

Pumped Up and Distorted

You are not alone if you are perplexed about the recent strength in the stock market. In the midst of a spiking pandemic, mushrooming unemployment, and plunging earnings, how can the popular market indexes be climbing to new highs? We explore four primary reasons.

You are also not alone if your portfolio has not risen in accordance with popular market indexes. Unlike the S&P 500 index, it is a rare portfolio that has risen to its peak value reached earlier this year. We explain why.

The Prospects for a Vaccine

The news has been encouraging. Trials have begun to show immune responses in humans. The market has been banking on the development of an effective vaccine, and that it will be soon enough to stem any prolonged economic damage.

That is banking on a lot. Large scale trials have commenced on 30,000 humans. Any disappointing news—such as adverse side effects on any patients, or lack of adequate efficacy -- is bound to rattle markets.

Fiscal Aid

Congress and the Administration has been much more aggressive than in the 2008-09 meltdown. Aid has been enormous and been softening the economic slide.

While the aid has been desperately needed and welcome, it has not been stimulating economic activity directly. Without an economic rebound prompting demand from customers, businesses will not be able to retain employees indefinitely beyond the periods proscribed for the aid.



Gray Cardiff, Editor

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

The Federal Reserve

The Federal Reserve has been pumping trillions into the economy and dropping short-term interest rates to zero. It is quantitative easing (QE) all over again. As a result, investment capital has nowhere else to go. It has been funneled into the market which has propped up stock prices. QE is bound to continue as long as the economic outlook is bleak.

Good News – Bad News

When there is news that the economy is recovering, it will be received as good news. However, it will be bad news for the stock and bond markets. The need for QE will diminish and so will the need for historically low interest rates. The engine that has been pumping up stock prices will start to sputter, and interest rates will begin rising.

We have seen this movie before. In 2013, when Fed Chairman Bernanke mentioned that the Fed might begin tapering off its QE bond buying, the market panicked in what became known as the Taper Tantrum. Then in late 2018, the market corrected 20 percent when the Fed started talking about raising rates to give them wiggle room to lower them again for the next recession.

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Adding to the problem will be the trillions of dollars injected into the economy by the recent massive QE. All of this extra money supply sloshing around the economy is bound to spur the resurgence of inflation, further raising the specter of a tightening monetary policy.

The Wall Street Darlings

A handful of stocks has been dominating the stock market indexes. After weighting for their market capitalization, six stocks make up 25 percent of the S&P. They are popularly referred to as the FANG stocks – Facebook, Amazon, Netflix, and Google. In 2013, these stocks accounted for just 3 percent of the S&P 500. Since then, two other stocks gained \$1 trillion in market capitalization: Microsoft and Apple. Now, these six stocks are distorting the S&P 500 index. (They comprise nearly one-half of the NASDAQ index.) The acronym for these six stocks has been expanded to FANGMA.

Since the end of 2012, these six stocks have multiplied the performance of the S&P 500 index by 6.3-fold. Without these six stocks, the other 494 stocks in the S&P 500 grew by 76 percent. However, with them the index grew by 482 percent including the impact of these six stocks. (Source: <https://www.yardeni.com/pub/faangms.pdf>)

For good reason, these six stocks have become the darlings of Wall Street. They all have high growth prospects with handsome profit margins and impressive returns on their equity. However, these stocks have had a tremendous run-up and are now at lofty levels. This is evidenced by astronomical price/earnings (P/E) ratios. The table below summarizes the FANGMA stocks.

Facebook, with trailing twelve month (TTM) earnings per share (EPS) of \$7.84 has a TTM P/E of 32. Amazon has a TTM P/E above 120. Netflix has a TTM P/E above 86. Google has a TTM P/E above 30. Microsoft has a TTM P/E above 36. Apple, which is in our portfolio

Wall Street Darlings - FANGMA Stocks

Company	Symbol	Price	TTM EPS	TTM P/E
Facebook	FB	253	7.84	32.3
Amazon	AMZN	3165	26.02	121.6
Netflix	NFLX	489	5.64	86.7
Google	GOOGL	1523	49.53	30.7
Microsoft	MSFT	204	5.64	36.2
Apple	AAPL	425	13.16	32.3
Average				56.6

and will be discussed later, has a TTM P/E above 30. On average, these six FANGMA stocks are sporting a TTM P/E of 56.6, which assumes a growth rate that is inconceivable to fulfill. By conventional standards, a P/E of 30 is high and assumes a robust and uninterrupted growth rate. Any minor disappointments, or just slower growth predictions, cause serious downdrafts in their stock prices.

Based on their track records, it is tempting to jump into the FANGMA stocks. However, until we have a substantial correction, the best and safest performance ahead lies outside these pumped-up and pampered Wall Street darlings, in other stocks and ETFs that are not bloated with risk and offering a long-term value proposition.

The run-up of these six stocks has distorted the S&P 500 index and pushed it to new highs while the vast majority of stocks are still well below their previous highs. This is why most portfolios have under-performed the S&P 500 index. To match the S&P 500, it would have had to be loaded with FANGMA stocks beyond a reasonable allocation.

Updating 2020 Earnings Projections

Since our last issue one month ago, earnings projections have declined slightly for the S&P 500. As we have noted in past issues, we are referencing “operating” earnings, which are cash earnings without special, non-cash charges included in “reported” earnings which include write-offs such as depreciation, impairment charges due to falling commodity prices, or charges for bad loan reserves. In their regular quarterly earnings reports, companies normally state both: so-called GAAP (generally accepted accounting principles) earnings which include non-cash charges, as well as operating earnings which reflect actual cash results.

During economic downturns, GAAP earnings become much more volatile because they contain relatively large non-cash adjustments. Investors tend to view these as one-off accounting adjustments, and not as important as actual cash operating earnings.

A Constant Measure

As quarterly operating earnings drop during recessions, so does the TTM total which is widely used to calculate the price-to-earnings (P/E) ratio of the market. Notably, during these periods, the TTM P/E ratio based on operating earnings remains relatively stable.

This stands to reason because investors are facing great uncertainty and the future is much less predictable than usual. However, investors can look back and

measure the market against TTM operating earnings. Although quarterly operating earnings may be dropping and the end of the decline is unknown, investors know that operating earnings always recover after recessions. Sooner or later, the TTM operating earnings will recur. Accordingly, investors are willing to pay a reasonable P/E based on those TTM operating earnings.

During the last recession, the P/E on the TTM operating earnings averaged 17.8 while staying within a narrow range, with a low of 17.09 and a high of 18.36. TTM operating earnings declined 46 percent through the fourth quarter of 2008, and this is close to the amount stock prices dropped.

Evaluating the S&P 500

Since the peak of the last recession, the P/E of the S&P 500 has averaged 18.03 based on the TTM operating earnings. To see a likely path of stock prices ahead, we can apply this P/E to the rolling TTM total of operating earnings that are projected in the quarters ahead.

During the 2020 first quarter, operating earnings ended up declining by 48.7 percent from the same quarter one year ago (Y/Y). Operating earnings for the second quarter that just ended are expected to see a 43.7 percent decline from one year ago and are expected to decline (year-over-year) in the third and fourth quarters as well.

The operating earnings projections shown in the table below are from S&P Senior Index Analyst, Howard Silverblatt, who publishes extensive data of the S&P 500 companies.

Based on an average P/E of 18.03, the downside risk for the S&P index is a decline to below 2,000 later this year – a drop of 37 percent. Whether this decline materializes is probable but not certain. However, what

is certain is that the market is in the clouds, with a P/E above 26 based on operating earnings. This is not a good time for aggressive long-term investing.

The Sound Advice Stock Market Indicators

The **Sound Advice Risk Indicator** (page 10) is substantially above 2.0 again, revealing that the risk in the stock market is high. Moreover, the **Diffusion Index of Lagging Indicators** (page 11) is still in caution mode.

The Portfolio

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

Our portfolio recommendations are made with regard to the money you have allocated to the stock market, and in accordance with our current cautionary mode. To add downside protection, we continue to recommend hedging your portfolio.

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

Earnings Projections for the S&P 500

Quarter Ending	Quarterly Earnings	Actual/Projected	Change Y/Y	Trailing 4Q Earnings	Change Y/Y	S&P 500 @18.03 P/E
6/30/2019	40.14	Actual	3.9%	154.54	10.1%	
9/30/2019	39.81	Actual	-3.8%	152.97	1.7%	
12/31/2019	39.18	Actual	11.8%	157.12	3.6%	
3/31/2020	19.50	Actual	-48.7%	138.63	0.0%	
6/30/2020	22.59	Projected	-43.7%	121.08	-21.7%	2183.07
9/30/2020	31.26	Projected	-21.5%	112.53	-26.4%	2028.92
12/31/2020	35.88	Projected	-8.4%	109.23	-30.5%	1969.42

Earnings projections are by S&P Senior Index Analyst, Howard Silverblatt who publishes extensive data of the S&P 500 companies. See <https://us.spindices.com/documents/additional-material/sp-500-eps-est.xlsx>

Real Estate Stocks

In view of the risks presented by the COVID-19 crisis, we are recommending cumulative preferred stocks rather than common shares when possible. Preferred stocks are inherently safer than common stocks because they must be paid out full first in the event of a liquidation of the company, based on the stated "liquidation preference" of the preferred stock. Moreover, if they are cumulative preferreds, any unpaid dividends must be paid first before common dividends can be paid. Generally they have a relatively small number of outstanding shares, so we recommend using limit orders rather than market orders.

Hersha's Preferred D (HTPRD) has tremendous upside potential. The ticker symbols on this cumulative preferred D vary from HT.PD, HT'D for an iPhone, and Fidelity uses HTPRD.

The company suspended operations at most of its 48 hotels. The occupancy of the 27 hotels that are open has been 38 percent. The seven New York city hotels have been 55 percent occupied. The company has instituted cost reduction measures and says its break-even occupancy is between 40 and 50 percent, depending on rent and expense levels.

Hersha has received a waiver of its debt covenants through June 30, 2021. Beyond then, in the event that these covenants are not met (or not re-negotiated), lenders have the right to escrow funds for the purpose of paying debt service on a property-by-property basis. Management believes that the company will be able to generate sufficient liquidity to satisfy its obligations through that extension period.

The preferred shares have a liquidation preference of \$25 per share which comes before the common stock. At the end of 2019, value of the company's properties provided equity to fund the \$25 liquidation preference with enough left over to provide equity of approximately \$24 for each share of common stock. Of course, the COVID-19 pandemic impacted the hospitality industry adversely, raising fears that Hersha could fall into liquidation. However, even if the properties were valued at 68 cents on the dollar, there would still be sufficient equity for the \$25 liquidation preference for the preferred shares, with nothing for the common.

Evidently, the market is not viewing Hersha's situation that drastically because the price of common stock (HT) reflects substantial equity, well beyond the \$25 liquidation preference of the preferred stocks. However, our recommended preferred D is trading at less than one-half its liquidation preference value. A partial

explanation of the undervaluation is the suspension of the dividend payments on both company's preferred and common stocks for the balance of 2020 to enhance liquidity. However, this preferred stock is cumulative, which means that all unpaid preferred dividends must be restored before dividends on the common stock can be resumed. The preferred dividends in 2019 amounted to 26 percent of the company's FFO, which means that it will be much easier to restore the preferred stock dividends as we come out of the current recession.

The resumption and payment of unpaid dividends of \$1.64 per share (annually) on the preferred D would provide above a 14 percent annual yield based on today's stock price. Of course, just the prospect of a resumption of the dividend would propel a steep recovery in the price of the preferred D stock to its liquidation value of \$25.

RLJ Lodging Trust (RLJ) suspended operations on 57 of its 103 hotels during the first quarter and re-opened 19 of them during the second quarter. Debt covenants have been waived through the 2021 first quarter and operating costs have been sharply reduced.

We are recommending the company's **\$1.95 Series A Cumulative Convertible Preferred Shares (RLJPRA)** which is often quoted as RLJ.PA, but on the iPhone it is RLJ'A, and Fidelity uses RLJPRA. In any case, this is the only RLJ preferred stock.

This preferred stock has a liquidation preference of \$28.50 per share. Although RLJ reduced its dividend on the common stock to enhance liquidity, it is continuing to pay the dividend on the preferred stock at the annual rate of \$1.95 per share.

In the event that any dividends are suspended on this preferred stock, they would have to be made up before any dividends on the common stock could be paid. However, a suspension of the preferred dividend appears extremely unlikely. The preferred dividend in 2019 amounted to only 6.8 percent of the company's FFO.

Additionally, because this preferred stock is a small portion of the company's capitalization, the value of the company's real estate portfolio would have to drop to 27 cents on the dollar from its 2019 value for the full liquidation preference of this stock to be jeopardized. The market does not think that will happen because the common stock is reflecting substantial equity. As long as there is any equity in the common stock, the implication is that the preferred stock is worth its full liquidation preference value of \$28.50. Yet it is trading substantially below that value and yielding close to 9 percent.

RPT Realty 7.25% Series D Cumulative Convertible Perpetual Preferred

pays an annual dividend of \$3.62. It is a convertible preferred stock, convertible into 3.7758 shares of the common stock (RPT). The ticker symbol of this preferred stock varies depending on the device you are using or the brokerage service. It is often quoted as RPT.PD, but on the iPhone it is RPT'D, and Fidelity uses RPTPRD. In any case, this is the only RPT preferred stock for RPT Realty.

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

We are recommending preferred stock in lieu of the common stock because it is inherently safer. RPT has covenants regarding its debt, including maintaining a minimum tangible net worth, overall debt leverage, and various other calculations. These covenants are usually negotiable but not necessarily. The company's near-term financial condition is unpredictable, and a substantial deterioration could cause lenders to accelerate debt payments and force liquidation.

The preferred stock has a liquidation preference of \$50 per share which was well-covered at the company's 2019 property values. Because this preferred stock is a small portion of the company's capitalization, the value of the company's real estate portfolio would have to drop to 36 cents on the dollar from its 2019 value for the full liquidation preference to be jeopardized.

Like our other preferred selections, evidently the market does not think that will happen. The common stock is reflecting significant equity, which means the preferred stock is worth its full liquidation preference value of \$50. Yet it is trading at less than two-thirds of that value and yielding close to 11 percent.

To preserve liquidity, RPT has suspended the dividend on the common stock, but is maintaining the dividend on the preferred stock. The preferred dividend only absorbed 6.6 percent of the company's funds from operations (FFO) in 2019, which means it is relatively secure. If it is suspended, all unpaid preferred dividends must be paid first, and paid in full before any dividends are paid on the common stock.

Third Avenue Real Estate Value Investor Fund (TVRVX) has an advantage over other mutual funds during recessions. Unlike the typical REIT, management will go to cash when asset prices are generally high.

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

Management has a similar approach to ours because it is very price conscious, especially in relation to net asset value. Just as we do at *Sound Advice*, they eat their own cooking – they invest a substantial amount of their personal assets into their funds.

Financials

To ensure large banks remain resilient under any of these scenarios, the Federal Reserve is requiring large banks to preserve capital by suspending share repurchases during the third quarter. Dividend payments must be capped and paid based on recent income.

Our two selections are still substantially below their peak levels and are presenting compelling values. They have both took substantial loan loss charges in the first and second quarters to account for potential future losses, which means any surprises ahead should reflect positively on reported earnings.

JP Morgan Chase (JPM) set aside \$8.9 billion in the second quarter for expected loan losses. The dividend yield is close to 3.6 percent.

Wells Fargo (WFC) reported its first quarterly loss since the 2008-09 recession. Last month, we warned that the dividend may be adjusted because of the above regulations and this indeed happened. WFC reduced its quarterly dividend to 10 cents per share. The market expected the cut as evidenced by a small reaction in the price of the stock on the news.

Medically-Related Selections

Both of our selections make medical devices and products which are well-suited for an aging population. They have both been impacted by deferrals of elective surgical procedures during the COVID-19 outbreak. These deferrals have built up a pent-up demand because most of these procedures are essential and need to be performed sooner or later to treat debilitating, painful, and sometimes life-threatening conditions.

Boston Scientific (BSX) has been a global medical technology leader for three decades by providing a range of high-performance solutions aimed at addressing medical needs and reducing healthcare

costs in a wide range of critical areas, including cardiac rhythm and intervention, oncology, urology, and neuromodulation. The company's stream of new inventions acquisitions continues to add to promising growth prospects.

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

The Best in Biotech ETFs

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

We are recommending two top performers. Both of our selections have been strong and surpassed previous peak prices reached earlier this year; before the Coronavirus pandemic arrived. This relative strength underscores the vitality of the industry and these selections.

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

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

Small Caps

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

Numerous studies show that small caps perform better over the long run than the market as a whole. Small Caps are pure plays on the early stages of new industries and inventions. They have more dynamic and entrepreneurial management, and they are much more likely to be the target of an acquisition or merger, which is usually quite profitable.

Special Situations

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

Apple (AAPL) reported strong earnings at the end of July, up 18 percent on a revenue increase of 11 percent. While AAPL is a great stock, it is over-valued currently, along with the rest of the FANGMA stocks. AAPL is the least over-valued of the Wall Street darlings, especially considering the \$206 billion in cash in the company's coffers, which amounts to \$46 per share. However, even paying that much less for the stock still does not make it a good long-term value currently. The stock price needs to retreat from peak levels to make AAPL a value proposition. Our target is under \$300 per share.

Intel (INTC) reported second quarter earnings in late July of \$1.23 per share which were above expectations. The company cited production delays had impacted earnings. The stock did not take the news well, dropping 16 percent on the news.

As we have been pointing out in recent issues, Intel is developing a key role in providing infrastructure for 5G networks. The company recently added 18 new products in this segment. These are bound to be vital for the 6 million 5G base stations forecasted to be in place by 2024. Estimations are that Intel will capture 40 percent of this market by the end of 2021.

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

International Business Machines (IBM) reported second quarter earnings in mid-July. Although down 31 percent on an annualized basis, they were better than expected and the stock rose on the news. The good news was that gross margins improved for three of its five business segments.

IBM's Cloud and Cognitive Software segment, which includes Red Hat, produced \$5.75 billion in revenue, which was up 3 percent. Red Hat contributed revenue of \$1.09 billion, up 17%. This growth is significant, especially in the current economic environment. IBM is offering technology consulting services, via Red Hat, to customers modernizing legacy cloud services to work on scalable public platforms, including IBM Cloud, Amazon AWS, Microsoft Azure, Google Cloud, and even Alibaba.

The company is also capitalizing on its OpenShift platform along with the company's artificial intelligence (AI) platform, it calls "Watson", which can "think" like a human.

The dividend yield is close to 5 percent.

NCR Corp (NCR) makes automatic tellers (ATMs), retail point-of-sale (POS) workstations, self-service kiosks, and other self-service checkout systems. Until stay-in-place orders vacated retail centers, 485 million people used NCR products every day. When the crisis passes and shoppers return, there is room for substantial growth in the US and around the world. Last year, NCR earned \$3.54 per share. Based on those normalized earnings, the current price of this stock reflects an incredibly cheap P/E under 6.

Invesco S&P 500 Equal Weight Consumer Staples ETF (ticker symbol: RHS) is a diversified way of investing in the consumer staples sector - those unexciting products we use every day without much thought, ranging from food, beverages (including alcohol), household goods (including cleaning supplies), hygiene products, and tobacco. These are products that people are unable (or unwilling) to remove from their budgets regardless of their financial situation. The nature of these products makes this sector defensive and much less vulnerable to recessions and bear markets.

RHS tracks a collection of 33 consumer staple stocks within the S&P 500 index. This ETF is unique

Invesco (RHS) Portfolio of Consumer Staples

Company Name	Weight %
Church & Dwight Co Inc	3.34
McCormick & Co Inc Non-Voting	3.34
Walmart Inc	3.23
Conagra Brands Inc	3.23
Clorox Co	3.18
Monster Beverage Corp	3.18
Costco Wholesale Corp	3.15
The Kraft Heinz Co	3.15
Procter & Gamble Co	3.13
The Kroger Co	3.12
Philip Morris International Inc	3.09
General Mills Inc	3.08
Mondelez International	3.08
The Hershey Co	3.07
Hormel Foods Corp	3.07
Coca-Cola Co	3.06
Kimberly-Clark Corp	3.05
Kellogg Co	3.04
Altria Group Inc	3.04
PepsiCo Inc	3.03
Constellation Brands Inc A	3.02
Lamb Weston Holdings Inc	3.02
Campbell Soup Co	3.01
Archer-Daniels Midland Co	2.99
Brown-Forman Corp Class B	2.97
JM Smucker Co	2.95
The Estee Lauder Companies	2.93
Sysco Corp	2.92
Colgate-Palmolive Co	2.92
Walgreens Boots Alliance Inc	2.82
Tyson Foods Inc Class A	2.78
Molson Coors Beverage Co B	2.70
Coty Inc Class A	2.42

because it invests equal amounts in these 33 stocks and rebalances the investments at the beginning of each calendar quarter. This practice has given RHS a superior performance because it gives investors exposure to many consumer staple stocks that are under-weighted in most portfolios, making them targets for new investment capital. The current portfolio is shown in the table.

Earnings of consumer staple stocks are expected to continue to grow or remain steady while earnings of most other stocks are crashing and expected to be even worse throughout 2020.

The current coronavirus outbreak has given us a lesson on why consumer staples stocks generally provide stable investments, and this pandemic is giving cleaning products a larger boost than a typical recession, a demand that will likely reflect a “new-normal”.

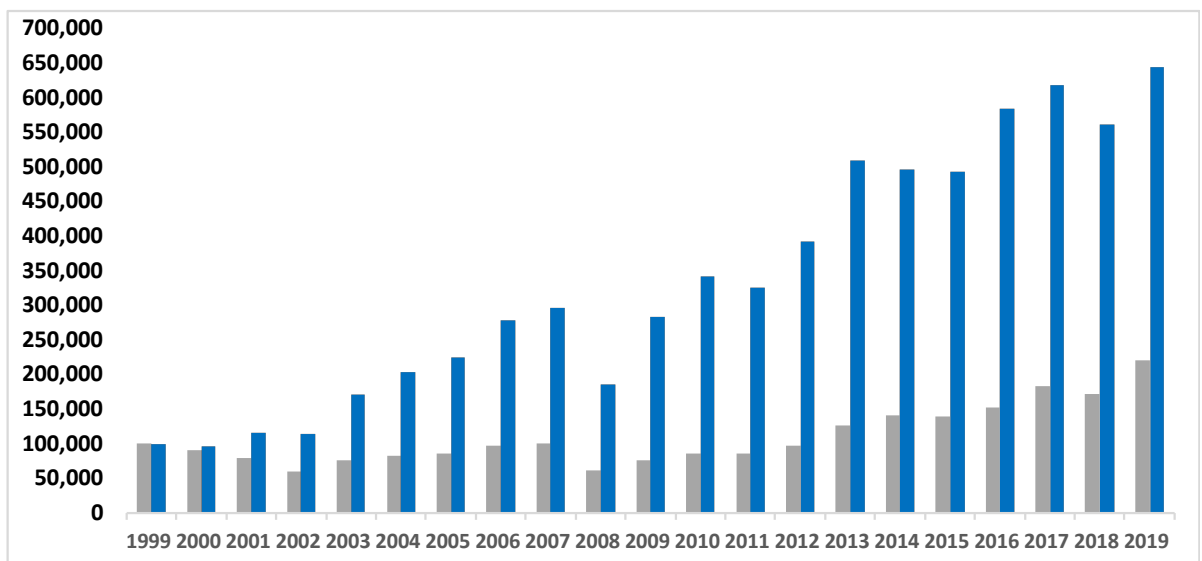
Valero Energy (VLO) has the flexibility to refine substantial quantities of both US light sweet (low sulfur) as well as heavy sour crude. This bodes well under the new regulations and over the longer term. Valero also has access to the US pipeline network for delivery to its gulf coast locations. This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

Declining oil prices adds profits to petroleum-based products because profits come from the “crack-spread”, the difference between the cost of oil as a feedstock and the price of refined products, predominantly gasoline and jet fuel. A lid is bound to be kept on oil prices for the foreseeable future as major oil producers compete for their portions of the petroleum market, including OPEC nations, Russia, and US frackers.

Valero is in a joint-venture partner with Diamond Green Diesel, which is producing renewable diesel at large profitable margins even during the COVID-19 pandemic. Renewable diesel is made from animal or plant waste material which reduces greenhouse gas emissions up to 80 percent because it only releases as much carbon dioxide that the material originally contained. Renewable diesel does not gel at low temperatures which means it can be easily transported through pipelines. Use for sustainable aviation fuel is expected to be a primary escalating demand factor.

Sound Advice versus the S&P 500

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



Portfolio Summary Table

This table is updated and live on our website:

www.soundadvice-newsletter.com

Income with Growth	Symbol	Price / NAV	Yield	Action	Limit
Hersha Hospitality Trust - Preferred D *	HTPRD	\$10.79	0.00%	BUY	\$19.00
International Business Machines	IBM	\$122.94	5.30%	BUY	\$129.09
RLJ Lodging Trust - Preferred A *	RLJPRA	\$22.03	8.85%	BUY	\$28.00
RPT Realty 7.25% Preferred D *	RPTPRD	\$33.62	10.78%	BUY	\$50.00
Valero	VLO	\$56.23	6.40%	BUY	\$59.04
Wells Fargo	WFC	\$24.26	1.65%	BUY	\$25.47
Growth with Moderate Income					
Intel	INTC	\$47.71	2.77%	BUY	\$50.09
Invesco Consumer Staples ETF	RHS	\$142.72	2.22%	BUY	\$149.86
JP Morgan Chase	JPM	\$96.64	3.73%	BUY	\$101.47
Growth					
Apple	AAPL	\$425.40	0.69%	HOLD	\$300.00
Boston Scientific	BSX	\$38.57	0.00%	BUY	\$40.50
Genomic Revolution Multi-Sector	ARKG	\$53.70	0.00%	BUY	\$56.39
NCR Corp	NCR	\$18.43	0.00%	BUY	\$19.35
Stryker Corp	SYK	\$193.30	1.19%	BUY	\$202.97
Third Avenue Real Estate Value Investor *	TVRVX	\$20.47	0.00%	BUY	\$23.00
Third Avenue Small-Cap Value Investor Fund *	TVSVX	\$14.32	0.00%	BUY	\$17.00
Virtus LifeSci Biotech Products	BBP	\$44.87	0.00%	BUY	\$47.11
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	\$17.22	0.00%	BUY	\$18.08

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

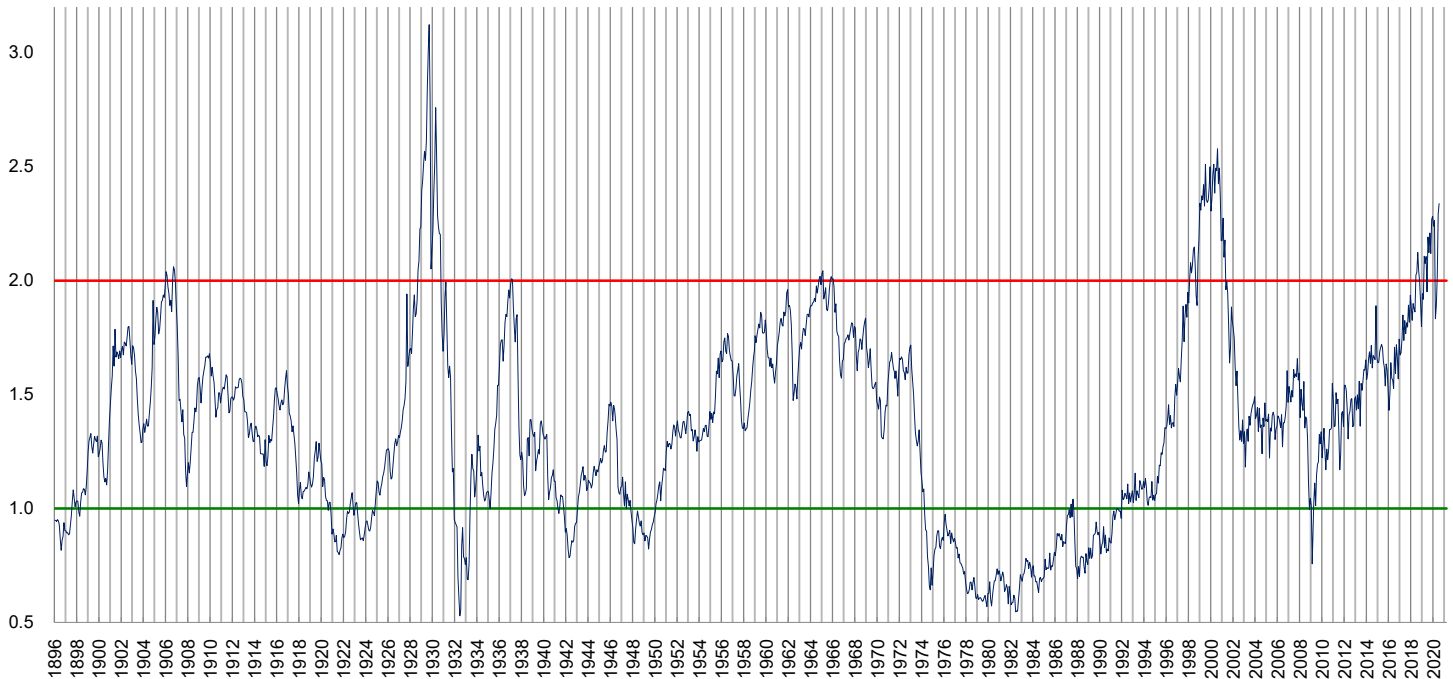
* It is not possible to offer live pricing.

General Comments: Our statistics are based on the assumption that \$10,000 is invested in each position. When a new position is added, we assume the same \$10,000 amount is invested in the new recommendation. When we recommend adding to a particular position, as we have done over the years, we assume another \$10,000 is invested again in that position.

If you are picking and choosing, you can focus on the sector of the portfolio that matches your investment objectives. Alternatively, you may have a higher degree of comfort with certain industries, funds, or stocks because of past experience or your profession. In that case, you may want to invest more heavily in one sector, or in one or more individual recommendations.

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

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



There are few forces that are more important to a market's destiny than the amount of capital that is available to it. In a normal situation, capital will flow easily between markets as their underlying conditions change. But if a market becomes dangerously superheated, it will absorb a larger proportion of available investment capital than economic conditions and market demand can justify. This change will be reflected not only in the rising market's prices but also in the prices of competing markets, which will be lower than their underlying fundamentals would indicate they should be. Over the last 120+ years, we can see this titanic struggle between the stock market and its foremost competitor for investment dollars: real estate.

To reveal this phenomenon, we have set up an equation based on the ratio of the S&P 500 Stock Index to median price of new houses for each month over the last 100+ years. This equation exhibits an elegant financial minuet as each market has taken turns outperforming the other.

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

We label this new tool the **Sound Advice** "Risk Indicator," since it will allow us to locate the point at which prices are so high when compared to competing markets that they have come loose from their moorings and are on the verge of declining or under performing the other market.

What is too high? When stock prices are very high

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

But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing, had an investor followed the signals of the **Sound Advice** Risk Indicator he or she would have made \$499 million, or 26.5 times more money than by simply holding stocks though the ups and downs.

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

The New York Times

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

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

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

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

It would not be until March 1998 when the Risk Indicator would cross 2.0 again, after stocks were up by more than tenfold. The Dot-Com bubble would push stocks higher into early 2000, but then began another 50 percent retracement. A switch to houses would produce a 44 percent gain through the end of 2008 while stock prices were lower by 17 percent. In February 2009, with the Dow careening below 700 once again, the Risk Indicator quietly dropped below 1.0 to 0.77 as the S&P tumbled under 700. Since then, the stock market has delivered stunning gains as the S&P 500 has quadrupled. For the sixth time in the last 125 years, the Risk Indicator rose above 2.0 again in July 2018. The Risk Indicator remained above 2.0 through the high-point of the market in February 2020.

With the latest median house price at \$310,200 in May and with the S&P 500 at 3200, the Sound Advice Risk Indicator reads 2.3, revealing the risk in stocks is very high.

As remarkable as the **Sound Advice** Risk Indicator has been, it does not pinpoint the exact time. In the past 125 years, its signal has ranged from being only one month after the zenith to as much as four years early. While the Risk Indicator has been early, it has never been wrong. An expensive crash was inevitable. This time, the signal was 8 months prior to the peak.

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

Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

Track Record of the SoundAdvice Diffusion Indexes

After each "Aggressive" signal, the S&P 500 climbed an average of 30.8 percent. During "Caution" signals, the S&P 500 either crashed, meandered, or climbed, recording an average increase of 4.2 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Mar-15	2,080.0	May-15	2,111.9
Sep-17	2,492.8	Jan-18	2,823.8
Ave +/-	30.8%		4.2%

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

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

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

When the **Sound Advice Diffusion Index of LEADING Indicators** drops to zero, it is time to buy stocks aggressively, regardless of how negative the atmosphere may be. This is not just an empirical coincidence. It is also logical. In order for all of the leading economic indicators to be giving off a zero value compared to six months before, it is nearly certain that the soft economy is providing an atmosphere for stable or declining interest rates.

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

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

Current Status

The Diffusion Index of LAGGING Indicators has been in caution mode. The most recent 100 percent reading was in January 2020, confirming previous 100 percent readings. **The latest data for June (reported in late June) caused a 33 percent reading.**

Our next signal will come from the Diffusion Index of LEADING Indicators, when it drops to zero. **The latest reading for June was 33 percent.**

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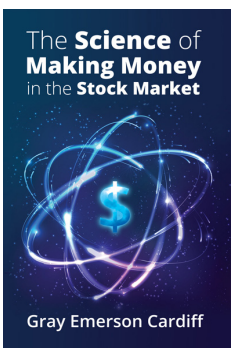
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