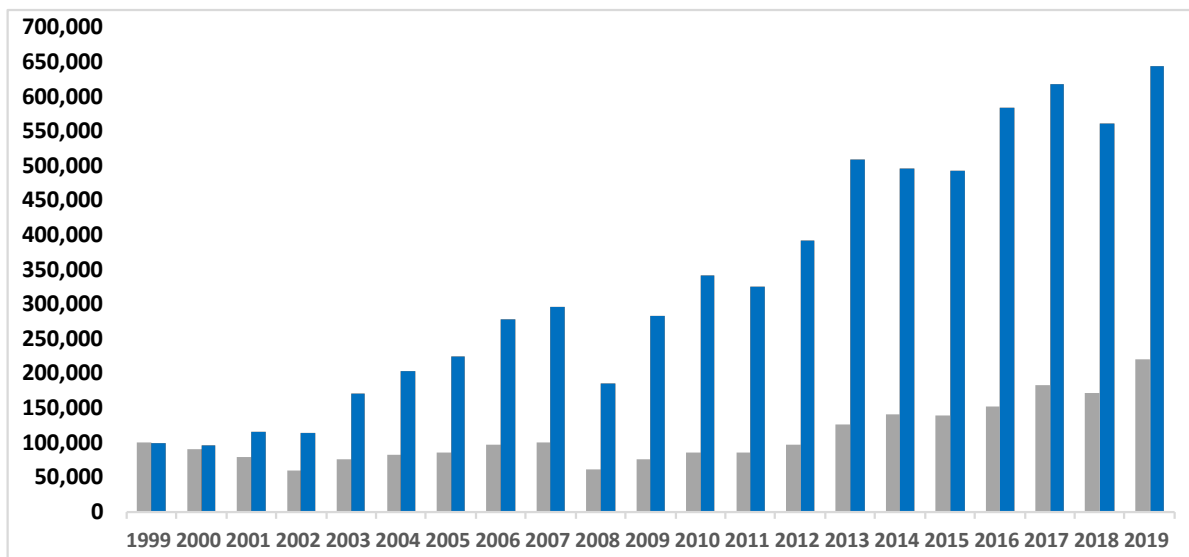
Bond Yields	ETF Prices		
	TBF	TBT	TMV
1.70	17.07	20.50	7.73
3.00	20.67	29.15	12.63
4.00	23.89	38.24	18.53
4.50	25.77	44.24	22.89
5.00	27.74	51.02	28.15
5.50	29.82	58.65	34.46
6.00	31.99	67.20	42.00

The Erosion Factor

As we point out regularly, these ETFs suffer from erosion because they decline slightly faster than they increase with an equivalent change in bond yields, particularly with higher leverage. To gauge this factor, we can assume that Treasury bond yields simply tread water, rising and falling by an unusually large amount, say, 0.03 percentage points (3 basis points) every day, and thus go nowhere. By the end of 2020, TMV would decline to \$7.43 (3.9 percent), TBT to \$20.10 (2.0 percent), and TBF to \$16.96 (0.6 percent). While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

Sound Advice vs the S&P 500

This chart shows the growth of \$100,000 invested in the S&P 500 (in gray), which would have grown to \$219,925, versus \$643,554 if it was invested in the Sound Advice recommendations (in blue).



Portfolio Summary Table

This table is updated and live on our website:

www.soundadvice-newsletter.com

Income with Growth	Symbol	Price / NAV	Yield	Action	Limit
Adams Natural Resource Fund	PEO	\$12.22	6.00%	SELL	
Carnival Cruise Lines	CCL	\$33.46	5.98%	BUY	\$35.13
Chevron	CVX	\$93.34	4.80%	BUY	\$98.01
Exxon Mobil	XOM	\$51.44	6.77%	BUY	\$54.01
Hersha Hospitality Trust	HT	\$11.53	9.71%	BUY	\$12.11
Hersha Hospitality Trust - Preferred D *	HTPRD	\$24.00	6.79%	BUY	\$25.00
International Business Machines	IBM	\$130.15	4.61%	BUY	\$136.66
RLJ Hospitality Trust	RLJ	\$13.21	9.99%	BUY	\$13.87
RLJ Lodging Trust - Preferred A *	RLJPRA	\$27.00	7.22%	BUY	\$29.00
RPT Realty 7.25% Preferred D *	RPTPRD	\$55.00	6.59%	BUY	\$58.00
Valero	VLO	\$66.25	5.43%	BUY	\$69.56
Wells Fargo	WFC	\$40.85	4.99%	BUY	\$42.89
Growth with Moderate Income					
Intel	INTC	\$55.52	2.38%	BUY	\$58.30
JP Morgan Chase	JPM	\$116.11	3.10%	BUY	\$121.92
Growth					
Apple	AAPL	\$273.36	1.07%	HOLD	\$262.00
Boston Scientific	BSX	\$37.39	0.00%	BUY	\$39.26
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	\$7.73	0.00%	BUY	\$8.12
ETF - ProShares Short 20+ Year Trsry	TBF	\$17.07	0.00%	BUY	\$17.92
ETF - ProShares UltraShort 20+ Year Trsry	TBT	\$20.05	0.00%	BUY	\$21.05
Fidelity Select Nat Gas Fund *	FSNGX	\$13.56	0.00%	BUY	\$15.00
Genomic Revolution Multi-Sector	ARKG	\$34.39	0.00%	BUY	\$36.11
NCR Corp	NCR	\$25.20	0.00%	BUY	\$26.46
Stryker Corp	SYK	\$190.59	1.21%	BUY	\$200.12
Third Avenue Real Estate Value Investor *	TVRVX	\$23.66	0.00%	BUY	\$25.00
Third Avenue Small-Cap Value Investor Fund *	TVSVX	\$15.66	0.00%	BUY	\$17.50
Virtus LifeSci Biotech Products	BBP	\$41.15	0.00%	BUY	\$43.21
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	\$29.09	0.00%	BUY	\$30.54

Notes to the table: The right hand column is the highest recommended price limit for purchases.

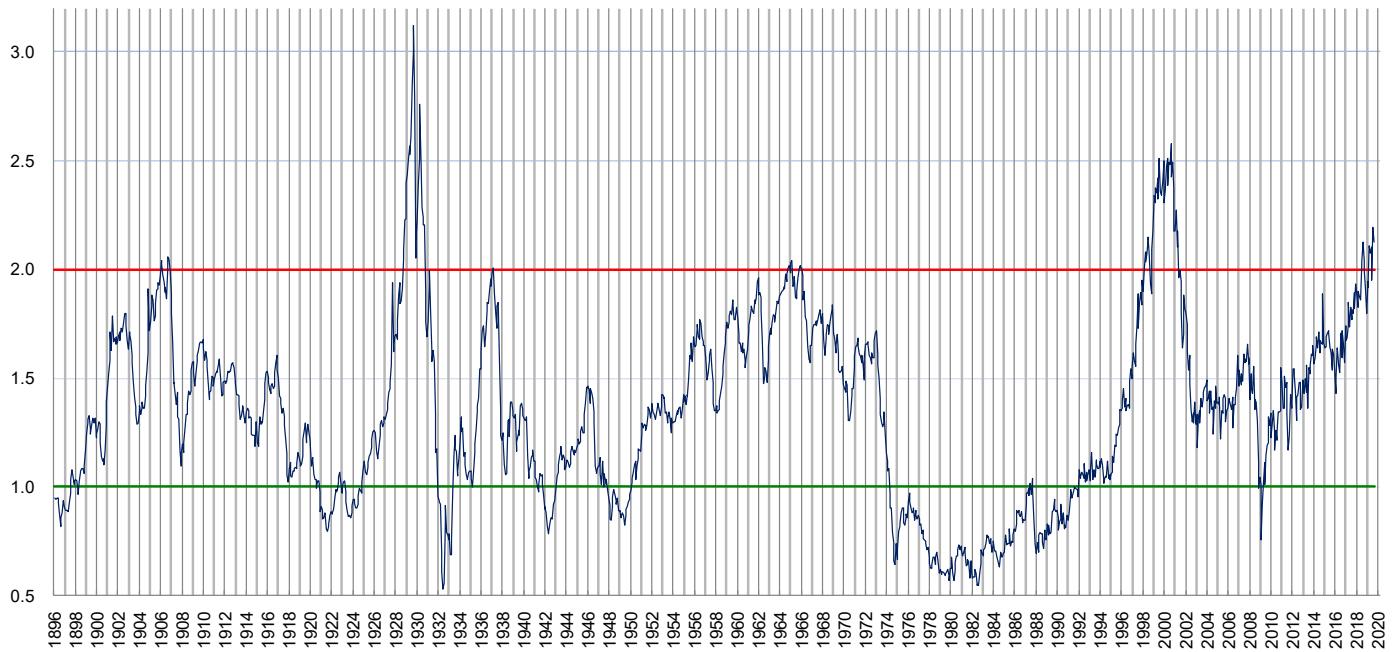
* It is not possible to offer live pricing..

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, as we have done over the years, we assume another \$10,000 is invested again in that position.

If you are picking and choosing, you can focus on the sector of the portfolio that matches your investment objectives. 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.

As always, broad diversification will temper volatility, add to safety, and improve long-term performance.

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 120+ 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 based on the ratio of the S&P 500 Stock Index to median price of new houses 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 label this new tool the **Sound Advice** "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 under performing the other market.

What is too high? When stock prices are very high

relative to house prices, the **Sound Advice** 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 **Sound Advice** 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.

But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing, had an investor followed the signals of the **Sound Advice** Risk Indicator he or she would have made \$460 million, or 26.5 times more money than by simply holding stocks though the ups and downs.

A brief walk through history shows just how reliable this indicator is. The first recorded time the Risk Indicator rose above 2.0 was in February 1906, after the eight-year-old Dow-Jones average doubled since 1903. The market peaked in September of 1906. A massive sell-off in October would later be labeled the Panic of 1907. Stock prices trended downward for 14 more years until the end of 1921 while, searing inflation after World War I boosted house prices 48 percent. The combination of falling stock prices and rising real estate prices forced the Risk Indicator to fall below 1.0 in 1920, just in time for the Roaring 20's when stock prices tripled. Then, in October 1928, the Risk Indicator rose above 2.0 again. On Tuesday, September 3, 1929,

The New York Times

"Cardiff's equation reveals an elegant financial minuet as each market takes turns outperforming the other."

the Dow peaked at 318.17. The October crash marked the beginning of a decline that lasted until July 8, 1932. Houses had declined only by 15 percent compared with the 85 percent loss in stocks. The relative superior performance of houses caused our Risk Indicator to fall below 1.0 at the beginning of 1932.

As America's GNP began posting positive gains and with 46 percent growth in three short years, stock prices would triple. Then the Risk Indicator crossed 2.0 in March 1937. This time, the signal came only one month after the zenith in stock prices. As stock prices retreated 50 percent, house prices remained relatively steady, causing the Risk Indicator to fall below 1.0 again in June 1941, within 9 months from the bottom.

As U.S. corporations expanded to meet growing demand, and the economy came to a rolling boil during the Eisenhower years, the stately rise would multiply stock prices by ten times until November 1964, when the Risk Indicator crossed over 2.0 again. The stock market would continue to climb into 1968, and then crashed into late 1974, wiping out the inflation-adjusted gains scored by investors since 1954. However, a switch to an investment in houses would avoid all that and double in price by the time the next signal came for stocks in May 1974, as the Risk Indicator fell below 1.0 again, as the Dow careened below 700.

It would not be until March 1998 when the Risk Indicator would cross 2.0 again, after stocks were up by more than tenfold. The Dot-Com bubble would push stocks higher into early 2000, but then began another 50 percent retracement. A switch to houses would produce a 44 percent gain through the end of 2008 while stock prices were lower by 17 percent. In February 2009, with the Dow careening below 700 once again, the Risk Indicator quietly dropped below 1.0 to 0.77 as the S&P tumbled under 700. Since then, the stock market has delivered stunning gains as the S&P 500 has quadrupled. For the sixth time in the last 123 years, the Risk Indicator rose above 2.0 again in July 2018.

With the latest median house price at \$320,900 in December and with the S&P 500 at 2954 at the end of February, the Sound Advice Risk Indicator reads 2.03, revealing the risk in stocks is high.

As remarkable as the **Sound Advice** Risk Indicator has been, it does not pinpoint the exact time. In the past 123 years, its signal has ranged from being only one month after the zenith to as much as four years early. While the Risk Indicator has been early, it has never been wrong. An expensive crash was inevitable. A 50 percent decline took a 100 percent recovery just to break even.

To help us narrow down the timing as well as gage the potential severity of an upcoming decline, we have our Diffusion Indexes.

Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

Track Record of the SoundAdvice Diffusion Indexes

After each "Aggressive" signal, the S&P 500 climbed an average of 31.9 percent. During "Caution" signals, the S&P 500 either crashed, meandered, or climbed, recording an average increase of 4.5 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Mar-15	2,080.0	May-15	2,111.9
Sep-17	2,492.8	Jan-18	2,823.8
Ave +/-	31.9%		3.9%

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 **Sound Advice** Diffusion Indexes, we observe changes in each of our selected indicators over a six-month period, and take the percentage of those increasing.

When the **Sound Advice 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 soft economy is providing an atmosphere for stable or declining interest rates.

This Diffusion Index gave us a zero reading in April, 2009, close to the bottom, officially giving us an "Aggressive" signal. That signal came at a time when the Risk Indicator was below 1.0, which revealed that Supercycle 5 came to an end, and that Supercycle 6 was born.

The **Sound Advice Diffusion Index of LAGGING Indicators** gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reading reveals that the US economy is strong enough to put upward pressures on interest rates.

Current Status

The Diffusion Index of LAGGING Indicators climbed to 100 percent for December 2018, giving us a new Caution Signal in January, very close to the peak in the market. **The latest data for January caused a 100 percent reading.**

Our next signal will come from the Diffusion Index of LEADING Indicators, when it drops to zero, which would take a surprising softening in the US economy. **The latest reading for this Diffusion Index is 100 percent.**

Concurrence

There are times when signals from the **Sound Advice** Risk Indicator and the Diffusion indexes are out of sync, when one is signaling caution and the other is not. This occurred in August 1987, when the Diffusion Index of Lagging Indicators switched into caution mode, just prior to the October 1987 Crash that took stocks sharply for a brief period. Non-concurrence also occurred in March of 2008, when the Diffusion Index of Lagging Indicators switched into caution mode, just prior to the 2008-09 bear market crash. Both of these crashes were brutal, but relatively short-lived. Once the Risk Indicator plunged below 1.0, a very profitable bull market followed.

Then there are times when both indicators concur, signaling the same thing at roughly the same time. This happens when the Risk Indicator is above 2.0, indicating the end of a supercycle, and the Diffusion Index of Lagging Indicators switches into caution mode, indicating the end of a business cycle. Of course, this concurrence indicates that a more vicious and potentially longer-lasting bear market, or series of bear markets, is bound to follow, eventually taking stock prices down substantially – usually by 50 percent -- until the Risk Indicator falls below 1.0 again. We have this concurrence today.

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