



The *Sound Advice* portfolio is up 20.5 percent so far this year, assuming an equal amount was invested in each position at the beginning of the year. If we look back to the beginning of last year, the portfolio is up 46.2 percent. We have an average gain of 62.2 percent based on the prices at which each stock, ETF, or mutual fund was originally recommended.

-Gray Emerson Cardiff

Bye-Bye Bernanke

Mr. Bernanke's semi-annual testimony before the House Committee on Financial Services was revealing and shed more light on the near-term path of interest rates and bond yields. Not only is this information significant for our "No-Brainers", it lays the foundation for the future path of the stock market as well.

One new perspective was that senator after senator bid Mr. Bernanke farewell and thanked him for his service. Mr. Bernanke did not comment or react, which was a silent confirmation of the wide expectation that this was his final semi-annual appearance before Congress as Fed chairman, and that he will step down in January.

While Mr. Bernanke has not officially said he is stepping down, he has pointed out that others "are well equipped to manage the central bank's exit from unconventional monetary policy."

President Obama commented before the testimony that Bernanke "*has been in the job longer than he intended to be*". After the testimony, an administration official said that President Obama won't be appointing a successor until this fall. The choice appears to have narrowed to either Janet Yellen or Lawrence Summers.

Yellen was the President of the San Francisco Federal Reserve from 2004 into 2010, and was one of the few Federal Reserve officials to point out the risks of subprime mortgages in 2007. She worked closely with Mr. Bernanke during the

height of the financial crisis and has since been #2 at the Fed during the quantitative easing programs.

President Obama also likes Larry Summers who was director of the National Economic Council during Obama's first two years and helped shape the administration's response to the financial crisis.

Like Yellen, Summers is an Ivy League-educated economist and both have similar outlooks on monetary policy. However, Summers will introduce controversy because he was instrumental in repealing the Glass-Steagall Act in the 1990s during the Clinton Administration. The removal of this post-depression law that prevented commercial banks from engaging in investment banking and other investment activities, is widely believed to be a primary cause and, in the very least, exacerbated the 2008-9 financial crisis. Congressional leaders from both sides of the aisle are calling for the return of the Glass-Steagall Act an action which Summers continues to oppose.

Whoever replaces Mr. Bernanke, he or she will inherit the delicate job of completing the tapering of the bond-buying program. The transition is likely to be smoothest with Yellen as she steps from #2 to #1. With Summers, the transition would likely introduce more volatility into the financial markets.

In either case, the Treasury bond market will be nervous. As the Federal Reserve's bond buying is tapered, the Treasury bond market will no longer have the support of the Fed's massive buying. Even worse, it will start to focus on the specter of the Fed selling its massive portfolio of bonds purchased during the quantitative easing programs – a portfolio that has grown by nearly 4 fold since 2007, to over \$3.3 trillion.

During Mr. Bernanke's Congressional testimony, Senator Schumer (D-NY) asked Mr. Bernanke, "*There seems to be some disparity between the other members and you, and if you're not there come next year, there's a worry there?*"

Mr. Bernanke answered the question by saying that it had already been answered: "*We have given some fairly specific qualitative guidance about what we're looking for... Specifically, the Fed wants the unemployment rate to decline from the current rate of 7.6 percent to a rate in the general vicinity of 7 percent with inflation moving back toward this 2 percent objective.*"

In an earlier press conference, Mr. Bernanke reiterated that the Fed expects to reduce its bond-buying later this year, and to end purchases by the middle of next year, as long as economic growth remains "broadly" in line with the Fed's expectations.

The timeline indicates that Mr. Bernanke will still be Chairman to begin the end of his quantitative easing program by tapering bond purchases.

Mr. Schumer also asked, "*Do they [other members of the Federal Reserve] think unemployment will be 7 percent this year, or*

do they have different assessments about the relative cost and benefit of quantitative easing?

Mr. Bernanke responded “The general scenario which I described in my press conference is broadly supported by people on the committee.” He added that the committee had “a very careful discussion” that led to his public statement about the probable timetable for tapering.

Another confirmation that the Federal Reserve will begin tapering its long-term bond buying soon came from Mr. Bernanke’s comments on the second day of his testimony when he said that the Fed had concluded that “such purchases aimed at reducing long-term interest rates do less to bolster the economy than the Fed’s traditional focus on reducing short-term rates.”

He also said “the central bank had other tools at its disposal, besides asset [bond] purchases.”

In yet another confirmation, Mr. Bernanke said that announcing a timeline for tapering was aimed at “tempering risk-taking in financial markets.” In other words, the rise in bond yields that followed his announcement about beginning tapering this fall was a desired effect.

Our “No-Brainers”

We have dubbed our reverse ETFs “No-Brainers” because they are designed to benefit from rising bond yields, and it was only going to be a matter of time when bond yields were going to rise. They always do after recessions – it was as simple as that. The only question was how soon and how fast.

So far, we have a 12 percent gain in the **Proshares Short 20 Plus Year Treasury (TBF-NYSE)**, which uses no leverage.

We have a 24.5 percent gain in the **Proshares Ultrashort Lehman 20 Plus Year Treasury (TBT-NYSE)**, which uses 2:1 leverage.

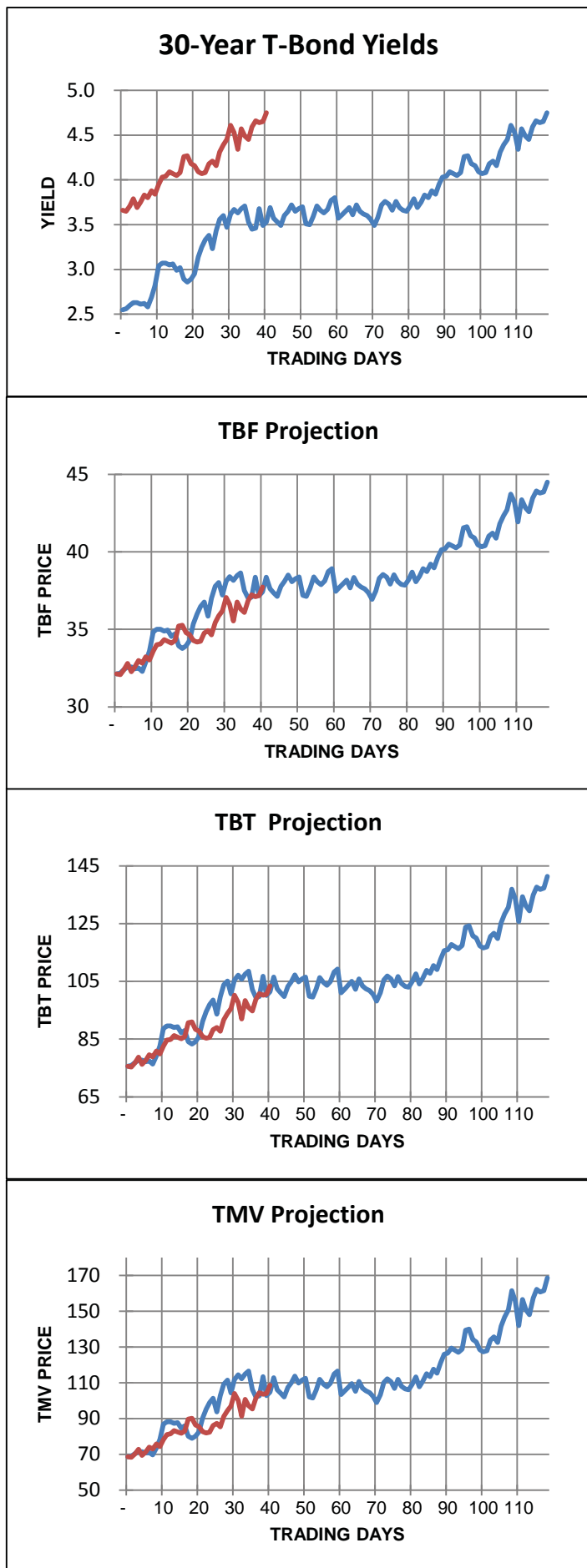
We have a 34 percent gain in the **Direxion Daily 20 Plus Year Bear 3 Shares (TMV)** which uses 3:1 leverage.

These are nice gains but we believe there is considerably more to come. From Mr. Bernanke’s testimony, it has become clear that the days of historically low long-term bond yields are over. Now, it’s not a question of whether bond yields will continue to rise, it is a matter of how fast.

The most recent time long-term Treasury bond yields rose significantly was from December 18, 2008 to June 10, 2009, (118 trading days) when 30-year Treasury bond yields rose from 2.55 percent to 4.75 percent, or 220 basis points. The pattern of this rise is shown by the blue line on the top chart.

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

The price action of these ETFs is based on the changes in long-term treasury bonds, specifically BlackRock’s iShares 20+ Year Treasury Bond ETF (symbol TLT) which holds a portfolio exclusively of long-term Treasury bonds with an average maturity length of 27.54 years. The prices of our No-Brainer ETFs fluctuate in accordance with the daily fluctuations of TLT, only in the opposite direction, multiplied by the leverage each



The History of 30-Year Treasury Bond Yields



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

Source: Yahoo! Finance

uses. For example, a decline of say, 1.0 percent in TLT will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in TLT will cause our No-Brainers to drop in the same fashion.

To construct our models, we start with a projection of an increase in 30-year Treasury bond yields. A conservative approach would be to assume that long-term Treasury bond yields will not rise beyond 4.75 percent -- not any higher than the last peak. We can use the pattern of the last 57 days of the 220 basis point rise when yields rose from 3.66 percent (close to today's yield) to the peak of 4.75 percent. That 57 day rise is shown by the red line on the top chart (as well as the last 57 days of the blue line).

In that scenario, our No-Brainers would rise to the following levels:

TBF would climb to \$37.7 for a 17 percent gain. See the red line on the second chart.

TBT would climb to \$103.4, for a 37 percent gain. See the red line on the third chart.

The most responsive ETF, **TMV**, would climb to \$108.6, for a 58 percent gain. See the red line on the fourth chart.

While the pattern of today's rise is unlikely to be exactly the same as the last 57 days of the previous rise, we believe this projection should serve as a minimum expectation. After yields rose to 4.75 percent on the last rise, the economy was considerably weaker than it is today and went into a decline, sending bond yields back down. Of course, we are following and will continue to watch economic indicators closely, especially as long-term Treasury bond yields approach 4.75 percent. However, this time it is likely that bond yields will be marching substantially higher in view of the imminence of the Fed's bond-buying tapering and ultimate selling of its massive portfolio of Treasury bonds. There negative forces on bond prices will be acting to push up bond yields. Accordingly, it

is not unreasonable to assume the current upswing in long-term Treasury bond yields will not end at 4.75 percent, but at a higher level.

If, for example, we assume that another 220 basis point rise is still ahead, yields would rise to 5.86 percent. If we assume a 220 basis point rise would take the same shape as it did the last time, here is what would happen to each of our No-Brainers:

TBF would climb to \$44.5, for a 39 percent gain. See the blue line on the second chart.

TBT would climb to \$141, for an 87 percent gain. See the blue line on the third chart.

TMV would climb to \$168, for a 146 percent gain. See the blue line on the fourth chart.

The Historical Perspective

Once again we have included the graph above showing the history of long-term Treasury bonds since 1977 to offer the historical perspective. As you can see, today's yields are still historically low. Also note that yields have been considerably higher than 5.86 percent most of the time. There is no reason the rise in long-term Treasury bond yields should stop at 5.86 percent.

These ETFs are not for an indefinite "buy and hold" investment strategy, especially the most highly-leveraged (TBT and TMV). Excess volatility in bond yields over an extended period will cause erosion in the prices of these ETFs. More importantly, they will drop when bond yields decline, and are only for periods when bond yields are certain to rise substantially. These ETFs are worth a substantial investment right now for the immediate future because the profit potential is so great. They are only "No-Brainers" right now, while the greatest and most explosive movement in long-term Treasury bond yields is still upward. However, there will definitely be a time to sell these ETFs and

we will continue to watch them closely to let you know when it is time to lighten up and/or get out completely.

Portfolio Updates

Most of the time, rising bond yields are not good news for stocks. However, in the early stages of an economic expansion, the growth in the economy and stimulus to earnings is a strong positive force and often outweighs the specter of rising interest rates. It is also important to distinguish between short-term and long-term interest rates.

This time, the business cycle has a major difference from typical cycles: the Fed is holding down short-term interest rates and is promising to continue to do so well into the expansion in order to stimulate the economy and bring down unemployment. This is a very positive factor for stocks.

Meanwhile, the improvement in the economy will be pushing up long-term interest rates (including yields on long-term Treasuries) because inflationary expectations will grow. Long-term interest rates typically carry a premium of 3 percentage points over the anticipated and perceived rate of inflation.

Once the economy gains traction and starts fueling inflation, the Federal Reserve is bound to step in and increase short-term interest rates to stem inflationary pressures. At this point, the tightening monetary policy will not be good for stocks and will push long-term rates even higher.

In the past, we have relied on our Diffusion Index of Lagging Indicators (Page 11) to tell us when that critical point occurs. These have been times when major declines in stocks have followed, most notably in 2008 and in 2000. We received another such reading again in April 2012 but the Federal Reserve continued to keep short-term interest rates low by continuing its quantitative easing program.

This indicator was instrumental in recommending our “No-Brainer” ETFs designed to profit from rising Treasury bond yields. We have continued to be bullish about stocks due to the Federal Reserve’s extraordinary easy monetary policy which has been distorting the natural business cycle this time.

Here are updates on the rest of our recommendations in alphabetical order. The table on page 7 details our buy limits and other information on each recommendation, and organizes them by investment objective. Also see our website for live pricing.

Agrium (AGU) is down 15 percent this year, trimming our profit to 617 percent. This is the largest farm products retailer in North America and a wholesaler to the world.

Falling demand from India is undermining the fertilizer market. The Indian government is cutting subsidies on major fertilizers to reduce its budget deficit. India imports all of it potash. 30 percent of which from the US. However only 9 percent came from Agrium’s total sales. For the most part, AGU’s customer is the US and Canada.

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

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

AMN Healthcare (AHS) is up 28 percent this year, extending our profit to 179 percent. AMN Healthcare provides temporary healthcare staffing services to the healthcare industry, ranging from nurses to physicians. We recommended this stock at

an average price of \$5.35 based on the rationale that it was a two-fer. AHS was not just an opportunity to invest in healthcare, which is traditionally a non-cyclical industry, but it is also a chance to buy into a healthcare business which will benefit from a recovery in the economy.

As the stock advanced and its price/earnings (P/E) ratio expanded, ultimately climbing over 25, we recommended holding off on purchases. The stock price has declined from its peak recently but still remains above our upper buy limit. We continue to recommend holding for now and waiting for a pull-back to buy more.

Associated Estates Realty Corp (AEC) is down 5 percent this year trimming our gain to 10 percent. There was no significant news in July. In recent months we have noted AEC has been reducing debt and diversifying into California, both of which are certain to

benefit the bottom line.

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

Boston Scientific (BSX) is up 90 percent this year. In late July, the stock jumped over \$11 a share, its highest level since September 2009, after the company reported better-than-expected earnings from sales of its stents and other cardiovascular devices which currently account for approximately half of the company’s revenue. Second quarter earnings were 10 cents per share, compared with a net loss of \$2.51 per share one year ago.

In July, BSX received clearance from the FDA as well as in Europe for the Guide Extension Catheter called “Guidezilla”. This device allows for safer and more efficient coronary intervention procedures, such as installing stents and angioplasty balloons.

Growth prospects continue to become more favorable from new products. One of the most significant is *Watchman*, a device that decreases the chances of a blood clot in patients with erratic heartbeats. The *Watchman* is approved in Europe



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

CGM Real Estate Fund (CGMRX) is up 3 percent this year, extending our profit at 60 percent. We believe that this fund is poised for considerably more gains ahead as the economy recovers.

Most of the time, above average investment returns can be earned in REITs. By far, CGMRX has been the best performer of REIT funds over the last ten years. (See the February 1st Issue of *Sound Advice* for the complete rundown of all REIT Funds.) CGMRX has produced an annual return of 15.99 percent over the last ten years through July. By comparison, the S&P 500 produced an annual return of close to 8 percent over the same period.

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

Chesapeake Energy (CHK) is up 40 percent this year giving us a gain of 41 percent since we added it to the portfolio last year. CHK is the second largest producer of natural gas. We added it to the portfolio last year because it was greatly undervalued for three principle reasons: (1) Natural gas prices were historically low at the time, close to \$2.00 for one million BTUs, (2) the company had poor corporate governance, and (3) it was suffering from a severe cash squeeze.

Natural gas prices have nearly doubled since our recommendation and production is clearly on the upswing. Through its pioneering and prolific use of fracking technology to produce oil and liquids from shale, CHK has increased the amount of unconventional oil it produces by 22% during the last year from its acreage in the Eagle Ford, Granite Wash, and Mississippi Lime.

CHK is also a leading driller in Ohio's Utica Shale, and the company expects its success to accelerate this year along with a substantial decline in its costs. Two major processing plants are opening in the area which is bound to provide a big boost to production. With the addition of the new infrastructure, CHK management is confident that it will achieve its year-end target of 330 million cubic feet of gas per day from its Utica wells. If CHK achieves that goal, it would quadruple the average first-quarter natural gas volumes.

Regarding CHK's corporate governance, Carl Icahn purchased a substantial stake and was instrumental in removing the founder, Aubrey McClendon, as chairman of the board and replacing several other board members. Doug Lawler officially took over as CEO in June, after spending his

entire career at Anadarko Petroleum and its predecessor Kerr-McGee.

CHK's cash squeeze has been solved for the most part through the sale of targeted divestments.

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

Comcast (CMCSA) is up 21 percent this year, extending our profit to 108 percent. This is the nation's largest cable TV provider. But it is no longer just a cable company. It also provides internet and telephone service. CMCSA now has sole ownership of NBC Universal which operates major broadcast and cable networks (NBC, Bravo, USA), as well as film studios (Universal Pictures), digital media content, and resort theme parks. CMCSA's synergistic array of products provides a solid growth path. Earnings have increased every year since 2003, and so have dividends since they commenced in 2008.

In July, Comcast expanded its X1 Platform from Xfinity in Maryland and Delaware. Tom Coughlin, a senior vice president, said *"The X1 Platform is a huge leap forward for us and transforms traditional television viewing into an entirely new, integrated entertainment experience. X1 uses cloud-based technology to make the TV experience smarter, richer and more personalized, and allows us to deliver new features to our customers faster than ever."*

At the heart of Comcast is its high-speed broadband through which it delivers internet and cable TV along with its library of digital media, content as well as additional bundled services, including home thermostat controls and security systems with alarms and cameras, all of which can be accessed from a smart phone or tablet. The bundled packages are often less expensive than if delivered from separate providers.

The housing recovery is also a source of growth for CMCSA.

CommonWealth REIT (CWH) is up 45.6 percent this year. In June, Corvex Management and Related Fund Management announced that they have delivered consents from holders of over 70 percent of the outstanding shares approving their proposal to remove the entire Board of Trustees. CWH management is contesting the validity of the consent solicitation, and the matter is currently in arbitration.

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

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

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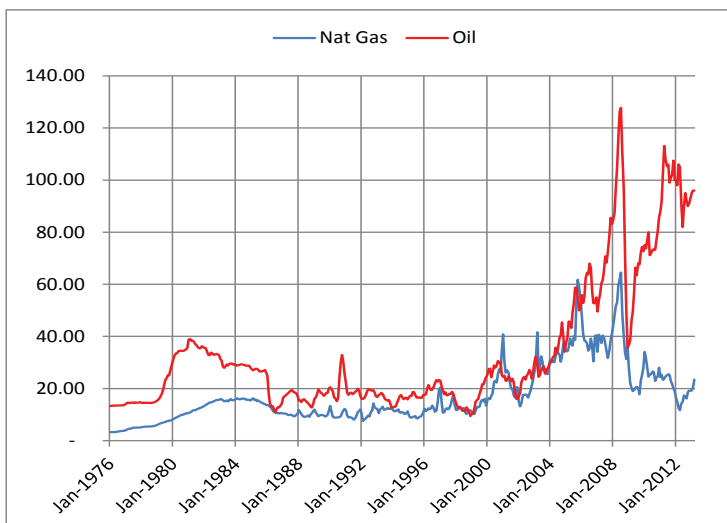
translates to \$63.74 per share.

Fidelity Select Natural Gas Fund (FSNGX) is up 12.7 percent this year which is close to our profit. This is the only mutual fund that concentrates on the natural gas industry, and a diversified play on the gap between the energy equivalents of oil and natural gas.

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

We continue to display the historic relationship between the costs of these two forms of energy in the chart below because it demonstrates that today's disparity is not a normal situation.

The Cost of Energy Equivalents of Oil and Natural Gas



The red line shows the price of a barrel of oil since the mid-1970s. The blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. Note that for most of the time (36 years), the two forms of energy are closely aligned. This stands to reason. After all, energy is energy, and it should cost approximately the same regardless of the form in which it comes. However, that is not the case today. For 5.8 million BTUs of energy, it costs approximately \$100 if it is in the form of oil, but only \$23.20 in the form of natural gas.

The US is self-sufficient in natural gas with only 9 percent imported from Canada. At 23.2 cents on the dollar versus oil, natural gas is bound to have a growing role in America's energy needs as well as independence from importing oil. This fund is well positioned to benefit from an expanding natural gas industry.

Hambrecht & Quist Life Sciences Fund (HQL) is up 34 percent this year, extending our profit to 105 percent. At the end of June, HQL paid a quarterly stock distribution of \$0.34 per share, derived from long-term capital gains.

The most explosive profits in the entire healthcare industry

can be found here in biotech companies. This is a volatile sector, so diversification is crucial. HQL is a superior way to gain exposure to biotech on a diversified basis.

ICON Energy Fund Class S (ICENX) was added to the portfolio a few months ago because the demand for energy accelerates with an economic expansion. The best time to invest is when the economy is coming out of a slump, before demand increases.

Aside from the cyclical timing, above average investment returns can be earned over the long run. Over the last 10 years, the Energy Equity Index produced an average above 13 percent annually through the end of July, far outstripping the performance of the S&P 500. The superior performance is due to the fact that energy is in the fabric of the economy. It takes energy to make everything, and especially large amounts to make the most vital materials and substances, such as chemicals, plastics, and to run data centers.

In addition, there is always the possibility of geopolitical disturbances threatening supplies and driving up energy prices.

Most energy mutual funds have not been able to match the performance of the Energy Equity Index. However, this fund not only beat the Energy Equity Index resoundingly, it has turned in the best performance – by far – of energy funds. This no-load fund furnished an annual return of 15.6 percent during the last ten years through the end of July. This Fund's performance also led the pack in shorter durations – 5 year, 3 year, and 1 year. See the April 1, 2013, Issue for a complete analysis of all no-load energy funds.

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

Masco (MAS) is up 23 percent this year, extending our profit to 178 percent. MAS manufactures a wide range of products for home construction and remodeling--everything from kitchen cabinets and faucets to windows and paint.

We added MAS to the portfolio at \$7.49 after the shares got hammered during the recession. However, after the share price rocketed we put the stock on "Hold" because the price/earnings ratio got too rich, approaching 30 times the 2013 earnings estimate of \$0.70 a share. This high price/earnings ratio is already anticipating a steep growth rate. We continue to recommend waiting for a pullback to accumulate more shares. The stock has been pulling back recently, but still above our upper buy price limit.

Maxim Integrated Products (MXIM) is down 2.7 percent this year, reducing our profit to 47 percent. MXIM specializes in high-performance electronic chips that convert digital signals into analog format so that we can hear them. Such chips are in every cell phone. MXIM also makes integrated power management chips (PMIC) for portable devices makers to extend battery lives.

Income With Growth	Symbol	Exchange	Price	Yield	Buy Limit	Action
Associated Estates Realty Corp	AEC	NYSE/Nasdaq	\$ 15.28	4.97%	\$ 18.00	BUY
Commonwealth REIT	CWH	NYSE	\$ 23.07	4.33%	\$ 25.00	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 13.70	4.09%	\$ 15.00	BUY
Diversified Growth						
CGM Realty Fund	CGMRX	800-343-5678	\$ 30.11	1.59%	\$ 31.00	BUY
Comcast	CMCSA	NASDAQ	\$ 45.08	1.44%	\$ 42.00	HOLD
Masco	MAS	NYSE	\$ 20.52	1.46%	\$ 18.00	HOLD
Paychex	PAYX	NASDAQ	\$ 39.44	3.25%	\$ 34.00	HOLD
Pfizer	PFE	NYSE	\$ 29.23	3.01%	\$ 30.00	BUY
Stryker Corp.	SYK	NYSE	\$ 70.46	1.21%	\$ 71.00	BUY
Xerox	XRX	NYSE	\$ 9.70	1.75%	\$ 10.00	BUY
Energy/Natural Resources						
Agrium	AGU	NYSE/TSE	\$ 85.00	2.35%	\$ 95.00	BUY
Chesapeake Energy Corp	CHK	NYSE	\$ 23.30	1.50%	\$ 24.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 34.78	0.16%	\$ 36.00	BUY
ICON Energy Fund Class S	ICENX	800-435-5697	\$ 22.19	0.00%	\$ 25.00	BUY
Tetra Tech	TTEK	NASDAQ	\$ 23.60	0.00%	\$ 26.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$ 15.66	2.84%	\$ 18.00	BUY
Aggressive Growth						
AMN Healthcare	AHS	NYSE	\$ 14.78	0.00%	\$ 12.00	HOLD
Boston Scientific	BSX	NYSE	\$ 10.92	0.00%	\$ 11.50	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 68.14	0.00%	\$ 75.00	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 32.06	0.00%	\$ 34.00	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 75.30	0.00%	\$ 78.00	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$ 19.48	0.00%	\$ 20.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$ 28.61	3.36%	\$ 33.00	BUY
Symantec	SYMC	NASDAQ	\$ 26.68	0.00%	\$ 25.00	BUY
Tellabs	TLAB	NASDAQ	\$ 2.24	0.00%	\$ 2.50	BUY

Prices are as of 7/31/2013. See our website for live pricing and buy limits.

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

Yields on funds do not include distributions of capital gains. Note that all fund distributions fluctuate annually.

Both revenue and earnings were below expectations for the second quarter primarily due to a drop-off in Samsung's prior-generation Galaxy S III smartphone and Note II tablet.

During the last four quarters, revenue from Samsung accounted for 28% of total company sales. As MXIM's top customer, Samsung has been a source of growth. Recognizing the risk with so much riding on one customer, MXIM has been diversifying and noted that revenue grew in 22 out of 24 of its market segments during the quarter.

MXIM will continue to emphasize high-end smartphones because that is where the innovation takes place. However, as new technologies are developed, MXIM plans to leverage and selectively migrate the technology to lower- and midrange-priced smartphones and tablets, and see growth from the mobility sector resume in calendar 2014.

MXIM is in excellent financial health with more than \$1.5 billion of cash and plenty of cash flow to support operations.

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

In July, MXIM announced an increase in its dividend by 8% along with a new \$1 billion share repurchase program.

Paychex (PAYX) is up 27 percent this year, extending our profit to 47 percent. This is the second-largest provider of payroll services to small to medium-sized companies serving a total of approximately 567,000 payroll clients. Accordingly, its revenues and earnings directly mirror the employment situation.

In July, PAYX announced an increase in its quarterly dividend to \$0.35 per share from the prior dividend of \$0.33.

There is definitely further growth ahead with a recovery in the economy. Another attractive feature is it is pristine with no long-term debt exposure.

However, in its typical fashion, the market has been anticipating future growth by bidding up the stock price. The price/earnings ratio has been close to 25, which is substantially above the market and not a bargain. Accordingly, we have had PAYX on "Hold".

Pfizer (PFE) is up 16.6 percent this year, extending our profit to 74 percent. We added PFE to the portfolio when it became dirt cheap as the expiration date approached on its blockbuster drug, Lipitor. However, its future was brighter due to the arsenal of new pharmaceutical products. Pfizer is poised to launch several blockbusters in cancer, heart disease, and immunology.

The company's two most promising new products are Xeljanz for rheumatoid arthritis and its blood-thinner, Eliquis, for stroke prevention. Both were approved in late 2012 for use in the US and are scheduled to be widely available later this year, and both could be Pfizer's next blockbusters.

In July, PFE announced that Xeljanz was approved in several countries, including Switzerland, Argentina, Kuwait, the UAE, and Russia, for patients who had an inadequate response to existing therapies. This amounts to a third of rheumatoid arthritis patients, and approximately half who stop responding within five years.

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

The **Zoetis (ZTS)** offering was fully subscribed when PFE offered to exchange your PFE stock for shares in Zoetis. We recommended that you reject the offer, and ZTS stock has not done as well as PFE.

We noted that getting rid of ZTS was beneficial to PFE's earnings per share, which could only mean that it would not be as good for you. We also noted that the potential of the FDA issuing more restrictive, involuntary guidelines regarding the use of antibiotics on animals used in food production would be highly detrimental to Zoetis.

Retail Opportunities Investment Corp (ROIC) is up 6.6 percent this year, extending our profit to 29 percent. This REIT began as an IPO in October 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains.

ROIC buys distressed retail properties with high-quality demographics, refurbishes them, and then leases them at a premium. As new properties are added, along with tenant upgrades, FFO is bound to continue to rise, along with the dividend, and push the price of this REIT upward.

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

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

Stryker (SYK) is up 28 percent so far this year, extending our profit to 70 percent. SYK is best known for its orthopedic devices: artificial knees and hips. SYK also provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products.

Reconstructive implants account for 45 percent of SYK's revenues, and more profits are assured by accelerating demand for joint replacements on aging baby boomers. As life expectancies continue to increase, and obesity trends continue, more and more hip, knee, and spinal procedures will be needed.

In July, Stryker announced second quarter earnings and the stock price reacted by hitting a new high for the year, closing at \$70.80. SYK has had a string of quarters that have been hurt by product recalls and the latest quarter was no exception, with a \$170 million charge. However, overall revenue for the quarter was up 5.0 percent on a year-over-year basis.

There are signs that elective surgeries are no longer being postponed due to economic uncertainties. Stryker says it expects revenue growth to continue to increase from the hip-and-knee market in the US, and is hopeful that results will improve in Europe.

Stryker's cash-rich balance sheet (with over \$2 billion in net cash) and robust cash flow, gives SYK multiple avenues for growth through mergers and acquisitions.

Symantec (SYMC) is up 41 percent this year, extending our profit to 60 percent. SYMC is the dominant supplier of software for computer security and protection against viruses and other nuisances through its leading flagship brand, Norton.

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

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

The strongest sector of growth is for cloud-based services. Due to lower cost and ease of installation and operations, smaller companies prefer cloud services. Larger companies are switching to cloud-based services in order to obtain outside professional management for their security services.

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

Tellabs (TLAB) is down 1.8 percent this year. TLAB designs and manufactures hardware and systems for the

telecommunications industry. It is down slightly this year, still near its all-time low and below its net asset value.

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

In June, TLAB joined forces with WESCO International (WCC) to distribute TLAB's popular fiber optical network systems products. Tellabs fiber optical systems combine all of a building's communications networks into one, improving security and eliminating the need for future re-cabling. They save 80% of energy consumption over conventional copper wire Ethernet network systems in addition to saving up to 70% of the cost of ownership.

Its fiber optical systems and products accounted for 41 percent of TLAB's total revenue in 2012. Increased sales through Wesco's strong distribution network should be substantial.

TLAB shares showed some life in July after the company appointed Lawrence Rieger as acting CFO. President Dan Kelly said *"We're glad to add Larry Rieger to Tellabs' executive team... Larry brings Tellabs deep expertise in finance, plus more than a decade of experience working with our finance team, so he can hit the ground running."* Mr. Rieger has worked with Tellabs since 2003 as the managing partner and CEO of Crowe Horwath Global Risk Consulting Service. Previously he was with Arthur Andersen from 1973 to 2002 where he was a partner.

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

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

Tetra Tech (TTEK) is down 10.8 percent this year, trimming our profit to 53 percent. The stock price fell after one-time charges translated into a disappointing earnings quarter. We view the dip as a buying opportunity. TTEK is a leading company in water technologies and environmental remediation with a healthy balance sheet and a backlog of approximately \$2 billion in signed contracts.

In July, TTEK added to its inventory of contracts by signing its third consecutive contract to provide technical support to the U.S. Environmental Protection Agency's (EPA) Regional Superfund Program. Also in July TTEK was awarded the \$100 million U.S. Navy Unrestricted Remedial Action Contract (RAC) VI for environmental remediation services in Alaska, Arizona, California, Colorado, Nevada, New Mexico, Oregon, Utah, and Washington.

Other major contracts include cleaning up the McClellan Business Park in California (formerly the McClellan Air Force Base), and remediating the Naval Facilities in North Carolina, Virginia, Maryland, Connecticut, Maine, West Virginia, Africa, and Vieques, Puerto Rico.

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

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

USAA Precious Metals & Minerals Fund (USAGX) is down 41 percent this year as the price of precious metals suffered. Rising interest rates (as lead by rising bond yields) have strengthened the dollar which has adversely impacted all commodity prices. However, this is not a permanent situation.

During Mr. Bernanke's congressional testimony Congressman Keith Rothfus asked, "Where does the Fed get the money to buy [assets] ... Do you create the reserves?" After receiving a simple "yes" from Bernanke, Rothfus asked, "Are you printing money?" Bernanke answered, "Not literally."

When the economy gets more traction, the money created in recent years will be sloshing through the economy, putting upward pressure on the prices of commodities including precious metals. USAGX is the best diversified way to invest in precious metals. It is the top-performing fund, and has constantly out-performed precious metal equities for ten years. Even after the poor markets and declines of precious metals, USAGX still provided an annualized return of 9.8 percent over the last ten years through the end of July and continued to outperform the Index of Equity Precious Metals.

Xerox (XRX) has climbed 42 percent this year. We have been recommending XRX because it has been transforming from a seller of printers and copiers to a company providing services on those machines as well as I.T. services in a variety of other areas. The revenue from services is more profitable and less cyclical, and it now accounts for more than half of XRX's revenues.

In late July, XRX reported second quarter earnings that were above consensus estimates. Revenues were higher from all subdivisions of the Services segment. Chairman and Chief Executive Officer, Ursula Burns said, *"our shift to a Services-led growth portfolio is paying off. Services revenue represents 55% of our total revenue. That's up 3 points from the end of 2012. It's growing at a steady pace, contributing to annuity revenue stream that represents 84% of our total business and grew 1% this quarter. We're taking a disciplined approach to improving operating margins, so that our bottom line benefits more from top line growth in Services... We exceeded our EPS guidance for the second quarter and generated strong cash flow. We're making the decisions to invest in growth and in building shareholder value. I feel good about our progress through the first half of this year, and I'm confident that we're positioned very well to deliver on our full year expectations."*

XRX is now expected to earn between \$1.09 per share and \$1.15 this year. At less than 10 times 2013 earnings, XRX is at a steep discount to the overall market's price earnings ratio of approximately 14. XRX is also cheap in comparison to its competitors like IBM with a P/E ratio of 13.5 and Canon at a P/E ratio of 15. XRX is continuing to buy back its own stock.

Capital Competition: Real Estate versus Stocks: The SoundAdvice Risk Indicator

There are few forces that are more important to a market's destiny than the amount of capital that is available to it. In a normal situation, capital will flow easily between markets as their underlying conditions change. But if a market becomes dangerously superheated, it will absorb a larger proportion of available investment capital than economic conditions and market demand can justify. This change will be reflected not only in the rising market's prices but also in the prices of competing markets, which will be lower than their underlying fundamentals would indicate they should be. Over the last 100+ years, we can see this titanic struggle between the stock market and its foremost competitor for investment dollars: real estate.

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

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

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

and are on the verge of declining or underperforming the other market.

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

The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$9,917,412 in stocks and to \$1,404,255 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 \$394,176,383, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the SoundAdvice Risk Indicator would have provided.

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

The SoundAdvice Risk Indicator

The latest reading for the SoundAdvice Risk Indicator is 1.55. This reading reveals that stock prices are slightly above average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

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



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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

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

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

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

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

An "Aggressive" signal coming at a time when the Risk Indicator was below 1.0 revealed that Supercycle 5 came to an end, and that Supercycle 6 was born. Our next signal will come from a zero reading from our Diffusion Index of Leading Indicators. The latest reading is 50 percent.

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

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

This index hit 100% in 2012 when the economy began to turn around, and marked the low-point of the long term Treasury bond yields. This indicator was instrumental in recommending our "No-Brainer" ETFs designed to profit from rising Treasury bond yields. We have continued to be bullish about stocks due to the Federal Reserve's extraordinary monetary policy which has been distorting the natural business cycle this time.

Track Record of the SoundAdvice Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 climbed an average of 34.4 percent. During "Caution" signals, the S&P 500 declined an average of 0.1 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Ave +/-	34.4%		-0.1%

See *The Science of Making Money in Turbulent Markets* for a complete explanation of the SoundAdvice Diffusion Indexes and their track record. (You received a copy of this book with your paid subscription, and you will also receive an updated copy when you renew your subscription.)

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