Gray Cardiff's

SOUND ADVICE

Volume XIX, Number 9 | Subscription Rate: $195 per year | September 15, 2006

Buy It Where They Ain't

Being a successful hitter is no more complex today than it was when Wee Willie Keeler, after hitting a phenomenal .424 for the 1897 Baltimore Orioles, was asked how someone his size (reportedly 5'4" and 140 lbs) could out hit every other professional baseball player, modestly pointed out that he just "hit 'em where they ain't." At *Sound Advice* we certainly don't have the heft enjoyed by today's financial media's sluggers who can move a stock by touting it on CNBC or in the *Wall Street Journal* but we've been successful in developing ideas that usually depend on going where the rest of the investing world ain't.

We go there not because we have any special information. David Einhorn, a successful hedge fund manager who this year gained unexpected fame by finishing 16th in The World Series of Poker despite not playing much poker, tried to explain his unlikely Vegas success: "Both poker and investing are games of incomplete information. You have a certain set of facts and you are looking for situations where you have an edge, whether the edge is psychological or statistical." However, sets of facts and what those facts signify are open to interpretation, and that makes all the difference. In Texas Hold'Em, every player knows his cards, knows what is in the shared cards (the flop), can calculate the possible outcomes for his hand, and doesn't know what his opponents' cards are. For stock pickers, we all have the same SEC filings, the same press releases, the same macroeconomic statistics, and we don't know the future. The same facts that tell some professional investors to avoid or even short a stock can encourage others to research and recommend it.

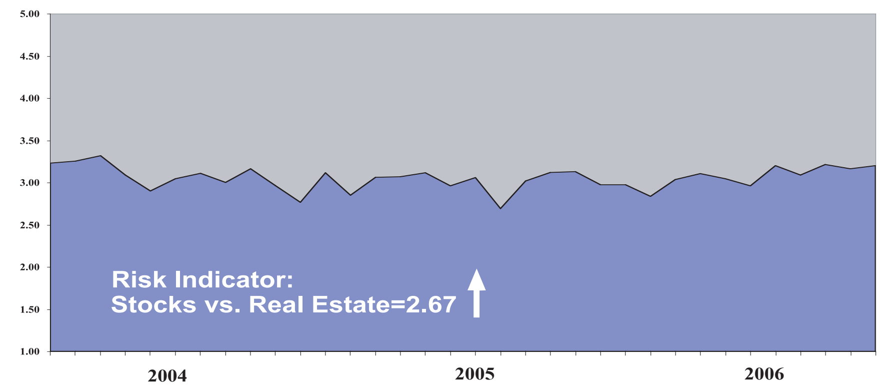
How do we come up with our ideas? In part, we let the market tell us where value can be found, and that invariably means going where the crowd ain't. We truly are generalists and are willing to look anywhere and everywhere. The only real limitation is that we cannot recommend stocks that trade by appointment, since our audience is large enough that any sudden interest by thousands of subscribers would distort the stock's price. We need at least a couple of hundred thousands shares to trade on average each day to be comfortable with a recommendation.

FUTURE TRENDS

Sound Advice pays attention to what the market disdains, since we start with the notion that stocks with good fundamentals trading at historically low valuations are the safest way to make a living off Wall Street. And stocks don't usually get that cheap unless there are real problems, though sometimes the problems are more matters of perception than fact.

Sometimes, there aren't even problems, and a sector is just being neglected. Occasionally, if you find an entire sector that is depressed, you often are witnessing a future trend.

Now, you might snort at "future trend," since it's an oxymoron, like "jumbo shrimp" or "unbiased opinion." Our portfolio has benefited from a succession of such future trends. Take Real Estate Investment Trusts in the late 1990s. You couldn't give them away. Believe me, Mr. Market in 1999 and early 2000 tried his darndest to shovel REITs out of his portfolio to raise cash to buy Internet and telecom stocks. Ever since then, Mr. Market has not been able to get enough of those REITs, even when their share prices erased the sharp discounts that they had traded at during the late 1990s.



For 100 years, massive amounts of capital have been flowing between stocks and real estate. Today's high reading confirms a continuing move from stocks into real estate. Following this Risk Indicator over the last 100 years would have produced 29 times more profits than simply staying in stocks. Equities Remain Overvalued Relative to Real Estate. See *A Millionaire's Guide to Panic Proof Investing* for a full explanation.

Then there were the energy stocks in the early 2000s when *The Economist* published one of its most regrettable cover stories: "A World Awash in Oil." More recently, we've been gravitating toward consumer non-durables, consumer staple and food-related stocks during a period in which the market just could not get enough of energy and metals shares, and was certain that tech was just about to bloom.

I wish I could tell you that we are so smart that we can outthink the market at moneychess, and understand why certain sectors are primed to profit. We aren't and we can't. We just let the market price things so cheaply that we figure, heck, these shares in the past have not fallen below this point, the balance sheet looks solid, nobody has a good word for these companies, maybe there's an above-average dividend, so why not take our chances? Sure beats buying something which everyone loves and clamors to buy at any price.

What do we mean by "cheap?" The last thing that interests us is the dollar price at which a stock is trading, though the price does figure into what is important: the ratio of price to measures such as cash flow, sales, earnings and book value. Of course, like everyone else, our head turns when we see a big change in share price whether it is up or down, though the downs gain our attention most of all. But that is only the red flag. What to make of that flag is another matter.

Take this month's recommendation, **Getty Images**, which got clobbered after sequential quarters that fell short of expectations. Though everyone is willing to concede that Getty is a great company, some portion of Wall Street avoids the stock because, despite better results, it disappointed, and isn't promising a breakout in the near future.

In short, most investors are appallingly short sighted. The only time they are not short sighted is when they look into the future, and when they do that, they are just as misguided. Why? Because most investors project current circumstances on a straight line far into the future. Thus, if a company is shooting out the lights on sales and profits, they assume this is guaranteed to continue to the horizon and beyond. Ditto for poor sales and earnings.

Finally, the majority of investors also are most influenced by changes in price rather than changes in fundamental valuations. Unfortunately, most investors concentrate on price and price alone, though they might give lip service to valuations but invariably reference the least reliable of them, price to earnings, since earnings are so easily massaged by management. Chartists, for example, concern themselves almost purely with price movement. When was the last time you saw a chart for a stock's P/E ratio to say nothing of charts for its Price to Sales, Price to Cash Flow or Price to Book Value? I would love to have these as readily available as are standard price and volume charts.

WHAT TO DO?

Our Diffusion Indexes remain negative on the general market (see page 8). Inflation risks and a precarious dollar remain major worries, and despite the drop in longer-term interest rates that has resulted in an inverted yield curve, we are uninterested in even medium-duration bonds, since if our general view about inflation is correct, interest rates

(continued on inside back cover...)

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On a flight last month, my seatmate and I chatted, and she asked what I did. When I told her that I wrote an investment newsletter, she brightened, and told me that she was a financial planner, and asked what sorts of investments we recommend. After I reeled off some recent names, she responded that her clients relied on index funds, and that individual stocks, especially damaged goods like Symantec or Telecom New Zealand, held no interest. Her clients wanted not to outperform the market but to control risk. We talked a bit more about the brokerage business, how it has changed from being stock picking to money management, and respectively settled back into our reading.

Thinking back to that conversation, I considered that much of what passes for investment advice can be reduced to insulating investors from risk, and yet this search for security coexists with the client's yearning for the big score.

Every week, I get a call or two from subscribers who want a single idea that will be both very profitable and very safe. There is no such thing. If you are looking for infallibility, buy an FDIC-insured CD. If you are looking for the big hit, your odds are probably better in Vegas than on Wall Street.

Remember the strutting fund managers who in 1999 turned in not double but triple-digit returns. Watching them on CNBC and elsewhere in the financial media at the time reminded me of nothing more than watching a successful winner at Russian roulette. Envy the luck, not the strategy that captured those returns.

--Gray Emerson Cardiff

Get the Picture?

First it was TV and now it is the Internet and all the other digital imagery that shapes our culture. We might be losing the ability or taste for absorbing written information but our appetite for visual information seems limitless. Lately, I've been reading about the image business, or more precisely, about the biggest vendor of images, both still and moving, to all parts of the media industry. Though as a company this firm might be invisible to the public, for advertising, journalism, and all the ways that visuals are essential, this company plays the essential role. If anything, as the Internet continues to expand and other communication methods such as cell phones become conduits for more sophisticated visual information, the market for images expands. Hence, the future is promising for the dominant provider of stock photographs, Getty Images **(GYI—NYSE)**, though it abruptly tumbled from the verge of being a $100 stock as recently as Thanksgiving 2005 to its current $44.40. From a P/E of 41 to its current 20.5, GYI has gone from enjoying a very positive image to a negative. We think that its problems have more to do with unmet expectations than with the business model, and believe that the current price offers nice exposure to better times.

GETTY IMAGES

Getty, co-founded 11 years ago in the U.K. by Mark Getty, a scion of the Getty oil family, and now Chairman, and Jonathan Klein, an IT whiz, and now the CEO, relocated to Seattle, Washington in the late 1990s becoming a U.S. corporation. Last year, it had sales of $734 million, an 18% year-over-year increase, operational income was even more robust, a 34% jump, and net income was best of all, up 40%. Cash flow from operations swelled the balance sheet by $257 million. Management could claim—as it did in its 2005 annual report to shareholders—that it had exceeded its targets, "a clear indicator of how we did when measured against what we promised." Wall Street clearly endorsed that enthusiasm, and banked on GYI's ability

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to maintain such superlative performance. Management coming into 2006 set formidable goals: 15% organic currency-neutral sales growth, 25% earnings share growth, and further increases in margins—everything that a growth company with a P/E of 41 needed to maintain altitude. The shares had a built-in euphoria premium.

Performance for 2005 continued what had been a great four-year run. In its early years, Getty Images' stock price in part had benefited from the Internet boom, since it was working toward using the Internet for digitized images rather than old-style analog. GYI shot as high as $64 in early 2000. It had the right buzz. Well, frankly, anything that said it was involved with or had plans to work with the Internet immediately had that buzz. You could have gotten venture capital in 1999 for a business plan to sell anvils to Eskimos, if you said you'd do it over the Net.

However, as the Internet frenzy collapsed, investors looked at GYI's sales of $8.69 per share, its per share capital expenditures of $1.40 (16% of sales), and its substantial successive annual losses for every year since going public as a U.S. corporation in 1998, and decided that the shares' strong run was as unwarranted as the rest of the bubble.

However, Getty was selling not anvils but images, digitized images, which lent themselves perfectly to a maturing post-bubble Internet market. The pivotal moment for Getty was its substantial transition from a traditional stock image agency to a web-based company. The costs involved in setting up the new platform were significant, and contributed to those annual losses between 1998 and 2001.

But once the website was launched in 2001, benefits were quickly realized. Sales increased without an increase in operating expenses. Employee headcount decreased as transactions were simplified by display and distribution through the Internet. At the same time that Getty Images was becoming more efficient, demand from advertisers and other publications surged as the U.S. economy improved in 2003 and 2004. The combination of rising sales and rising margins got Wall Street's animal spirits going again.

Starting in 2001, GYI regularly exceeded analysts' expectations, and in tandem with names such as Yahoo! and Amazon recaptured their Wall Street audience. The last quarter in 2005 was the high water mark, however.

As 2006's quarterly reports failed to meet expectations, the share price suffered. A price chart for GYI starting in January 2006 resembles a series of waterfalls after the announcement of each quarter's results: January triggered a 10% drop, May a 21% drop, and July a 19% decline. There's no guarantee that the next quarterly conference call, scheduled for October 24th, will be much more encouraging, but—and this is where gauging pessimism must be recognized as an art—we think that Wall Street has given up on Getty Images, and is unlikely to punish its shares too harshly should this next quarter report be uninspiring. Yahoo! lists 12 Holds against 6 Buys. Were Getty to pull a rabbit out of the hat, and report better than expected results, the stock could move crisply higher. In any case, the positive story for the shares over time should more than pay us to get interested at current levels.

HOW GETTY WORKS

The image business draws revenues from several sectors, though the most lucrative is also the most sensitive to the business cycle: advertising. Current concerns over whether the U.S. economy is slowing contribute to GYI's weakened stock price. Globally, Getty gets 42% of its revenues from the U.S., 13% from the United Kingdom, 8% from Germany, and 6% from France. Accordingly, fluctuations in exchange rates have an impact on sales and earnings. If our expectation that the dollar is headed lower is realized, GYI's foreign results should be enhanced when converted into dollars.

The company has been investing to develop both a physical presence as well as online marketing and distribution in Asia, especially in Japan and China, where growth even now is fastest, and as the revenue base increases will become a substantial contributor to sales and profits. In the last quarter,

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Asia saw 30% sales growth. Japan was at 50%, and China was even better, though compared to Japan as a market it is still immature.

As with everything else in media, the Internet has been both an extraordinary opportunity and a threat for Getty and its competitors. Marketing and distribution using the Internet provides immediate access to digitalized images. Visit www.gettyimages.com and you can glimpse the wide and deep inventory Getty controls, and how simple it is to sift through and download pictures. Compared to the laborious methods that predated the Internet model, selecting and purchasing digitized images today can be almost simultaneous with their creation. For example, had you needed images from the University of Texas vs. North Texas game played on the first Saturday of this season, they were on the Getty website literally moments after they were snapped.

The Internet that has allowed Getty not only to slash the cost of operations and provided incredible marketing reach also has also given smaller competitors an opening. Though such companies have no hope of rivaling giants like Getty in terms of inventory, they can compete on price, especially for less-than-premium products in the so-called micro-payment market, which we'll touch on below. There is also room for agencies specializing in niche products such as medical or scientific images. The Internet has also magnified price competition, especially in the royalty-free (RF) business, which Getty pioneered.

The traditional arrangement, the so-called rights-managed (RM) contract, meant that each image would be leased for a specific purpose for a specific period of time for use in a specific publication. Negotiating each contract could be tedious or tendentious, or both. The Internet has changed the physical side of the process, and competition has introduced a new way of acquiring rights: royalty-free, which means that a customer can acquire rights to do almost anything with an image over a defined period. Visit http://creative.gettyimages.com/source/home/license.aspx for a description of the various ways Getty will sell rights to its images.

For the first six months of this fiscal year, Getty's revenues by contract type breaks down to 42% from traditional RM stills, 37% from RF images, 12% from editorial imagery, 6% from motion pictures, and 3% from "other," which includes CDs and other lower quality distribution models. The relative costs for the dominant fee-types shows that rights-managed images command an average cost of $575 versus $245 for royalty-free. As for margins, the royalty-free sales generate higher margins. Getty estimates that four out of every five RF transactions do not involve human support. Everything is done by the customer on the website.

> Getty Images might have disappointed Wall Street this year in not hitting its promised targets, but Getty is perfectly focused on images, the single element that bridges all media, and has a bright future that its current price does not capture.

NOT MEETING EXPECTATIONS

Getty missed its projections for the last couple of quarters primarily because RF transactions stumbled. In the first quarter, RF showed a 6% drop in sales volume in the U.S., GYI's biggest market. In the second quarter, though that decline was reversed (up 11% compared to the first quarter) but against the same quarter in 2005, it was still flat. The company makes clear that no dramatic improvements are on the horizon in 2006, and that RF revenues would continue to lag earlier projections. After these sobering results, Getty now prefers not to make sales and earnings projections for future years.

Also cutting into profits were higher operating cost, especially in marketing where management has restructured its sales force along product rather than its previous system that was organized according to markets, and has added staff to meet growing competition. Advertising costs have also risen in response to more aggressive advertising and promotions by competitors.

Acquisitions have been integral to building Getty's inventory, to accessing national markets, and to gaining expertise in particular niches. Indeed, the key insight Getty and Klein had was that the fragmented stock photography business with its hundreds of small agencies itself was an obstacle to efficiency, and that if a single dominant player could gather inventory under one roof, it would immediately have a competitive advantage.

Getty Images went at this with zeal. CEO Klein in a conference call breezily referred to the "50 or 60" acquisitions he had made over the years. Getty, thanks to its strong balance sheet and cash flow, when it identifies an opportunity to expand geographically or to enter a market niche can write a check. For example, Getty earlier in the decade was accumulating foreign agencies such as Bongarts Sportfotagraphie, a German company with branches elsewhere in Europe, and this year acquired Laura Ronchi, its Italian agent as well as an Irish agency. Getty also bought iStockphoto, which is in the micro-payment market that makes sales for as little as $1 a transaction. Many of the companies GYI acquires already were its agents, which means that Getty gains exclusive control but also eliminates having to share revenues.

The company also is expanding organically. Lately, it set up a Japanese language version of its website to cultivate the world's second largest advertising market, and entered the China market with a bureau in Beijing to cover mainland China, Taiwan and Hong Kong, and followed up its Japanese site with a Chinese language website aimed at the world's fifth largest market.

MANAGEMENT

Klein has driven the technological revolution at Getty. We also like his candor. After watching its shares tumble by half during 2006, CEO Klein recently said "Things have definitely slowed down in one of our important businesses and it's having an impact…When a company does not meet expectations and brings guidance down, the reaction by the market is both predictable and appropriate." Klein, noting he can do nothing about the stock price, says better performance will meet the challenge. This beats blaming shorts or the weather.

When times do get difficult for a company, we like to see a strong balance sheet and good cash flow, which provide a buffer against making forced decisions. In Getty's case the balance sheet is very strong with only a $265 million convertible issue that from one quarter to the next depending on market conditions is considered either long-term debt (when the conversion price condition has not been reached) or short-term debt (when the conversion conditions have been met). We would not mind seeing the convertible conditions met, since that would mean that GYI had traded during any given quarter at or above $73.30, a 64% premium to its current price. The debt service amounts to $1.3 million annually. Beyond this convertible, there are no preferreds, and no pension obligations.

Getty has a share repurchase plan in place, and with shares down this year, has upped the amount earmarked for buying from $150 million to $250 million. During the last quarter, 2.5 million shares costing $161.4 million (average cost of $64.56) were bought in. Getty generates significant free cash flow, and is signaling that continued stock buybacks will be one way to deploy that cash to benefit shareholders.

INSIDER ACTIVITY

It's not just Getty's treasury that is buying shares. Though insider transactions at Getty have tilted toward sells over the past year, with one exception significant sales ceased when GYI started its sharp decline below $90. The lone exception was Elizabeth Heubner, the CFO, who sold 35,000 shares at $64.19 in May, a transaction related to her retirement from the company.

Three option-related purchases occurred in June and July at $63.52, and even more interestingly, two large open-market purchases were made by a long-time director, James Bailey, in May. Some might argue that given GYI's tumble, these purchases were mistakes. We're no stranger to getting to a good idea too early, so we interpret the buying at much higher prices as testimony to Getty's prospects: if knowledgeable insiders thought the stock worth owning in the low $60s, we are encouraged to think that it is certainly worth owning in the mid-$40s.

As for institutional ownership, there has been a distinct shift over the last few months: whereas at the end of 2005, the biggest holders were Fidelity funds (8.4% of shares outstanding), Morgan Stanley (8.2%), and Massachusetts Financial Services (5.5%), now only MFS has a significant position, albeit reduced during 2005. Fidelity and Morgan Stanley, which established positions during 2005 based on expectations of Getty not missing a beat, beat it when the unimaginable happened. A new, and the largest, stakeholder is American Funds Growth Fund. We expect to see hard-core value funds starting to nibble at Getty Images.

SUMMARY

Sound Advice usually relies on a stock's long historical record to benchmark valuation ranges. In Getty Images' case that is not meaningful, since it has been a publicly traded U.S. company for a brief period, and during that period has ridden a very steep roller coaster, shooting up during the bubble years, careening down when the bubble imploded, and then riding steeply higher from 2002 till the end of last year. There is no norm. \

Instead, we'll have to take the rude adjustment in price and downward valuations in price ratios as an invitation to start building a position. Getty Images might have disappointed Wall Street this year in not hitting its promised targets, but Getty is perfectly focused on images, the single element that bridges all media, and has a bright future that its current price does not capture. We recommend GYI up to $49. ***SA***

PORTFOLIO UPDATES

For the last month, cyclicals, especially natural resource stocks, gave ground. The overall market continues to interpret the Fed's decision to not raise rates at the FOMC's last meeting as an all-clear signal that it's safe to bid up stocks. We think not, and still prefer a defensive stance. Nonetheless, for the first time this year, our portfolio did not outperform the benchmark indexes: the Dow added 1.4%, the S&P 1.5%, and the Nasdaq 3.9%. Our portfolio was up 1.1%. For the year, however, performance remains excellent, up 11.4% vs. +6.3% for the Dow, +4.1% for the S&P, and a 1.8% loss for the Nasdaq.

Telecom New Zealand had a kangaroo bounce after its shares plummeted just before we recommended them. It's rare—heck, it's just dumb luck—for our recommendations to coincide with a bottom. In the absence of any positive news about NZT, the 16% total return gain remains a mystery, though it's likely that potential buyers were lying in wait for the sort of negative news that accompanied the most recent quarter's results, and then pounced. Meanwhile, NZT might sell its directory business, a strategy U.S. Baby Bells followed to generate cash. Should that happen, Telecom could use the proceeds for capital investments, a share buyback, or a direct special dividend to shareholders. NZT is very much a work in progress, and though we cannot be certain how long the remake will take, we like the shares.

The trio of stocks in the July basket had a mixed month: **Johnson & Johnson** rose and fell to end the month flat, but is up 5% overall, while **American International Group** added 7.2% since the last letter, and 8.9% overall. The turning point was the announcement of quarterly results on August 8th that helped resolve concerns over how AIG's insurance arm was doing. Sales grew by 8%, and though the financial services division showed lackluster results, the overall numbers exceeded estimates. Another part of the AIG story undoubtedly is a federal court decision that favors insurers against claims stemming from hurricanes Katrina and Rita. The question, whether water damage caused by wind that drove water into homes was covered by policies that excluded water damage, was resolved in favor of the insurers. The court remains willing to entertain evidence to show that wind caused non-water damage.

EnCana, the third position, gave back its strong gains—and more—as natural gas prices and energy in general have faltered. We'll touch on that below. For the month, ECA is down 7.4%.

Indeed, it was a volatile month for energy and metals in general, though **Phelps Dodge**, the beneficiary of market happiness that its attempt to acquire Inco, the nickel miner, failed, led to a 5.7% upmove. Indeed, news of Phelps' White Knight deal with Inco had triggered a collapse in the shares, taking PD down to $75 in July. We thought that was an opportunity, and now that PD is trading over $91, that advice has been rewarded. However, all the natural resource stocks were under pressure this month. Gold is hovering in the low $600s as the market tries to decide whether a recession is ahead, whether the Fed will return to raising rates, whether Republicans will continue to hold sway in Congress, whether hurricanes are not the menace to the Gulf of Mexico's energy infrastructure.

It's tricky trying to divine what explains the price drop in gold, but if investors believe that the Fed has only paused and soon will be raising rates again because it is concerned about inflation, then the market will buy the dollar (because higher interest rates attracts buyers to a currency), which depresses prices for precious metals. The irony is, if inflation is still at work, ultimately precious metals stand to benefit. **American Century Global Gold Fund** was flat, and **Coeur d'Alene** retreated from August highs to end down 5.5%.

We're in the shoulder season for energy: summer heat has retreated while winter heating demands are over the horizon. Summer driving's demand for gasoline is back in the garage for another 10 months. The only forces impacting energy prices for the moment are the prospect of hurricanes disrupting the Gulf of Mexico, and the ever-present geopolitical premium that feeds off events such as Mideaset instabil-

Password for Online Updates and Next Issue

The NEW PASSWORD for Updates to be published at the start of October will be pumpkin. To access the October issue (www.soundadvice-newsletter.com) when posted online (Monday, Oct. 16th) the same password, pumpkin, should be used.

If you are not enrolled to receive this free access, please send us an email at sound_advice_ca@yahoo.com with your name, zip code and email address.

ity, relations with Venezuela, civil instability in Nigeria etc. We had a euphoric day when Chevron, Devon Energy and Statoil announced a successful initial well 200 miles south of Houston that under the best of outcomes could boost U.S. energy reserves by 50%. That euphoria declined as investors took these estimates with a grain of salt, and considered how expensive it would be to lift oil and natural gas from depths of five and six miles beneath the waves. In addition to EnCana, **Royal Dutch** dropped 6.4%, and **Icon Energy Fund** 6.3%. The only plus this month in our energy positions is **Transocean**, which looks to be the big winner on the news of that Gulf of Mexico find, since the consortium of energy companies used the Cajun Express, one of RIG's ultra-deepwater drilling platforms to reach these deep pockets of oil and natural gas. For the month, Transocean is up 1.7%.

Sara Lee completed the spinoff of its apparel division, which now trades as **Hanesbrands (HBI—NYSE)**. We are selling HBI, since Sara Lee has larded it with debt that makes SLE more svelte but could be a burden for HBI. SLE so far has failed to convince investors to put a higher price on its diverse businesses. With only **Sara Lee**, we'll either get its food assets' value recognized, or it will be time to admit we were wrong. The spinoff gives each SLE shareholder one share of HBI for every eight SLE shares. Our other consumer non-durables and staples are doing fine. The market, unless it is worried about a slowing economy, rarely grabs for such stocks because they are boring and show little potential for explosive growth. However, when investors do get worried about economic weakness these names draw an audience. **ConAgra**, which languished for months after its recommendation a year ago, saw a bottom at the moment it slashed its dividend this past March. From that bottom, CAG is up more than 40% including the diminished dividend. CAG has continued to trim non-core businesses such as its August sale of its cheese division and its refrigerated meats division in July. Since the August letter, CAG is up 7.5%. **Coca Cola Enterprises**, the largest bottler of Coke beverages, has also done well this year, up13%, but flat since the last issue. for the year.The story is better execution both here at home and in its European operation.

Molson Coors has put in average results so far this year, but had a good month, up 6%. Results for the last quarter looked good but benefited from tax adjustments, and suggest that the company continues to struggle in combining Coors with Canadian Molson. Nonetheless, we see good things ahead for TAP starting with its selling off of its unfortunate Brazilian business.

We can add **Safeway** to this group, since this is where these products are sold. In addition, SWY's investment several years ago in updating its stores so that they compete not head to head against **Wal-Mart** but provide a more upscale experience has paid off with higher sales and profits. For the month, SWY added 7.2%. WMT moved 4.5% higher.

Symantec is now in the black, and compared to its post-recommendation low on July 12th is up 27%. Since the last letter, SYMC is 9.1% to the good. Carl Icahn, who has pushed share prices higher for companies he thinks are undervalued, acquired 6.1 million shares of SYMC during the last quarter. We last glimpsed Icahn when he was trying to bludgeon **Time Warner** into following his suggestions about how to boost the share price. He seemed to have lost interest in TWX, but apparently he's back. Icahn now reports that he has increased his TWX position by 8.4% to 49.6 million shares. Since the last letter, TWX gained 2.2%.

Friedman, Billings, Ramsey, a hybrid financial services and mortgage REIT, has not so far performed to plan. It's been a particularly jagged course for FBR, because market attitudes have turned on where investors think the yield curve is headed. Since FBR's REIT status depends on its mortgage-backed security portfolio, the prospect of an inverted yield curve, in which long-term rates are lower than short-term rates, is deadly, since you borrow short-term money to lend to long-term borrowers. Until the yield curve returns to its normal upward direction, expect to see FBR suffer. Since the last letter, FBR is down 13.4%. The financial services arm is doing fine.

Our other REITs are putting in a solid year, though **HRPT Properties Trust** this month gave back 3.7%. Early in August, management announced second quarter results below the previous year's quarter. We don't see anything extraordinary in the report, and are happy to be a buyer. **Senior Housing Properties Trust** had a better month, moving up 7% as it was added to the S&P MidCap 400 Index. **Crescent** has been steadily rising since late May, and we now have if not an explanation at least a rumor: supposedly several private buyers, including an investment arm of the Emirate of Dubai, want to take CEI private. Don't get excited now. We think any price paid won't include much of a premium above the current price, which crept up another 1.4% for the month. ***SA***

Sound Advice: Portfolio for September 2006

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
HRPT Properties	HRP	NYSE	$11.58	7.25%	$12.40	BUY
Senior Housing Properties	SNH	NYSE	$20.59	6.02%	$21.00	BUY
Diversified Growth					.	
Agrium	AGU	NYSE/TSE	$23.48	0.47%	$29.00	BUY
American International	AIG	NYSE	$64.24	0.78%	**$68.00**	BUY
AT&T	T	NYSE	$31.35	3.99%	$33.00	BUY
Coca-Cola Enterprises	CCE	NYSE	$21.46	0.75%	$24.00	BUY
ConAgra	CAG	NYSE	$23.52	4.64%	$26.00	BUY
CSX Corporation	CSX	NYSE	$30.30	1.32%	$35.00	BUY
Disney	DIS	NYSE	$29.58	0.81%	$34.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	$39.63	0.36%	N/A	BUY
Excelsior Value & Restructuring	UMBIX	800-446-1012	$47.68	0.71%	N/A	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	$17.12	0.00%	N/A	BUY
Friedman, Billings, Ramsey	FBR	NYSE	$8.03	9.96%	**$9.25**	BUY
Gabelli Global Telecom	GABTX	800-422-3554	$19.43	0.00%	N/A	BUY
Getty Images	**GYI**	**GYI**	**$45.40**	**0.00%**	**$49.00**	**BUY**
Honeywell	HON	NYSE	$38.28	1.96%	$45.00	BUY
Johnson & Johnson	JNJ	NYSE	$63.59	2.08%	$65.00	BUY
Liberty Capital***	LCAPA	NASDAQ	$86.72	0.00%	**$90.00**	BUY
Mattel	MAT	NYSE	$19.01	2.10%	**$21.00**	BUY
McDonald's	MCD	NYSE	$37.50	0.61%	**$40.00**	BUY
Molson Coors Brewing	TAP	NYSE	$69.86	1.17%	$72.00	BUY
Newell Rubbermaid	NWL	NYSE	$27.00	2.44%	$31.00	BUY
New York Times Co.	NYT	NYSE	$22.09	2.99%	**$27.00**	BUY
Perrigo	PRGO	NASDAQ	$16.09	0.62%	$18.00	BUY
Safeway	SWY	NYSE	$30.35	0.00%	**$33.00**	BUY
Sara Lee****	SLE	NYSE	$14.50	5.19%	**$17.00**	BUY
Schering-Plough	SGP	NYSE	$20.59	0.97%	$24.00	BUY
Sony	SNE	NYSE	$42.53	0.53%	**$48.00**	BUY
Superior Industries	SUP	NYSE	$16.80	3.81%	$23.00	BUY
Telecom New Zealand	NZT	NYSE	$19.53	9.7%***	$23.00	BUY
Tetra Tech	TTEK	NASDAQ	$16.25	0.00%	$20.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	$58.29	2.58%	N/A	BUY
United Parcel	UPS	NYSE	$69.56	1.21%	**$72.00**	BUY
Wal-Mart Stores	WMT	NYSE	$46.72	1.43%	$52.00	BUY
Xerox	XRX	NYSE	$14.90	0.00%	$18.00	BUY
Energy/Natural Resources						
American Cent. Gold Fund	BGEIX	800-826-8323	$18.83	0.00%	N/A	BUY
Coeur d'Alene	CDE	NYSE	$5.12	0.00%	**$6.50**	BUY
EnCana	ECA	NYSE/TSE	$49.53	1.21%	**$55.00**	BUY
Icon Energy Fund	ICENX	800-764-0442	$32.95	0.00%	N/A	BUY
Phelps Dodge	PD	NYSE	$91.09	1.10%	**$92.00**	BUY
Plum Creek Timber	PCL	NYSE	$34.48	4.18%	$41.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	$66.57	2.00%	**$70.00**	BUY
Transocean	RIG	NYSE	$71.24	0.00%	**$78.00**	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	$34.90	0.00%	$38.00	BUY
Crescent Real Estate	CEI	NYSE	$22.00	6.82%	**$22.50**	BUY
Discovery Holdings	DISCA	Nasdaq	$13.68	0.00%	$17.00	BUY
Electronic Data Systems	EDS	NYSE	$24.12	0.83%	$30.00	BUY
Liberty Global	LBTYA	NASDAQ	$24.32	0.00%	$26.00	BUY
Mitsubishi UFJ Financial	MTU	NYSE	$13.46	0.71%	$18.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	$6.07	5.44%	N/A	BUY
Time Warner	TWX	NYSE	$16.87	0.00%	$22.00	BUY
Symantec	SYMC	NASDAQ	$18.78	0.00%	**$20.00**	BUY
Western Digital	WDC	NYSE	$16.37	0.00%	$20.00	BUY

****Prices as of the market close on Friday, September 8, 2006***
*****Yield represents all distributions during current calendar year divided by share price.***
******CSX Split 2:1 as of 3/12/2006***
*******SLE spun off HBI on 9/5/06. We are selling the spunoff shares***

BUY, HOLD, SELL OR LIMIT IN BOLD SIGNALS CHANGE IN ACTION OR LIMIT

Sound Advice: Market Indicators for September 2006

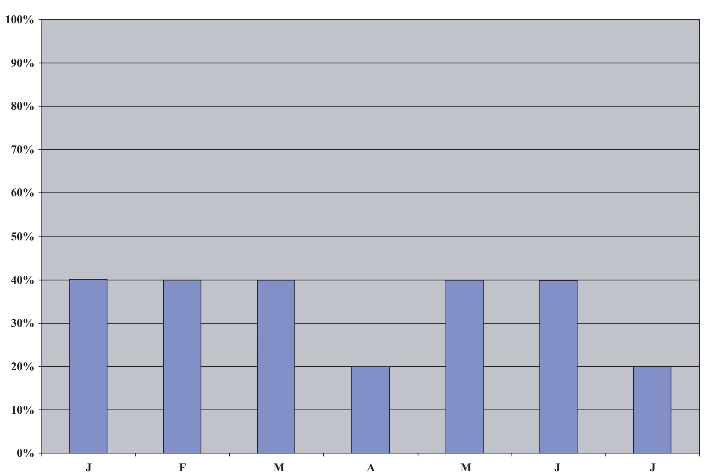
Sound Advice depends on three trustworthy indicators to determine our investment direction. The Risk Indicator (see inside front cover) measures investors' interest in real estate compared to stocks. Currently we see that the stock market is significantly overvalued versus real estate. The Leading and Lagging Indicators track the direction of the U.S. economy. We want to be aggressively buying the broad market when these indicators signal the economy has slowed, cautiously selective when counter trends exist, and out when storm warnings are up. The charts and explanations are updated monthly. To see how far ahead the Indicators would have put us had an investor made decisions based on these Indicators, review the performance statistics to the right, and compare these results against how the Standard & Poors 500 has done.

START DATE	ANNUAL COMPOUNDED RETURN
JAN 2003	20.55%
JAN 2000	11.60%
JAN 1992	11.74%
JAN 1980	18.31%
JAN 1975	19.53%
$25,000 invested in 1975 would equal $6,957,381 today using our buy/sell signals	

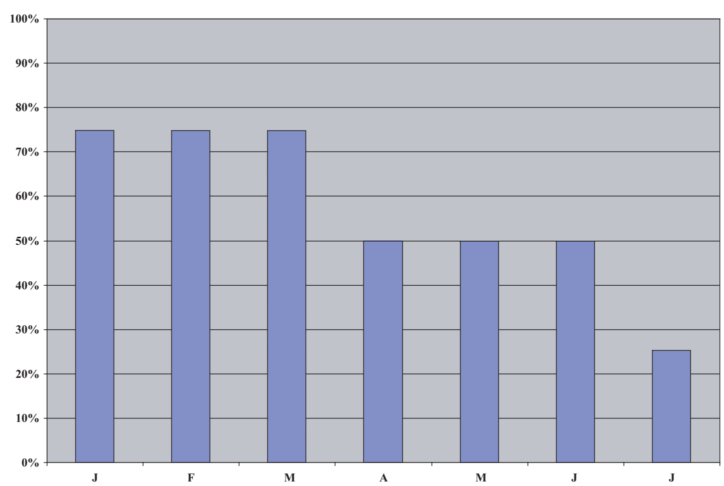
For years prior to 1992, the return percentages are calculated by purchasing the Twentieth Century Growth Fund on buy signals and investing in money market funds on sell signals. Following January 1992, the calculated returns assume funds were switched to the Sound Advice Model Portfolio. Signal Performance: 6.22 times better than the overall market since 1975. We recommend confining your investments to our portfolio selections.

The Diffusion Index of Leading Indicators chart compares each of five leading economic indicators with its level of six months earlier. A value of one point is given for each indicator that rises, one-half point for each unchanged , and zero for each indicator that drops. The sum of these points is divided by five and converted to a percentage. Buy signals are generated at zero readings, when all five leading indicators have fallen below their levels of six months earlier, revealing that the economy has softened sufficiently to cause a lasting decline in interest rates.Currently, the Diffusion Index of Leading Indicators stands at 20%. The Diffusion Index of Lagging Indicators chart is calculated in the same fashion. It generates sell signals when 100 percent of its four lagging indicators rise above their levels of six months earlier, revealing that the economy is heating up enough to cause a lasting rise in interest rates. **The Diffusion Index of Lagging Indicators in October hit 100% based on figures from The Conference Board. This constituted a Sell Signal.** Though this Index has fallen back to 25%, the Sell Signal remains in force as a caution light for us. We recommend avoiding the broad market, and restricting your portfolio to positions recommended in *Sound Advice.*

Leading Indicators



Lagging Indicators



NEXT ISSUE MAILS ON OCTOBER 13TH

are primed to rise, which would be hard on bonds.

We continue to emphasize out-of-favor situations that have more upside potential than downside risk, and are especially interested in non-U.S. investments that can pair price appreciation with exchange-rate benefits.

Consumer non-durables and staples are also well positioned if the domestic economy slows as consumers respond to higher inflation, and imports due to a weaker dollar become more expensive. Also, the end of residential real estate euphoria is taking its toll on consumers.

Then there are the cyclicals including energy, which this month have backtracked to levels not seen this year. Wall Street likes to call these drops "corrections," which suggests it's an appropriate recalibration rather than a fire sale. Cyclicals, as does every hot sector, have been through this before. We believe that the underlying story that has so much to do with Asian demand remains intact. Are we making the same straight-line projection error we ridiculed several paragraphs above? Until we have evidence that Asia has gone cold (which it eventually will), we'll stick with our thesis. If you have benefited from our profitable approach to the markets, and see a brightly colored sticker on this issue alerting you that your subscription is about to expire, we invite you to choose among the attractively priced resubscription plans listed below.

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