

SOUND ADVICE

A Funny Thing About Sure Things

In April 2001, Standard & Poor's without explanation dropped coverage of precious metals from its well-regarded Industry Survey series. Ironically, the analyst, Leo Larkin, in that last issue was prescient about where precious metals were to head. Too bad S&P's executive suite decided precious metals were passé. S&P was at the time just the most recent to write off commodities. Merrill Lynch in 1998 famously closed its entire commodity trading department in the midst of the tech bull market, because, management concluded, commodities were dead. It was a sure thing.

Less than two years after S&P turned its back on precious metals, *Sound Advice* reached a different conclusion. After a generation of neglect not just by investors and the media but by industry leaders who were slashing capital investments and even shuttering operations, we saw metals prices starting to inch up. We also noted the dollar was starting to droop, Washington was cutting taxes at the same time it was gearing up for a global war on terror and spending money on pork as if there were no tomorrow, and the Federal Reserve was dropping not only interest rates but also talking metaphorically about dropping cash out of helicopters to prevent deflation. That turned out to be the launch pad for the commodities rocket that is ascendant almost five years later. We thought it was a sure thing. Better yet, we got instant gratification.

Instant gratification, however, is hardly guaranteed. Before we made our commodities call, we were equally confident about tech. We warned subscribers to be wary as tech shares zoomed to impossible valuations, and felt like morons as they just kept going. When, for example, we wrote that Cisco, then trading in the \$70s, merited no more than \$14 or \$15 a share, subscribers cancelled, and advised us that by restricting our portfolio to stodgy sectors like REITs, of which our portfolio contained 10 positions in January 2000, we were losing them money. It took two years of waiting before gravity took hold and confirmed our skepticism.

What else do we think is a slam dunk? We've been harping on the likelihood of a steep dollar decline for years, and except for the 2004 swoon, have little to

show for it. Sure, precious metals and other commodities as well as our international investments got some support from a dollar that is lower today than when we formed our opinion. But the climactic drop has yet to happen. Are we early, or are we wrong? "Sure Things" are funny that way.

THE FED AND RATES

Ever since Alan Greenspan and the Fed went on their jihad against recession by rigging short-term rates first to keep the U.S. economy from tumbling into a deep recession and then to keep it firing on all cylinders well after the recession risk had receded, we warned that such monetary policies alongside the profligate deficit spending coming from Washington and its mirror image in consumer debt were setting the stage for inflation. Alongside those rising debt levels stood the trade deficit that perversely was financed by the very countries from which we love to buy so much. China, Japan, and other major exporters recycled the dollars they received for their products into dollar-denominated assets, especially federal debt, and thus suppressed U.S. interest rates and supported the dollar. The biggest beneficiaries of those low rates have been our own housing industry and our stock market.

But remember this: the Asian central banks that recycled those dollars back into dollar-denominated assets could just as easily put those dollars into Euro or Yen-denominated assets. In fact, Russia, which is getting rich during the natural resource boom, has begun to move away from the dollar, and is building its Euro and Yen reserves. Iran has decided to take payment for oil in Euros. You could argue that this makes financial sense when the dollar is expected to weaken further, but it also reflects vulnerability created by our reliance on foreign central banks to help us maintain the dollar as well as moderate interest rates.

Consider that across America all those white picket fences and the homes they enclose were financed with money borrowed indirectly from factory workers in Guangdong Province and elsewhere in China. But even

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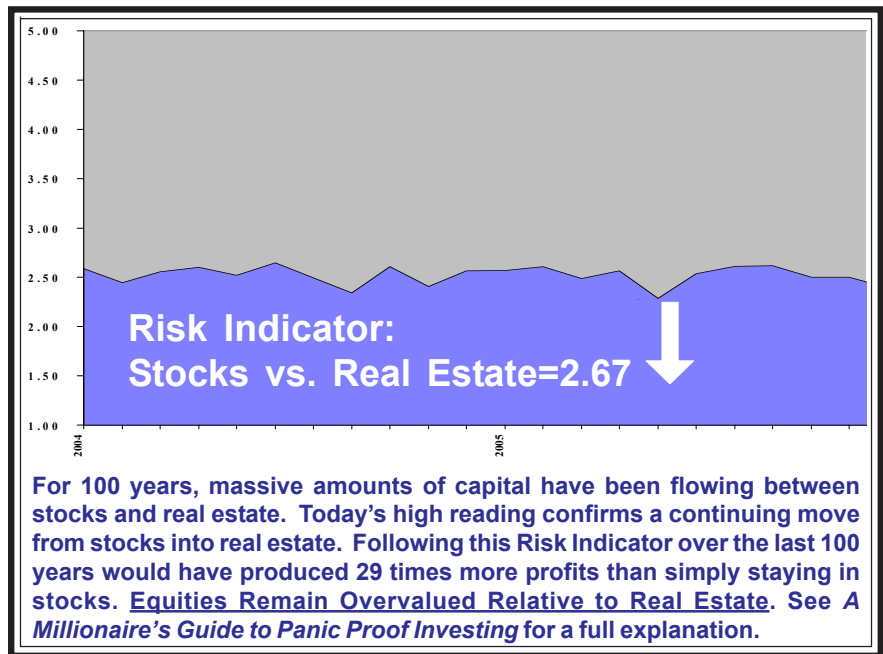
cheap interest rates couldn't keep the housing bubble from losing air. However, rates remain cheap enough for sophisticated borrowers (particularly hedge funds and private equity buyout funds) to leverage their own cash by borrowing heavily, thus increasing the bang their own bucks bring. If you are stunned by some of the recent buyouts, just keep in mind they're being financed with other people's money. It's estimated that most buyers put 10% of their own capital into a deal. The other 90% comes from banks, junk bonds, and other cash pools.

The unnatural buoyancy of the dollar, we believe, has begun to change. European interest rates are rising, and the gap between those rates and ours is shrinking. Higher yields elsewhere draw investments away from the U.S. and weaken the dollar. In early November, an influential Chinese banking authority said the Yuan would become more flexible and that the central bank intended to diversify its \$1 trillion in foreign exchange holdings, of which about 70% is in dollars. That comment caused turmoil in currency markets, and helped accelerate the dollar's decline. Our trading partners have to balance their self-interest in keeping the dollar strong enough to maintain robust sales to the U.S. against the losses they could suffer were the dollar to drop sharply. It's a delicate matter, but lately the trend is moving against the Greenback.

SLOWING U.S. ECONOMY PRELUDE TO RECESSION?

After an extended period of higher Gross Domestic Product, the revised GDP for the last quarter fell to 2.2%, and has put investors and economists on notice to ratchet expectations for growth and earnings lower. The moribund auto industry and the stagnant housing sector are keys to that slowdown. If, as was argued during the boom years, increasing home prices created a wealth effect among homeowners that translated into happy spending, then shrinking or just dull housing prices should have exactly the opposite effect on consumption. This Christmas season will test that hypothesis.

Some observers believe that the U.S. economy is primed to revisit the recession those Greenspan interest



rate cuts avoided. We lean in that direction. Certainly the strength we've seen in defensive sectors such as food, utility and pharmaceutical stocks testifies to such concerns. The currently inverted yield curve that reflects lower yields for longer-term debt than for shorter-term debt is justifiably believed to portend recessions, since it anticipates the likelihood that during a recession yields further out on the maturity scale would dwindle even lower.

INFLATION AND THE DOLLAR

However, we also believe that inflation is growing, notwithstanding statistics from the Federal government and purrs of contentment from Wall Street market strategists who assert inflation is well under control. They discount contrary evidence and even concerns expressed by members of the Federal Reserve's Board of Governors as overly touchy about what the all-is-good crowd considers negligible evidence of inflation. Such confidence would be justified if you looked only at the CPI for the last couple of months. For instance, the overall CPI declined in both October and September by 0.5% driven lower primarily by decreased transportation costs (=lower fuel prices plus lower new vehicle prices). If you believe that energy prices will resume their decline—which we do not—then these CPI numbers are reassuring. Fuel prices are holding in their current range (\$56-\$62), and eventually, we believe, will work their way higher.

Sure, the drop in natural gas and oil-derived products halted the month-after-month surge in energy-related

(continued on inside back cover...)

SOUND ADVICE

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This month marks the 10th anniversary of Alan Greenspan's "irrational exuberance" address to Congress that briefly unnerved Wall Street, which thought the Fed would take away the bulls' punch bowl by raising rates.

But the Fed didn't. Jeremy Siegel argues in the *WSJ* that Greenspan, contrary to critics who assert that he should have raised to puncture the speculative bubble, acted appropriately because the real stock market bubble did not form until 1998, two years afterward.

Siegel is wrong. Greenspan when he gave that speech personally believed the market had lost its moorings, but did not act. For that matter, when the bubble did burgeon in 1998, 1999, and early 2000, when by implication Siegel thinks raising rates would have been appropriate, Greenspan was, well, irrational: at first he did nothing to check the bubble, and finally he fueled the market by pandering to the worst Y2K fears and flooded the economy with cheap credit, thus providing the bubble's last hurrah.

There's more. Remember that in 2004, as the white-hot housing market was zooming, Mr. Greenspan lectured bankers on the virtues of creative adjustable mortgages. What was he thinking? Could it be that in both cases, the Chairman preferred to abet a bubble rather than risk reining in the economy? Keep this possibility in mind whenever a Fed Chairman shares his thoughts with us.

Perhaps Mr. Greenspan misunderstood his predecessor, William McChesney Martin, and rather than perform the essential task of taking away the punchbowl when the party gets too raucous, decided to drink the bowl dry himself.

--Gray Emerson Cardiff

Show Me the Metal

When the bull market in metals was on few investors' radar screens back in late 2002, we started looking for a mutual fund that could provide exposure to metals, especially non-precious metals, and discovered that at the time there was no such animal. However, as we researched the underlying companies, we found one that was so compellingly cheap that we confidently went with the rifle rather than the shotgun approach to the miners, since that company was a play on a crucial industrial metal, copper. That was **Phelps Dodge**, which has turned out to be a more than OK surrogate for the sector, up 693% since March 2003 and 78% this year. With Phelps being sold out of the portfolio, we need to revisit the metals sector to identify a suitable replacement.

The landscape has changed. Thanks to the bull market in metals, Wall Street created products to soak up cash from investors anxious to profit from the sector—and we'll ignore them all. Instead, we will go for a vast holding company that participates in almost every significant natural resource sector, and plays a dominant role in two. Its portfolio of businesses provides as much diversification as any mutual fund, and the management at Britain's **Anglo American Plc. (AAUK—Nasdaq)**, which trades in the U.S. as an American Depository Receipt (ADR), knows how to maximize shareholder value. AAUK, with a market cap of \$73 billion is the world's second largest diversified mining company (BHP is the largest with a market cap of \$121 billion) and has its shovel in nearly every major commodity that can be dug from the earth. The shares currently also have a nice, though variable, yield (4.1%).

We recognize that commodities and mining shares have soared, and AAUK is no exception. Emerging economies, especially China, are consuming energy, metals and other commodities, and driving prices to historic levels. To argue that value remains to be extracted from this sector might strike you as inconsistent with our "buy-em
(continued on next page)

IN THIS ISSUE...

Anglo American (AAUK—Nasdaq)	Pg. 1
Sound Advice Portfolio Updates.....	Pg. 5
Sound Advice Model Portfolio.....	Pg. 7
Sound Advice Indicators & Track Record.....	Pg. 8

Sound Advice on Anglo American Plc.

cheap" approach. However, we believe that the bull market in commodities is not nearly done. Though this might sound like momentum jibberish, in fact it is based on still cheap valuations for mining companies. Anglo American, we think, is also a special case. Because of the very diversification that attracts us, the market fails to value its parts properly. Management is dealing with this mispricing by restructuring the company through asset sales. Finally, AAUK and China are converging in tantalizing ways. It's a story that has a few very nice potential endings.

ANGLO AMERICAN

Anglo American is a complicated holding company that owns several businesses outright, and has controlling interests in what it terms "associates," that is companies in which AAUK can exercise significant influence but does not control the business. There are also joint ventures in which AAUK works with partners. For example, Anglo American completely owns its coal, ferrous and industrial metals businesses, controls 45% of De Beers diamonds, 74% of Anglo American Platinum, and 41% of Anglo American Ashanti Gold. In the last two, it has more to say than any single owner, but cannot act unilaterally.

Despite how profitable they have been over the last few years, diversified mining companies remain

unexplored by investors. Ask yourself, can you say what Rio Tinto does, or CRVD, or Xstrata? Since most of the majors are foreign, they are even more of a mystery for American investors.

Look at how widely AAUK operates. Anglo American is domiciled in the United Kingdom, and sells primarily to Europe (\$15.1 billion), Australia and Asia (\$7.1 billion), South Africa (\$5.5 billion), North America (\$4.5 billion), and South America (\$1.7 billion). Commodities being, well, commodities, there is little reason for you to know AAUK's name, though you certainly recognize De Beers, whose founders, the Oppenheimers, play a crucial role in the holding company. More about them later.

In order of revenues (\$33.6 billion), Anglo American in FY 2005 derived 20.7% from paper and packaging (\$7 billion), 20.1% from Ferrous Metals and Industries (\$6.8 billion), 12.1% from Industrial Metals (\$4.1 billion), 10.8% from base metals (\$3.6 billion), 10% from coal (\$3.3 billion), 9.9% from diamonds (\$3.3 billion), 9.3% (\$9.3 billion) from platinum, and 7.2% from gold (\$2.4 billion).

Profits reveal a different pecking order: industrial metals generated the highest profits (\$1.7 billion), followed by ferrous metals and industries (\$1.5 billion), coal (\$1 billion), platinum (\$854 million), diamonds (\$583 million), paper and packaging (\$495 million), industrial min-

erals (\$370 million), and gold (\$332 million).

AAUK dominates platinum mining, extracting 40% of the world's newly mined output. De Beers accounts for 45% of the world's rough diamond trade, and is the largest supplier and marketer of gem diamonds. But keep in mind, even if AAUK is a highly diversified natural resource company, it is mostly natural resources, and would be severely hurt if commodity prices turn downward sharply. Anglo American has risen and, eventually, will fall with demand for those resources, which is just the way management prefers. In fact, the restructuring intends to cut loose non-core activities, and concentrate on metals.

AWASH IN CASH

As with other natural resource companies that are selling everything they can produce at handsome prices, Anglo American has more cash than it can invest. Ideally, management would like to use that cash to expand its mining assets, but insists that deals be accretive. At current prices, that is unlikely. The next best alternative is to return that cash to shareholders. Hence, these days, Anglo American pays a nice semi-annual dividend. Over the last 12 months, distributions have totaled \$0.98, which translates into a current yield of 4.1%.

The board of directors also has been pouring cash into share

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Sound Advice on Anglo American Plc.

buybacks. In October and November alone, AAUK spent \$1.3 billion to retire 29.7 million shares, which followed a 13.3 million share buy back in the spring.

Anglo American can only expect more challenges about how to deploy this cash hoard, since it intends to sell off its paper and packaging subsidiary, where margins are slim, as well as its position in Ashanti Gold because, it believes, the value is not reflected in AAUK's share price. When these deals are done and the cash is in the bank, AAUK might find itself under pressure to make acquisitions at prices that are not accretive. For example, after Freeport-McMoRan bid for Phelps Dodge, AAUK's was rumored to be mulling a rival bid. We hope this is just a rumor, not just because management asserts it won't overpay, but because, we think Anglo American itself is a likely acquisition target.

There are several scenarios being floated. One has the Oppenheimers family using their influence to engineer a sale to another company, or perhaps even a leveraged buyout that would take AAUK private. If it is obvious to us that the sum of AAUK's parts is worth more than the whole, it must be clear as well to smarter people. Anglo American shares lately are outperforming those of its peers, which might suggest that a sale of some assets is imminent, or that someone is stalking AAUK. And then there is China.

CHINA

Over the last few weeks, China seems to be especially on Anglo American's mind. In an address

four weeks ago to the China Mining Conference in Beijing, Sir Mark Moody-Stuart, AAUK's Chairman, provided insights not just into Anglo American's growing involvement in China but also to its underlying assumptions about where the metals industry is heading.

After citing the stunning growth in China's appetite for metals over the last decade (consumption of copper jumped from 7% to 29% of global purchases, 9% to 33% of iron ore, 8% to 28% of aluminum, and 5% to 45% of platinum jewelry), Moody-Stuart observed "China has shown itself determined to ensure that its economic fortunes

The bull market in metals is far from over, and despite historically high prices for mining shares, they could continue their run for the foreseeable future. There will be volatility galore, but the rewards even at this stage in the boom are substantial.

are not vulnerable to an interruption in the supply of key commodities. This has helped drive China's overseas investment programme in which oil, gas and mining make up the largest single element." Demand from China and other emerging economies have established a new price floor for metals, argued Moody-Stuart, that is certainly below where metals are today but much higher than ever before.

China's interest in securing energy supplies received attention—and created anxiety—when last year Chinese interests tried to snare U.S.-based Unocal, which owned significant oil and natural gas fields in Asia. It was thought that should the Chinese acquire Unocal, in order to placate America, it would be

willing to sell off non-Asian assets. Congressional hearings, angry editorials, and Chevron's emergence as a White Knight ended that foray.

However, China has been more successful in gaining access in South America, and especially in Africa, and has expanded its wishlist to metals. Though the Chairman's speech mostly concerns how mining companies and governments in emerging markets must encourage environmentally and socially sensitive practices, Moody-Stuart pitched Anglo American as a reliable partner for Chinese domestic and foreign projects. AAUK in China already has \$2 billion in sales, and has five on-going projects, including a \$300 million investment to explore development of coal mines in Shaanxi Province. The hard news from Moody-Stuart's speech is that Anglo American and the Chinese government have greenlighted full development at Shaanxi, and that the company is prepared to invest up to \$4 billion.

Four days before Moody-Stuart spoke in Beijing, China's third richest man, Rong Zhijian, and chairman of China Vision Resources, acquired 17 million shares of AAUK from the Oppenheimer family for \$800 million, one-third of the Oppenheimer holdings, and triggered speculation that Zhijian was acting if not as an agent of Beijing, then at least with its support, and that more Chinese buys would occur. Perhaps.

China learned a lesson from the resistance the Unocal offer generated in the U.S. In contrast, Anglo American is an international company, which merely is domiciled in Britain, and thus would not throw

Sound Advice on Anglo American Plc.

up as many obstacles to a Chinese bid as had Unocal.

There are more realistic parties who might want to own Anglo American's assets, and some read AAUK's plan to strip away its paper and packaging and gold assets as staging itself for a sale. The usual names come up such as BHP, Xstrata, Rio Tinto, or CVRD.

If we sound like touts with a hot tip, understand that we are drawn to AAUK not because we're betting someone soon will take it out but because someone might take it out because it is cheap in relation to other companies. If we are right about persistent demand for metals, we'd be ecstatic to own AAUK for the long haul. That is our primary rationale for recommending it.

RELATIVE VALUATIONS

As we noted, no mining company is absolutely cheap today in terms of historical valuations. However, if we look at how AAUK is valued as a whole and compare how its components would be valued were they free-standing operations, the various ways that value could be realized come to life. To appreciate the gap between how the market values pure-play companies and how it values diversified AAUK's assets, we applied price ratios of those companies to the sales and profits for AAUK's corresponding business.

When specific businesses have many participants, we apply the industry average. When there are only a handful of publicly traded peers, we select a single company. Anglo-American trades at a Price/Earnings ratio of 15.4 and a Price/Sales ratio of 2.29. By comparison, paper and packaging companies trade at a P/E

around 29 and a P/S of 2.17. Platinum companies are few, so we use, Stillwater Mining, a pure play on platinum/palladium, which trades at a P/E of 30.4 and a Price/Sales ratio of 2.2. Were you to apply the same valuation enjoyed by paper and packaging companies or by Stillwater to corresponding lines at Anglo American, their market value would vault. Platinum is Anglo American's most undervalued business, but similar patterns are evident in ferrous metals, which is undervalued by about 30%. The diamond business is underpriced relative to its peers by about 25%. Coal seems fairly priced, but management is confident its interest in Ashanti gold is valued well under market.

If we were to factor in what seems to us to be a misvaluation, shares of AAUK could trade in the current market environment at around a conservative estimate of \$32, about a 33% premium to its share price. We're hardly alone in noting this discrepancy.

CAVEATS

If it seems Anglo American is a "slam dunk," we should introduce a few caveats. First, of course, is the sustainability of the natural resource boom. It won't last forever.

Still, we believe it has further to run even if we can't endorse Jim Roger's notion that commodity booms last on average 18 years. Second, Anglo American operates in regions that are politically challenging. South Africa, where many of AAUK's mines are located, is feeling its way out of a

troubled past, and is rife with pitfalls, especially for industries like mining that prospered during Apartheid. Though we do not anticipate Bolivian-style nationalization of assets, corporations are making concessions. Anglo American has made and continues to make deals such as sale of a one-third interest in a prosperous iron mine to a South African economic betterment organization, or last year's agreement to sell a 26% equity interest in its diamond company to a South African group dedicated to sharing the country's resource wealth with natives rather than have it go to foreign corporate owners. With such deals Anglo American is making a prudent investment in amicable relations with the South African government, essential for AAUK's expansion. For example, AAUK intends to double iron ore production over the next decade, and to expand diamond mining, targets that can only be achieved through local authorities' cooperation.

SUMMARY

Anglo American is the second largest diversified mining company in the world, and, we think these diversified players are undervalued, AAUK in particular. Management is working to monetize this value by selling off non-core assets, a process that looks no different than prettying itself up for suitors. We also believe that the bull market in metals is far from over, and despite historically high prices for mining shares, they could continue their run for the foreseeable future. There will be volatility galore, but the rewards even at this stage in the boom are substantial. Buy up to \$29. *SA*

PORTFOLIO UPDATES

Before we get into the updates, we offer a seasonal reminder about buying mutual funds toward the end of the year. Funds often in December make distributions, and sometimes they can be significant. Consider **Third Avenue Value Fund**, which is scheduled to make a \$3.41 distribution on or soon after December 19th. Keep in mind should you buy shares outside an IRA, 401(k), 403(b) or other tax-deferred or tax-sheltered account that you will be taxed on that distribution even if you buy the shares on the eve of the record date. Talk about taxation without representation. For IRA and similar accounts, it's irrelevant. Avoid making purchases in tax-exposed accounts as distribution season approaches.

* * *

Since the November letter, the market has been running higher, continuing a surprisingly strong second half for the year. *Sound Advice* has been more than keeping pace. The Dow since the last letter is up 2.7%, the S&P 500 3.3%, and the Nasdaq 4.6%. As a whole, the *SA* portfolio added 4.3%, while last month's Five for 2007 basket moved 3.5% higher, powered by our bet that a weakening dollar would help both commodities and foreign investments: **American Century Global Gold Fund** is up 5.1% and **Dodge & Cox International Fund** 4.7%. **American International Group** contributed 5.3%. **Schering-Plough** is 1.9% to the good, and **Tetra Tech** was flat. The biggest move—and it is big enough to move the stock out of our portfolio—was **Phelps Dodge**, which agreed to be acquired by Freeport-McMoRan, a smaller com-

petitor for around \$129 a share. PD closed on December 8th, when we priced our portfolio, at \$123.67, a 24.4% gain since the last letter, 78% for the year, and 693% since we recommended it in March 2003 as part of our Reflation theme. Some will be tempted to hold the shares until

gets murkier. We hope you took advantage of weakness in the sector when the getting was best. It is still good. **Agrium**, which is tied to commodity prices to the extent that higher food prices trigger more acres under cultivation and thus higher demand for fertilizers, spiked

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the deal closes. Others will hold in hopes that another bid might emerge, which in the mining sector lately seems par for the course. One ambitious analyst suggests PD could be worth \$170 to an optimistic acquirer. We're satisfied to sell PD, and move on to another miner.

The Freeport bid turbocharged PD, but even without it the copper sector would have rallied along with other natural resource stocks, all of which were strong: **Coeur d'Alene** lifted 5.9%; we've already mentioned BGEIX, **Plum Creek**, which has snoozed for most of the year, added 8.9%. Energy stocks rallied: **EnCana** added 9.7%, **Icon Energy Fund** 9.9%, **Transocean** 6.6%, and **Royal Dutch** 2.4%. Several forces reinforced each other to fuel the rise: winter arrived in some places, which seemed to take the market by surprise, OPEC, led by Saudi Arabia, wants to limit production, and geopolitical worries are boiling again in Nigeria, while the Middle East just

another 9.2%. AGU also has benefited from cheaper regional prices for natural gas, the primary feedstock for nitrogen fertilizers, at its western Canadian plants. Still, as natural gas prices recover from their fall lows, the production costs for Agrium rise. Inevitably, Agrium will have to raise prices to cover those costs, farmers will pay those prices, and, guess what, our food bills will rise. That is called inflation.

Other big winners are a hodgepodge. **Western Digital** spun 11.4% higher, extending its recovery from a drop triggered by delay of its 10Q as it sorted out backdating of options issues. The backdating of already generous options so as to maximize profits for corporate executives is simply taking money from shareholders, but unfortunately in corporate culture, especially in techland, it is business as usual. Accept that at both good companies and bad, senior executives demonstrate a sense of entitlement that

Sound Advice: Portfolio Updates for December 2006

would make Paris Hilton feel right at home.

Safeway added 10.5% amid growing optimism about grocers, highlighted by unexpectedly good news from a competitor, Kroger. SWY also fattened its buyback by another \$500 million. So far, management has retired \$3.25 billion of its common, which represents a mind-boggling 21% shrinkage of publicly traded shares.

Indeed, buybacks are the order of the day for cash-rich companies. **Royal Dutch**, for instance, issues daily press releases chronicling how many shares were bought back that day. A typical number is 500,000 shares, about 1/10,000th of the float of 3.25 billion shares, but a significant portion of daily trading. Reducing shares outstanding boosts the per share impact of sales, cash flow, book value and revenue, all good news for the remaining shares. Other companies are just sending checks directly. **McDonalds**, for instance, announced a special dividend of \$1 a share, and why not? Same-store-sales last month in the U.S. jumped 5.1%, in Europe 8.4%, and in Africa, Asia-Pacific and the Mid East by 4.3%. What we find especially encouraging is that MCD, which got itself into trouble by mindlessly using every spare dollar it made to overexpand its stores in the U.S., recognized that it needed not more stores but better run stores. The result is a company that not only is coining money but also is in no rush to repeat its past mistakes. Now it is happy to pass the cash to shareholder. For the month MCD is up 8.5% on a total return basis.

Dare we mention that **Superior Industries**, the rim and wheel manufacturer, added 11.8% last month? Results for the third quarter, announced at the start of November, were consistently depressing, which

is no surprise given weakness in production from SUP's biggest U.S. customers: Ford, GM, and Chrysler. As a result of slow sales and restructuring, there was more red ink on the income statement, more write-offs on the balance sheet, and no clue as to when demand will pick up. Why then would SUP have had a good month? You'd think with shares down again this year that sellers would dominate the trades. Reasons to think some value investors are back buying Superior include its debt-free balance sheet, its continuing transfer of production to Mexican plants as it shuts down U.S. operations, and the contrarian's instinct for whatever the market hates. If you want an example, try **McDonalds**, which three years ago was a \$12 stock, and was as despised as is **Wal-Mart** today.

Our 54 positions contain only eight stocks down this month, the worst of which was **Wal-Mart**, off 2.5% on news it expected December same-store-sales to be between flat and 1%, a minuscule change compared not only to its own past but to competitors. Not happy news, but par for a company that Wall Street currently loves to hate. We're content being a buyer at this level.

Perrigo, down 1.5%, got hit by another recall, this time of its generic Tylenol, which was found to contain small bits of metal. Management is trying to determine where in the manufacturing process this occurred, but shares tumbled when the news hit the wire. Our advice is to take advantage of the fall, since costs to the company look to be only 1 cent a share in profits (5% decline for the quarter), there have been no reports of harm to customers, and the company still expects to hit its 86 to 91 cent profit target for the fiscal year. We'd pay more atten-

tion to Perrigo's long-term growth than this blip.

Johnson & Johnson had two knocks. First, all drug companies got hit when Republicans lost Congress, and then JNJ as a maker of drug-eluting stents for bypass procedures was affected by an FDA panel's concerns over stents' safety. It lost 2.2% for the month. We need to watch the stent issue, though should it have further impact on JNJ, we'd be a buyer on weakness. **Schering-Plough** bucked major pharma's post-election problem, adding 1.9%. Pfizer's cancellation of its Phase III trial of torcetrapib, which raises HDL (good cholesterol), and was widely expected to be a multi-billion dollar blockbuster, leaves SGP's Zetia and Vytorin (Zetia combined with Merck's statin Zocor) as the only prescription alternative to simple statins.

MEDIA

Media stocks continue to ramp higher. We got a boost from spinoffs and tracking stocks from our original purchase of **Liberty Media**. The key was a deal between John Malone, the shrewd creator of Liberty, and Rupert Murdoch, the media mogul behind News Corp. Murdoch is swapping News Corp's ownership of DirectTV for the 19% of News Corp Liberty owned, thus ending a contentious relationship. The deal is tax-free to Liberty. On the news, all these shares jumped, and for the month **Liberty Capital** added 4.2%, **Liberty Global** 8.7%. **Discovery Holdings** is merely a spinoff from Liberty. Nonetheless, it is up 6.4%. Our other media shares, all like Liberty itself picked up when the sector was deemed "dead money," also marched higher: **Time Warner** by 5.7%, **Disney** 7.8%, and **Comcast** 5.2%. **SA**

Sound Advice: Portfolio for December 2006

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
HRPT Properties	HRP	NYSE	\$12.59	6.67%	\$13.25	BUY
Senior Housing Properties	SNH	NYSE	\$22.07	5.62%	\$23.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$31.33	0.35%	\$33.00	BUY
American International	AIG	NYSE	\$70.35	0.71%	\$75.00	BUY
AT&T	T	NYSE	\$34.97	3.58%	\$38.00	BUY
Coca-Cola Enterprises	CCE	NYSE	\$20.52	0.78%	\$24.00	BUY
ConAgra	CAG	NYSE	\$26.06	4.19%	\$28.00	BUY
CSX Corporation	CSX	NYSE	\$36.77	1.09%	\$40.00	BUY
Disney	DIS	NYSE	\$34.39	0.70%	\$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$43.55	0.33%	N/A	BUY
Excelsior Value & Restructuring	UMBIX	800-446-1012	\$52.92	0.64%	N/A	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$16.88	0.00%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$22.03	0.00%	N/A	BUY
Getty Images	GYI	GYI	\$43.74	0.00%	\$49.00	BUY
Honeywell	HON	NYSE	\$42.48	1.77%	\$45.00	BUY
Johnson & Johnson	JNJ	NYSE	\$65.95	2.00%	\$69.00	BUY
Liberty Capital	LCAPA	NASDAQ	\$91.61	0.00%	\$98.00	BUY
Mattel	MAT	NYSE	\$21.99	1.82%	\$23.00	BUY
McDonald's	MCD	NYSE	\$43.76	0.53%	\$47.00	BUY
Molson Coors Brewing	TAP	NYSE	\$72.49	1.13%	\$77.00	BUY
Newell Rubbermaid	NWL	NYSE	\$28.92	2.28%	\$31.00	BUY
New York Times Co.	NYT	NYSE	\$23.72	2.78%	\$27.00	BUY
Perrigo	PRGO	NASDAQ	\$16.60	0.60%	\$20.00	BUY
Safeway	SWY	NYSE	\$31.55	0.00%	\$33.00	BUY
Sara Lee	SLE	NYSE	\$16.96	2.36%	\$18.00	BUY
Schering-Plough	SGP	NYSE	\$22.71	0.88%	\$24.00	BUY
Sony	SNE	NYSE	\$40.10	0.57%	\$44.00	BUY
Superior Industries	SUP	NYSE	\$19.57	3.27%	\$23.00	BUY
Telecom New Zealand	NZT	NYSE	\$25.28	9.7%***	\$27.00	BUY
Tetra Tech	TTEK	NASDAQ	\$17.74	0.00%	\$20.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$62.10	2.58%	N/A	BUY
United Parcel	UPS	NYSE	\$78.11	1.08%	\$82.00	BUY
Wal-Mart Stores	WMT	NYSE	\$46.35	1.45%	\$52.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$57.77	3.16%	N/A	BUY
Xerox	XRX	NYSE	\$16.98	0.00%	\$18.00	BUY
Energy/Natural Resources						
American Cent. Gold Fund	BGEIX	800-826-8323	\$19.74	0.00%	N/A	BUY
Anglo American PLC	AAUK	NASDAQ	\$23.84	4.11%	\$29.00	BUY
Coeur d'Alene	CDE	NYSE	\$5.20	0.00%	\$6.00	BUY
EnCana	ECA	NYSE/TSE	\$52.80	1.14%	\$58.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$36.33	0.00%	N/A	BUY
Phelps Dodge	PD	NYSE	\$123.67	0.81%	N/A	SELL
Plum Creek Timber	PCL	NYSE	\$37.38	3.85%	\$41.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$70.87	1.88%	\$74.00	BUY
Transocean	RIG	NYSE	\$80.00	0.00%	\$85.00	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	\$42.11	0.00%	\$45.00	BUY
Crescent Real Estate	CEI	NYSE	\$20.85	7.19%	\$22.50	BUY
Discovery Holdings	DISCA	Nasdaq	\$15.91	0.00%	\$17.00	BUY
Electronic Data Systems	EDS	NYSE	\$26.59	0.75%	\$30.00	BUY
Friedman, Billings, Ramsey	FBR	NYSE	\$7.60	10.53%	\$9.00	BUY
Liberty Global	LBTYA	NASDAQ	\$28.24	0.00%	\$31.00	BUY
Mitsubishi UFJ Financial	MTU	NYSE	\$12.83	0.74%	\$16.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$5.89	5.60%	N/A	BUY
Time Warner	TWX	NYSE	\$20.91	0.00%	\$22.00	BUY
Symantec	SYMC	NASDAQ	\$19.93	0.00%	\$25.00	BUY
Western Digital	WDC	NYSE	\$21.10	0.00%	\$24.00	BUY

*Prices as of the market close on Friday, December 8, 2006.

**Yield represents all distributions during current calendar year divided by share price.

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

Sound Advice Market Indicators for December 2006

Sound Advice depends on three trustworthy indicators to determine our investment direction. The **Risk Indicator** (see inside front cover) measures investors' interest in real estate compared to stocks, and measures very long cycles. Currently the stock market remains significantly overvalued versus real estate. The **Leading** and **Lagging Indicators** track the direction of the U.S. economy. We want to be aggressively buying the broad market when these indicators signal the economy has slowed, cautiously selective when counter trends exist, and fundamentally defensive when storm warnings are up. The charts (see below) and explanations are updated monthly. To see how far ahead the Indicators have put us, glance at the performance statistics to the right, and consider these results against how the Standard & Poors 500 has done.

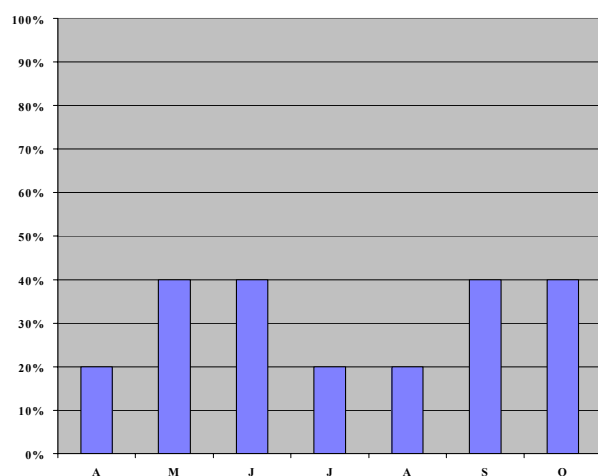
START DATE	ANNUAL COMPOUNDED RETURN
JAN 2003	21.88%
JAN 2000	12.81%
JAN 1992	12.38%
JAN 1980	18.58%
JAN 1975	19.75%
\$25,000 invested in 1975 would equal \$7,929,301 today using our buy/sell signals	

For years prior to 1992, the return percentages are calculated by purchasing the Twentieth Century Growth Fund on buy signals and investing in money market funds on sell signals. Following January 1992, the calculated returns assume funds were switched to the Sound Advice Model Portfolio. Signal Performance: **6.85 times better than the overall market since 1975**. We recommend confining your investments to our portfolio selections.

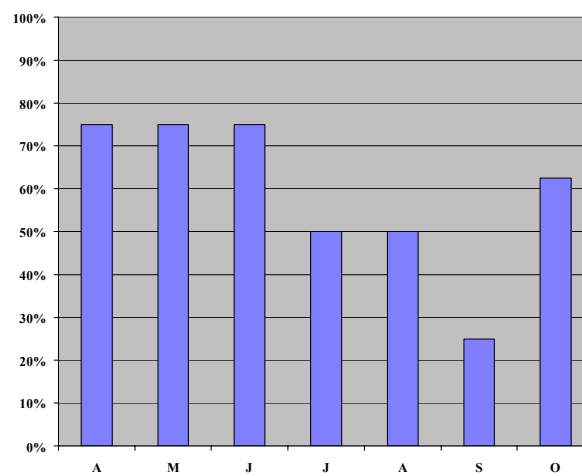
The **Diffusion Index of Leading Indicators** chart compares each of five leading economic indicators with its level of six months earlier. A value of one point is given for each indicator that rises, one-half point for each unchanged, and zero for each indicator that drops. The sum of these points is divided by five and converted to a percentage. Buy signals are generated at zero readings, when all five leading indicators have fallen below their levels of six months earlier, revealing that the economy has softened sufficiently to cause a lasting decline in interest rates. **The Leading Indicators are now at 40%, while the Lagging Indicators stand at 62.5%.**

The **Diffusion Index of Lagging Indicators** chart is calculated similarly, and generates sell signals when 100 percent of its four lagging indicators rise above their levels of six months earlier, revealing that the economy is heating up enough to cause a lasting rise in interest rates. **The Diffusion Index of Lagging Indicators hit 100% in October, which constitutes a Sell Signal.** Though this Index subsequently has fallen below 100%, the Sell Signal remains in effect until we get a Buy signal.

Leading Indicators



Lagging Indicators



NEXT ISSUE MAILED ON JANUARY 15TH

(...continued from inside front cover...)

prices, but they remain far from what anyone thought possible just a two years ago. Wages also seem to be on the upswing, more pressure on prices, after years of stagnation. Finally, one number we hear very little about, the money supply, is marching higher, albeit not at the rate it did during the credit-pumping 2003 surge. Milton Friedman, the Nobel Laureate, whose death last month occasioned deep praise for his insights, the most important of which is that excessive growth of the money supply is a direct cause of inflation, would be waving a red flag.

How can we entertain concerns about both recession and inflation, which are not natural companions? The answer is we're old enough to recall the Carter and early Reagan years (1977 to 1983) when "stagflation," inflation occurring in a stagnant or receding economy, flummoxed economists. The cure turned out to be the

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Federal Reserve's imposition of brutally high interest rates that wrecked the stock and bond markets, but led to the bull market that began in 1982.

WHAT TO DO?

Hard assets still ring true, but a glance at this year's winners shows that buying unloved sectors we've loaded up on works fine too. With just a couple of weeks left in 2006, we expect to close out the year comfortably ahead of the market, the confluence of good choices and good luck. We can hope for, but can not guarantee, more of the same in 2007. If there's a red notice next to your address on this issue alerting you that your subscription is about to end, and you want to continue to profit from working with *Sound Advice*, consider the offers below. **SA**

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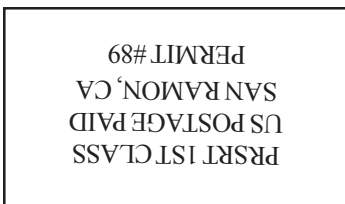


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