

Trumponomics: A Sugar High?



The *Sound Advice* Portfolio is up 14 percent this year, as compared to 7.6 percent for the S&P 500. We have an average profit of 59 percent based on the prices at which each position was recommended.

-- Gray Emerson Cardiff, Editor

Both President Reagan and President-elect Trump had economic plans based on cutting taxes to stimulate growth. Reaganomics, as it was called, became the Tax Reform Act of 1981, which cut taxes by 3 percent of GDP. Trump's plan, which is becoming known as Trumponomics, proposes to cut taxes by approximately 4 percent of GDP. The prospect of a boost in economic growth, along with lowering corporate taxes, has propelled the stock market to new highs since election-day.

A primary difference between the two is that Reagan's plan was enacted in recessionary times, with unemployment close to 8 percent, relatively high interest rates, and plenty of slack in the economy. Today the situation is sharply different. After 7 years of economic expansion thanks to the medication of historically low interest rates, today's unemployment rate is close to 5 percent which is considered close to full employment. Most economists agree (and worry) that stimulating a fully-employed economy will have the side effect of causing a fever of rising inflation and interest rates. That is the diagnosis given by the bond market, as evidenced by the eruption of Treasury bond yields since election-day.

The potential problem is that a continued and pronounced escalation of interest rates could choke the revival caused by the injection of economic steroids, and cause the expansion to be a short-lived spike, much like a sugar high.

Whether this will be the case depends on a number of factors. One of the most important is whether or not the US economy is actually fully employed. If Trump follows through on his campaign pledge to deport all undocumented workers, it would reduce the US labor supply significantly and force employers to pay higher wages, which would lead to significant inflation. So far, Trump is only pledging to start with the criminals, which is some 20 to 30 percent of the total and not part of the productive work-force.

The boost in economic activity could also prompt discouraged workers, along with knowledgeable retirees, to re-join the workforce, adding to the participation rate and the overall labor force. This would mitigate wage inflation.

The other important factor is Trump's pledge to impose trade tariffs on China and Mexico. This would increase the cost of a wide range of goods which would be inflationary. Trump's trade proposals are likely to meet stiff resistance from both houses of Congress because Republicans are generally advocates of free-trade, and any proposed tariffs are likely to be watered-down.

Infrastructure spending, earmarked at \$550 billion, is another pillar of Trumponomics. While a strong stimulus, it comes at a time when there is a shortage of skilled construction workers. Wages are bound to escalate and add to inflationary pressures. It is not clear where the infrastructure funds will come from. The obvious answer is that it will be borrowed and add to the national debt. Here again, the plan is bound to meet with resistance from Republicans because they are traditionally advocating reducing spending and deficits. These plans are likely to be watered-down as well.

Due to the complexity, timing of any enactments, and the unknown strength of opposing political forces, it is too early to make a solid prediction about the lasting impact of Trumponomics. Easy campaign promises become difficult to implement when faced with complex economic and political realities. As a practical matter, it is not critical to determine whether we are embarking on just an economic sugar high or a more permanent change. Reaganomics changed the economic and investing landscape for a significant period of time. Trumponomics is bound to do the same thing.

What is crystal clear is that the era of slow economic growth, nearly zero inflation rates, and historically low-interest rates is over. Whether just a sugar high or not, Trumponomics will introduce new inflationary pressures, for at least a long enough time to impact our investments substantially.

In addition to the upcoming inflationary forces from Trumponomics, we have confirmation from the **SoundAdvice Diffusion Index of LAGGING Indicators** (page 11) which is telling us that a rise in interest rates is on the horizon. In addition, as we have been pointing out recently, for the first time in recent history, synchronized massive monetary expansions are in force among the world's largest countries, including Europe, Japan, and China. Energy-based economies, including Canada and Australia, are strengthening with the stabilization and upturn in commodity prices. In the immediate months ahead, the global synchronization of strong expansionary monetary policies around the world is bound to translate into higher economic growth rates abroad. This will also add to inflationary pressures and rising interest rates around the world.

Below we update the individual recommendations in the *Sound Advice* Model Portfolio with the new forces of Trumponomics in mind. We start with the most obvious sector.

ETFs for Rising Interest Rates

We have been recommending three ETFs designed to benefit from the normalization of interest rates and long-term bond yields. These ETFs differ in the amount of leverage used, and 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 bonds, as measured by benchmark bond indexes. Both TBF and TBT are based on the Barclays US 20+ Year Treasury Bond Index, TMV is based on the Intercontinental Exchange (ICE) US Treasury 20+ Year Bond Index. (We have compared these benchmark indexes with others, including BlackRock's iShares 20+ Year Treasury Bond ETF (symbol TLT) which was previously used as a benchmark, and found that using any of these benchmarks produces negligible differences in our projections.) The prices of these ETFs fluctuate in accordance with the daily fluctuations of their benchmark 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 benchmarks will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in their respective benchmarks will cause these ETFs to drop in the same fashion.

We can project the movements of these ETFs based on any given scenario. We have been using the Federal Reserve's prediction, which was as good as any. As part

of the Federal Reserve's quarterly Federal Open Market Committee (FOMC) meetings, each of the 17 committee members makes a prediction regarding the future path of interest rates. Those predictions are plotted in the so-called "Dot Plot".

The most recent Dot Plot was taken at the September meeting. There was a sharp difference in the predictions among this group of informed experts. The lowest prediction was that the Federal funds rate would end 2016 at 0.375 percent. The highest was 1.0 percent.

It will be interesting to see the next Dot Plots which will be taken in the upcoming December meeting. They are bound to be elevated in view of Trumponomics. In the spirit of being conservative, we can continue to use the average of the lowest half of the predictions of the September Dot Plots (8 of the 17). These averages predict that the Federal funds rate will be 0.625% by the end of 2016, 1.125% by the end of 2017, and 1.875% by the end of 2018. Assuming long-term Treasury bond yields would move in accordance with these target points (to preserve the same as today's real return), long-term Treasury bond yields would be yielding 3.895% by the end of 2017 and 4.595% by the end of 2018. (Last month this calculation projected long-term Treasury bond would yield 2.965% by the end of 2016. The Trump election caused long-term Treasury bond yields to rise above that prediction within 2 weeks of election-day. On November 29, 2016, 30-year Treasury bonds yielded 3.04%.)

If we stick to the September Dot Plots as described above, here is what would happen to each ETF by the end of 2017 and 2018:

TMV would rise from \$23.87 to \$37 by the end of 2017, and to \$52 by the end of 2018.

TBT would rise from \$40.57 to \$55 by the end of 2017, and to \$68 by the end of 2018.

TBF would rise from \$23.85 to \$27.7 by the end of 2017, and to \$30.9 by the end of 2018.

The Erosion Factor

As pointed 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, 0.04 percent (4 basis points) every day, and thus go nowhere for the next two years. Here is what would happen to each ETF:

TMV would decline to \$22 by the end of 2017 (8.1%).

TBT would decline to \$39 by the end of 2017 (4%).

TBF would decline to \$23.5 by the end of 2017 (1.3%).

While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

Energy/Natural Resource Selections

During his first hundred days, President-elect Trump promised that he “will lift the restrictions on the production of \$50 trillion worth of job-producing American energy reserves, including shale, oil, natural gas and clean coal.” During his campaign, Trump proposed to abolish the Environmental Protection Agency (EPA). While actually abolishing the EPA is an unrealistic goal, energy industry stocks have responded positively to the prospects of the relaxation of stifling regulations.

Although our energy stocks will benefit from a friendlier business climate, a larger benefit will come from a boost in demand for energy from a stronger US economy. As we went to press, news was leaking from the OPEC meeting that a deal is likely that production will be limited.

Here are the merits of each of our recommendations.

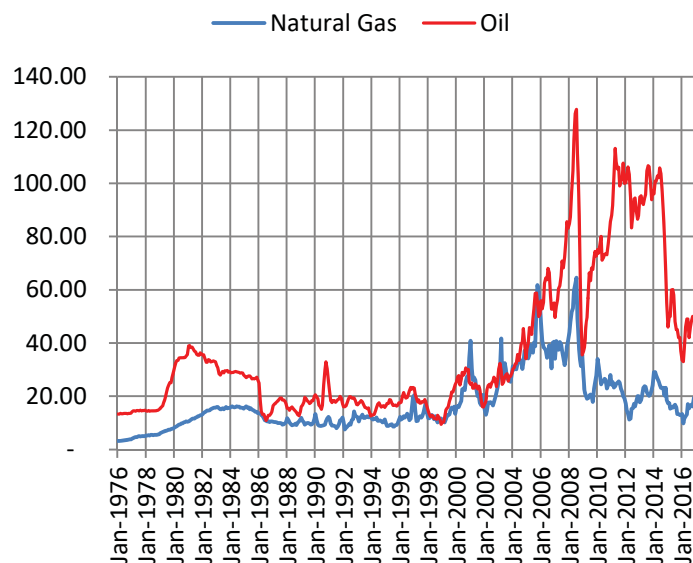
Chesapeake Energy (CHK) has a portfolio of 8 million net acres of oil and gas assets carried at a book value of \$70 billion. CHK’s debt load brought into question whether the company would survive the downturn. Chesapeake has made substantial progress on reducing its overall debt from \$9.7 to \$8.7 billion, as well as reducing near-term maturities in an effort to survive the current period of low energy prices. Debt maturing in 2016 has been paid off. Debt maturing in 2017 has been reduced to \$625 million from over \$2.2 billion. Maturities in 2018 have been cut \$504 million from \$1.0 billion, and 2019 maturities have been reduced to \$599 million from \$1.5 billion. The company has a \$4 billion credit facility that it can tap until early 2019. These moves greatly enhance CHK’s prospects for survival.

Chevron (CVX) is a vertically integrated oil company which means it has operations in all phases, from exploring and drilling (upstream), to transporting and refining (downstream). Profits vary from these stages of production, depending on price demand for oil and for refined products. High oil prices boost margins from drilling but squeeze margins from refining. When oil prices are low, profit margins expand from refining. Management has pronounced the annual dividend as “sacrosanct” which provides an attractive 4% + yield and limits the downside risk.

Fidelity Select Natural Gas Fund (FSNGX) is a diversified way to participate in the recovery of the natural gas industry through strong companies. Natural gas provides the same energy as oil for pennies on the dollar, and natural gas is more environmentally friendly.

The drop in the price of oil brought the energy-equivalent costs of oil and natural gas closer, but a substantial disparity still exists. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. At \$50 a barrel, that is the cost of 5.8 million BTUs. However, with the current market price for natural gas close to \$3.34 for one million BTUs, 5.8 million BTUs will cost \$19.37. So the same amount of energy is available for approximately 39 cents on the dollar, if it is in the form of

The Cost of Energy Equivalents of Oil and Natural Gas



natural gas rather than oil.

The updated chart 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 blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. The fact that natural gas provides energy for pennies on the dollar will translate into an expanding natural gas industry.

ICON Energy Fund Class S (ICENX) is also a diversified way to participate in the recovery with a basket of substantial companies. The hallmark of this fund has been its ability to look for changes within the energy sector to capture value, rather than simply depending on rising oil prices. This fund is a good way to capture today’s values and profit from the recovery and changing landscape on a diversified basis with professional management.

Freeport-McMoRan (FCX) is the world’s largest copper producer. Copper prices typically rise during economic expansions because of the wide use of copper for new construction. FCX is also an infrastructure play.

FCX is in our energy sector because it also has significant oil and gas assets in the Gulf of Mexico which it acquired at the top of the market in 2013. This was particularly unfortunate because FCX took on a large amount of debt to make the acquisition. The company has been working on a number of ways to reduce the burden. Through the third quarter, FCX had sold \$6.6 billion in non-core assets, and expects to receive \$5.2 billion in gross proceeds during fourth-quarter 2016. In late November, FCX completed a \$1.5 billion stock offering to reduce debt further and achieve its debt-reduction goals. CEO Richard Adkerson says that these moves clear the path for Freeport to get its balance sheet in order without being forced to sell

Hospitality REITs Comparison Table

Company Name	Symbol	Recent Stock Price	Dividend Yield	Stock Market Cap Rate	Portfolio Value @ 7.5% Cap Rate (\$Millions)	Stock Value	Discount (-) Premium (+)
RLJ Lodging	RLJ	22.79	5.8%	11.8%	6,472.5	40.80	-46.9%
Hospitality Properties	HPT	28.99	7.0%	10.7%	11,184.6	50.14	-42.2%
Hersha	HT	20.17	5.6%	10.0%	2,305.0	27.71	-32.3%
Host Hotels & Resorts	HST	17.87	4.5%	9.0%	19.2	22.05	-19.0%
Apple Hospitality	APLE	18.44	6.5%	7.2%	4,699.1	17.53	5.2%

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 7.5 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 7.5 percent cap rate valuation of each company’s real estate portfolio.

its highest quality assets. Carl Icahn remains the largest FCX shareholder with 88 million shares, which means moves are being made under his supervision.

Transocean (RIG) makes deep-water drilling rigs and leases them to major oil producers around the world. RIG has been sharply impacted because the utilization of its rigs has fallen along with the drop in oil prices. We continue to recommend RIG because of its prospects for survival. The company reports a backlog of orders totaling \$14.6 billion, nearly all of which is for ultra-deep water floaters. The long-term profit from RIG should be very good from here. Deep-water drilling is still a necessary source for the US and the world’s oil needs, especially as US fracking drops off.

Valero Energy (VLO) is the largest oil refiner in the US. It owns 15 refineries with a capacity for 2.9 million barrels per day. The company also has 7,400 retail outlets in the US, Canada, UK, and Ireland. Profitability in refining is a function of the so-called “crack spread”, the difference in the amount a refiner pays for crude oil and the amount for which it sells the resulting refined products such as gasoline and jet fuel. Fluctuations in these prices compress and expand margins which can make refining stocks volatile at times.

Valero is the most complex refiner in the US, which allows it to purchase lower quality crudes when they are priced at the most advantageous discounts. This flexibility allows VLO to capture the highest margins among its competitors. Valero’s refineries are also well positioned geographically, even for accessing the low-cost Maya crude from Mexico.

Real Estate Selections

Real estate stocks have not been exciting since election-day due to the dampening effect of rising bond yields which portend rising mortgage interest rates. It has been our posture for many months that the average real estate investment trust (REIT) does not present a particularly good value. As in the case of bond yields, low interest rates have pushed down real estate capitalization (cap) rates to historically low levels. (The cap rate is the cash yield before debt payments are considered.) As a result,

commercial real estate prices are historically high. Accordingly, the *Sound Advice* portfolio only includes real estate stocks offering an extraordinary value now.

Two examples currently exist in the hospitality industry: Hersha (HT) and RLJ Lodging (RLJ). Both are selling at deep discounts to their net asset values, with high dividend yields close to 6 percent, and present outstanding values.

The table above shows the comparative values of other hospitality REITs. **Hospitality Properties (HPT)** has the second largest 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. **Apple Hospitality (APLE)** is trading at a slight premium.

Hersha Hospitality (HT) is a real estate investment trust which owns and operates high quality upscale hotels in urban gateway markets. The Company’s 55 hotels totaling 8,654 rooms are located in New York, Boston, Philadelphia, Washington DC, Miami, and select markets on the West Coast. HT is selling at a discount to its hotel assets.

Many of HT’s major properties have been undergoing renovations and not producing their full income potential. Even with ongoing renovations in 2015, the year saw an 18.7 percent growth in funds from operations (FFO). The first 3 quarters of 2016 saw strong growth as well. As renovations are completed and rooms are put back on line, revenue and FFO should climb substantially higher. New acquisitions will also contribute to growth, along with sales of less-attractive properties.

During the last 2 years, Hersha has reported several hotel transactions it made at cap rates ranging from 5.4 to 8 percent. To be on the conservative side, we can establish a main street cap rate at the high end of this range, of 7.5 percent.

Based on the latest trailing four quarters’ financials,

including the most recent 2016 third quarter, and using 7.5 percent cap rate to evaluate the company's portfolio, we value HT at \$27.71 per share which is substantially higher than the current price. The dividend yield is attractive and lowers the risk profile. Hersha has repurchased \$186.6 million of its common stock during the last three years.

RLJ Lodging Trust (RLJ) has a large, geographically diversified portfolio of 125 hotels, branded by Marriott, Hilton, Hyatt, and Embassy Suites with over 20,000 rooms. Rather than traditional full service hotels, RLJ emphasizes "focused-service" or "compact full service" hotels, where only specially chosen services important for guests are offered. The most important amenity is an attractive, modern room offering quality features for the basic necessities – sleeping, bathing, and working. Excluded or minimized are amenities such as large restaurants, spas, and meeting rooms. Overall, the hotels are mid- to up-scale, but with reasonably-priced rooms. This concept translates into a larger portion of revenue from the rooms. The company has been upgrading its assets by purchasing properties in high growth markets with high barriers to entry. Management expects a significant ramp up of growth from recent acquisitions.

RLJ is also selling at a steep discount to its hotel assets. Based on the latest trailing four quarters' financials reported, including the most recent 2016 third quarter, and using a 7.5 percent cap rate to evaluate the company's portfolio, we value RLJ at \$40.80 per share which is considerably higher than the current price. The high dividend yield is attractive and lowers the risk profile.

Retail Opportunities Investment Corp (ROIC) is a real estate investment trust (REIT) that specializes in the acquisition, ownership and management of grocery-anchored shopping centers located in densely-populated, metropolitan markets across the West Coast. ROIC began as an IPO in 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains. ROIC buys distressed retail properties with high-quality demographics, refurbishes them, and then leases them at a premium.

More acquisitions are underway for the current fourth quarter. As new properties are added, along with tenant upgrades, FFO is bound to continue rising. The dividend yield is attractive which lowers its risk profile, along with the company's relatively low debt.

Third Avenue Real Estate Value Investor Fund (TVRVX) is loaded with good values substantially below 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. The managers expend great effort analyzing financial statements, visiting companies and their properties, and assessing management teams in order to come up with their estimates of intrinsic 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.

TVRVX has a number of distinguishing characteristics. This is a global real estate fund. 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.

Medically-Related Selections

During his campaign, Trump promised to repeal the Affordable Care Act (Obamacare) and replace it with Health Savings Accounts. After the election, he said he would keep the popular portions of Obamacare, including the provision that prevents insurers from denying coverage based on pre-existing conditions. He proposes forming high-risk pools and cutting back on costs through stricter immigration policies. He also wants to increase competition among insurance companies to sell across state lines.

Instead of the mandate that requires individuals to purchase insurance or pay a penalty, Trump wants to allow health insurance premiums to be tax-deductible, and allow individuals to shop for cost-effective treatments which allow

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for imported drugs.

How this will all shake out is anyone's guess, so it is too early to look for new investments in this area. We are comfortable with our current recommendations in this sector based on their own individual merits.

Boston Scientific (BSX) produces medical products well suited for an aging population. The company's mission is to transform lives through innovative medical solutions that improve the health of patients around the world. BSX has been a global medical technology leader for three decades by providing a range of high performance solutions aimed at addressing medical needs and reducing healthcare costs. In mid-November, BSX announced positive results from the first clinical trial on its HeartLogic Heart Failure Diagnostic Service to evaluate impending heart failure by combining heart sounds, respiration rate and volume, thoracic impedance, heart rate and activity.

In late November, BSX completed its acquisition of EndoChoice Holdings, Inc, a company developing infection control products, pathology services, and devices for treating gastrointestinal conditions.

Stryker (SYK) provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products, although SYK is best known for its orthopedic devices for artificial knees and hips. Continued growth is assured by accelerating demand for joint replacements on aging US baby boomers. As life expectancies continue to increase (and obesity trends continue), more and more hip, knee, and spinal procedures will be needed. Stryker's cash-rich balance sheet and strong cash flow give it avenues for continued diversified growth through acquisitions.

One of SYK's more significant acquisitions was in December 2013 when it acquired MAKO Surgical and entered the robot-assisted surgery market. In the 2016 third quarter, SYK initiated a limited launch of the "Triathlon" robotic knee replacement surgical system with 200 procedures with satisfactory results. A full launch is planned for 2017 which SYK expects to be successful because of its more consistent and efficient results with less soft tissue disruption.

Tekla Life Sciences Investors (formerly Hambrecht & Quist Life Sciences Fund - the symbol is still HQL) is in our portfolio because the most explosive profits in the entire healthcare industry can be found in biotech companies. Over the last 10 years, biotechnology has become a major industry and the source of the world's top breakthrough drugs. Biotech companies tend to be high risk and high

reward investments which makes diversification essential. This fund is an excellent way to invest in this sector.

Small Caps – Great Again

The president-elect's proposals are domestically focused and benefit small cap stocks more than others because small caps tend to be domestic companies without substantial overseas exposure. They are typically not buffeted by the currency fluctuations that often haunt larger companies. The Trumponomics benefit is evident by the rise in the Russell 2000 Index, which is oriented toward small caps. Since election-day, the Russell index has climbed 4 times more than the S&P 500.

Numerous studies show that small caps perform better over the long run than the market as a whole. They are pure plays on the early stages of new industries and inventions, they have more dynamic and entrepreneurial management, and they are much more likely to be the target of an acquisition or merger which is usually 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. TVSVX management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value (NAV), 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.

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.

Agrium (AGU) is a Canadian company offering a broad mix of agricultural products, from wholesale fertilizers to retail farm products, aimed at increasing the efficiency of food production. AGU products will be in growing demand as arable land continues to disappear around the world while population and per-capita income increases. This translates into a need for greater crop output per acre through the expanding use of AGU's products. Most of AGU's earnings come from its retail stores, offering farm products with the balance coming from its wholesale sales of fertilizers, mostly nitrogen-based but also from potash and phosphates. This diversification protects AGU from

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swings in the markets and brings steady sources of free cash flow for future growth.

Alcoa Aluminum (AA) spun off its downstream operations of value-added products into a separate company called Arconic (ARNC) since our last issue. Alcoa (AA) now just operates the upstream mining operations. After the spin-off, you had the same amount of shares of ARNC as you had in the prior Alcoa stock, and one third that amount in AA.

As we discussed in our November 4th email update, in our view the allocations in the split were lop-sided, and produced two stocks with sharply different profiles. If you have not already done so, **we are recommending selling Alcoa (AA) and investing the proceeds in Arconic (ARNC).**

The split left Alcoa (AA) extremely over-valued, with a sky-high price/earnings (P/E) ratio of 80, no dividend yield, and uncertain prospects for growth. AA is now purely a commodity company dependent on prices for bauxite, alumina, and aluminum. China is adding massive low-cost mining operations which will undermine prices over the longer run.

On the other hand, Arconic (ARNC) is under-valued with a relatively low price/earnings (P/E) ratio of 13, a dividend yield of 2.0 percent, and robust growth prospects. Arconic manufactures specialty metals products for aerospace and defense, building and construction, and automotive industries. These products are not limited to aluminum products, so Arconic is actually a multi-material specialty metals manufacturer.

A primary driver of growth is bound to come from the aerospace and defense sectors. Based on the defensive nature of these industries, growth is likely to be more secular than cyclical. The automotive sector is attractive now because more and more auto companies are increasing aluminum content in their cars for fuel efficiency. This trend should also make growth in this sector less cyclical. Stocks that are less cyclical generally command higher P/E ratios.

Arconic is one of only a few companies with the expertise and assets to use uniquely advanced metallurgical techniques to produce metals that can withstand harsh environments, such as within a jet engine, as well as in other vital uses in products that must not fail.

Arconic inherited the growth side of the business and was given the essential assets to achieve and deliver promising growth.

Apple (AAPL) has a pristine balance sheet, with as much cash as long-term debt. AAPL has the highest A++ financial ratings from both Value Line and Morningstar. However, the stock market has been giving AAPL a below-average price/earnings (P/E) ratio (because of slow and even negative growth prospects. Now, however, with a stronger growth path, Wall Street is bound to give AAPL a higher P/E.

Samsung has been Apple's fiercest competitor. Samsung has had 22.4 percent of the market share of smart phones

– nearly double that of Apple's 11.8 percent share. Slightly more than one-half (57%) of Apple's revenue comes from its iPhones, so any change in iPhone sales growth is huge for Apple. A gain of just one percent in market share translates to 14 million iPhones, which would add 7 percent to revenue.

The demise of Samsung's latest Galaxy Note 7 phones, and the damage to Samsung's reputation for the foreseeable future, has flung open the doors for a significant new growth path for Apple's iPhones. This is especially true in China, where Samsung had a strong position, and where Apple's sales declined 33 percent during the last year.

In addition, Apple has just released its new iPhone 7 which is introducing a new upgrade cycle. One of the primary reasons Apple's iPhone sales have been languishing recently is due to a lack of an upgrade cycle since the iPhone 6 was introduced a few years ago. Improvements over the iPhone 6 include water resistance, 40 percent faster processor and connectivity speed, double the storage capacity, enhanced camera quality to nearly professional grade, and 20 percent longer battery life.

AAPL has not done much since election-day. New tariffs on products made in China would raise the cost of products brought into the US and likely raise the ire of the Chinese government which could retaliate by limiting sales in China.

On the positive side, lower corporate tax rates would be a large benefit to the company's massive tax burden. Trumponomics also proposes a reduction of the current taxes levied on capital trapped overseas with a one-time repatriation tax of 10 percent (from 26 percent) on corporate profits brought into the US. Apple has \$216 billion stored offshore. Trump's repatriation tax break gives Apple the opportunity to potentially repatriate 37 percent of its market capitalization.

Ford (F) is in our model portfolio because it is an extraordinary value. Ford's all-aluminum F-150 truck, which gets close to 30 miles to the gallon, has been Ford's best-selling vehicle in the US for 34 consecutive years, and the company's most profitable product.

Trump's rhetoric against trade is negative for the car industry. Automakers build their small cars in Mexico because NAFTA provides them with access to cheaper labor. It is not profitable to build small cars in the US. Depending on what actually happens with NAFTA over the next four years, the small car industry may move to the southern US, the so-called "Detroit South" where plants are non-union.

Corporate Average Fuel Economy (CAFE) standards are scheduled to rise substantially for automakers selling vehicles in the US by 2025, requiring miles-per-gallon ratings to become more efficient. These requirements are based on the average for all cars sold by each automaker, and therefore can be met by selling more small cars. However, the mix of vehicles sold in the US has shifted from small cars to trucks and SUVs which now dominate

the US market.

The auto makers have been pushing back against the CAFE standards, and will have a better case if small cars become more expensive due to changes in NAFTA. A Republican White House and Congress will likely be more receptive to their cause.

SUVs and trucks are most profitable for the big three, including Ford. In order to sell fewer small cars and meet the CAFE requirements, automakers will need to make more all-aluminum larger cars, SUVs, and trucks (like Ford's F-150).

Although Trump's anti-trade plans introduce cross-currents in the car markets, Ford is positioned to adapt. Ford stock is selling at a huge discount to the rest of the market. The dividend yield is close to 5 percent puts a floor under the stock price and provides a nice yield while we wait for less uncertain times.

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.

In November, NCR announced two more significant alliances. One was with SkyBus, the operator of Melbourne Australia's express airport transport service, which now uses NCR's omni-channel solutions to offer self-service round-the-clock ticketing to its 3.5 million annual customers. The other was with Sparkasse Jena, a German savings bank who will replace its entire network of ATMs with the NCR system.

Management expects NCR's 2016 earnings to range between \$2.97 and \$3.02. NCR is still selling at less than 13 times earnings, which is below the market average.

Symantec (SYMC) is the dominant supplier of software for computer security and protection against viruses and other nuisances. Nearly all of the Fortune 500 companies are Symantec customers. If there ever was a more certain growth industry, protection from cyber espionage is it.

In November, SYMC announced it is buying LifeLock, the identity theft protection company for \$2.3 billion. LifeLock is generating revenue and has good growth prospects, and should give an immediate boost to Symantec's top line.

This acquisition follows the late October, partnership with Blue Coat to integrate its cyber threat intelligence capabilities with artificial intelligence. Symantec's products block 500,000 additional attacks per day and process eight billion security requests across these products daily for 175

million consumer and enterprise endpoints, 63 million email users, and 80 million web proxy users.

SYMC has furnished a nice investment return this year, especially considering its \$4.00 dividend paid in February.

Tetra Tech (TTEK) is a leading company in water technologies and environmental remediation with a healthy balance sheet for growth in strategic markets. Two recent acquisitions of Coffey and INDUS corporations have swelled TTEK's backlog of contracts and increased prospects for more Federal contracts in the IT sector.

The company's backlog is now \$2.3 billion, which reveals a robust pipeline with major government organizations like the US Department of State, US Army Corps of Engineers, and the US Air Force, which should continue to bolster growth.

In November, TTEK reported its fourth-quarter fiscal 2016 earnings of 59 cents, in line with expectations. Cost-management initiatives and better operating efficiencies helped earnings growth. The company's earnings benefited from a strong top-line growth. Net revenue rose 24% year over year to \$530.8 million. For fiscal 2016, the earnings per share came in at \$1.88, up 17% from the prior year.

Xerox (XRX) is continuing to transform from a seller of printers and copiers to a company providing information technology (IT) services and document outsourcing (printing

as a service). The services side now amounts to 55 percent of revenues. XRX will be splitting into two companies by the end of the year; one with the printers and other equipment and the other offering the IT services. The company predicts that the split will save \$2.4 billion during the first 3 years. Carl Icahn, who holds 82 million shares, believes XRX is undervalued and believes the split will improve management's efficiency and focus.

Hedging the Portfolio

We are also recommending a reverse ETF that essentially short-sells the market and will benefit from down-drafts in the S&P 500.

The **ProShares UltraShort S&P 500 (SDS)** 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 performs as it should, with daily premiums and discounts within 0.5 percent. It is also very liquid.



Energy/Natural Resources	Symbol	Price / NAV	Yield	Action	Limit
Chesapeake Energy Corp	CHK	\$7.00	0.00%	BUY	\$8.00
Chevron	CVX	\$111.56	3.87%	BUY	\$114.00
Fidelity Select Nat. Gas Fund	FSNGX	\$29.48	0.00%	HOLD	\$32.00
Freeport-McMoRan	FCX	\$15.35	0.00%	BUY	\$17.00
ICON Energy Fund Class S	ICENX	\$13.43	0.00%	BUY	\$14.50
Transocean	RIG	\$12.90	0.00%	BUY	\$14.00
Valero	VLO	\$61.56	3.90%	BUY	\$65.00
Real Estate					
Hersha Hospitality Trust	HT	\$20.17	5.55%	BUY	\$21.00
Retail Opportunity Investment Corp	ROIC	\$20.64	3.49%	BUY	\$22.00
RLJ Lodging Trust	RLJ	\$22.79	5.79%	BUY	\$25.00
Third Avenue Real Estate Value Investor	TVRVX	\$29.87	1.47%	BUY	\$32.00
Medically Related					
Boston Scientific	BSX	\$20.46	0.00%	BUY	\$23.00
Stryker Corp.	SYK	\$113.66	1.34%	BUY	\$120.00
Tekla Life Sciences Fund	HQL	\$17.63	0.00%	BUY	\$20.00
Small Caps					
Third Avenue Small-Cap Value Investor Fund	TVSVX	\$22.79	0.00%	BUY	\$24.00
Special Situations					
Agrium	AGU	\$100.85	3.47%	BUY	\$105.00
Alcoa	AA	\$28.97	0.00%	SELL	\$0.00
Apple	AAPL	\$110.52	2.06%	BUY	\$120.00
Arconic	ARNC	\$19.28	1.87%	BUY	\$21.00
Ford Motor Company	F	\$11.96	5.85%	BUY	\$13.50
NCR Corp	NCR	\$38.75	0.00%	BUY	\$40.00
Symantec	SYMC	\$24.39	1.31%	BUY	\$28.00
Tetra Tech	TTEK	\$42.85	0.84%	BUY	\$45.00
Xerox	XRX	\$9.35	2.99%	BUY	\$11.00
ETFs for Rising Interest Rates					
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	\$23.87	0.00%	BUY	\$26.00
ETF - ProShares Short 20+ Year Trsry	TBF	\$23.85	0.00%	BUY	\$25.00
ETF - ProShares UltraShort 20+ Year Trsry	TBT	\$40.58	0.00%	BUY	\$41.50
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	\$15.75	0.00%	BUY	\$16.50

Notes to the table:

Prices are as of 11/30/2016. See our website for live pricing and buy limits:

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

The right hand column is the highest recommended price limit for purchases.

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. The table above divides the portfolio into four sectors; Income with Growth, Diversified Growth, Energy and Natural Resources, and Aggressive Growth.

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

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 100+ years, we can see this titanic struggle between the stock market and its foremost competitor for investment dollars: real estate.

To reveal this phenomenon, we have set up an equation in which we divide the Standard and Poor's 500 Stock Index average by the median price of a new house for each month over the last 100+ years. This equation exhibits an elegant financial minuet as each market has taken turns outperforming the other.

As we look at the historical data, we find that there is a range in which the price disparities are so strong that they are too great to be accounted for by the fundamental economic conditions underlying each market. Every time prices get into these danger zones it has meant that the prices in one market or the other have gone too high, and that they are in imminent danger of falling.

We can, therefore, label this new tool the SoundAdvice "Risk Indicator," since it will allow us to locate the point at which prices are so high when compared to competing markets that they have come loose from their moorings and

are on the verge of declining or under performing the other market.

What is too high? When stock prices are very high relative to house prices, the SoundAdvice Risk Indicator will rise over the line marked 2.0, revealing a high-risk time for stocks. In contrast, when the indicator drops below the line marked 1.0, it means that it is a very low-risk time to buy stocks. Notice from the chart how the SoundAdvice Risk Indicator has oscillated back and forth, revealing the ongoing struggle between Stocks and houses for investment capital. We have labeled these long vacillations Supercycles.

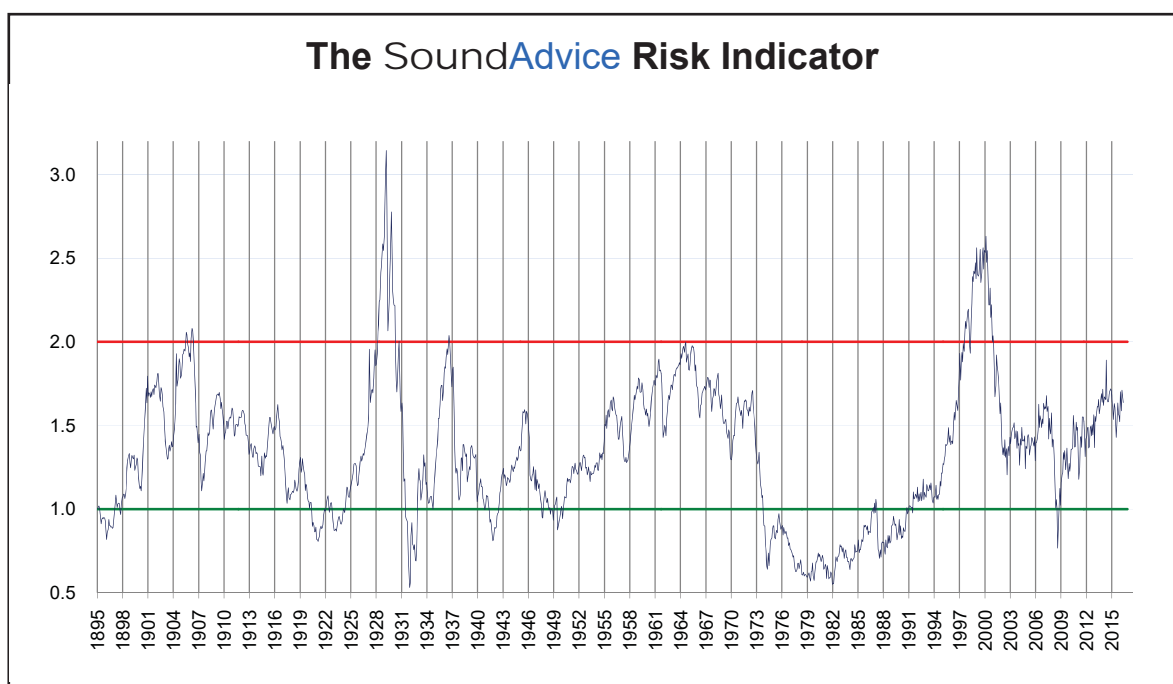
The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$12.9 million in stocks and to \$1.7 million in houses.

But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the SoundAdvice Risk Indicator he would have made \$514 million, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the SoundAdvice Risk Indicator would have provided.

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

The latest reading for the SoundAdvice Risk Indicator is 1.64. This reading reveals that stock prices are above average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

See *The Science of Making Money in the Stock Market* for a complete explanation of the SoundAdvice Risk Indicator and its track record.



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

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

When the SoundAdvice Diffusion Index of **LEADING Indicators** drops to zero, it is time to buy stocks aggressively, regardless of how negative the atmosphere may be. This is not just an empirical coincidence. It is also logical. In order for all of the leading economic indicators to be giving off a zero value compared to six months before, it is nearly certain that the 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 SoundAdvice Diffusion Index of **LAGGING Indicators** gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reading reveals that the US economy is strong enough to put upward pressures on interest rates.

We have been operating under a "Caution" signal since the June 2015 release of the May lagging economic indicators. This was just after the S&P 500 peaked at 2,130.82 on May 27, 2015.

The SoundAdvice Diffusion Index of **LAGGING Indicators** was **67 percent** again in October (the most recent data). This follows a consecutive string of **five 100 percent readings**.

Track Record of the SoundAdvice Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 climbed an average of 32.1 percent. During "Caution" signals, the S&P 500 increased an average of 2.8 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
Ave +/-	32.1%		2.8%

See *The Science of Making Money in the Stock Market* for a complete explanation of the SoundAdvice Diffusion Indexes and their track records.

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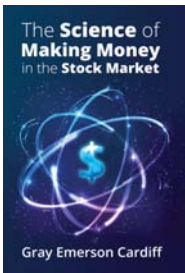
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