

Our Next Signal

Our *Sound Advice* Diffusion Index of Lagging Indicators (page 11) has been in Caution mode since January 2018. The *Sound Advice* Risk Indicator (page 10) climbed over 2.0 in July 2018 for only the sixth time in the last 123 years, revealing a high-risk time for stocks. After these signals, the market corrected substantially, bringing stocks down 20 percent, to the brink of a bear market.

Our next bull market signal will come from a zero reading from our Diffusion Index of Leading Indicators (page 11). This happens when the US economy softens sufficiently to bring down interest rates. We can already see this happening in the rest of the world, especially in China and Europe. (At the end of January, Italy announced it is officially in a recession after two contracting quarters of its GDP.) The growth of the US economy is not immune to global changes. Evidently the Federal Reserve is coming to the same conclusion.

The Federal Reserve increased the federal funds rate at its December 19 meeting because there was no evidence of weakness in the US economy. However, in the final days of January, the Federal Reserve changed its tune. In his most recent January 30 press conference following the 2-day meeting, Chairman Powell said the Federal Reserve has dropped its pledge of further increases in the Federal Funds rate, and that it will be “patient” as it determines what future changes may be appropriate.

Building Permits

This statement leaves open the possibility of decreases in the Federal Funds rate. This could occur if weakness in the US economy becomes evident, which would be revealed by a zero reading from our Diffusion Index of Leading Indicators.



Gray Emerson Cardiff, Editor

So far this year, the *Sound Advice* model portfolio is up 9.5 percent.

The *Sound Advice* investment returns in prior years have been calculated independently by the Hulbert Financial Group and concur with ours. They are as follows:

From 2000-2018

9.5% Annually versus.

2.8% from the S&P 500

Recall that we observe changes in each of our three selected economic indicators over a six-month period and take the percentage of those increasing. If all three are below their respective levels of six months earlier, this diffusion index drops to zero, telling us that interest rates are likely to decline, and that it is time to buy stocks aggressively.

Two of the three economic indicators, unemployment claims and the spread between the Federal Funds rate and 10-year Treasury bond yields, are lower than they were six months ago. Looking back at the sequence of readings beginning six months ago, we can see that these two economic indicators will remain below their prior six-month readings as long as they remain stagnant or decline further in the immediate months ahead.

The one economic indicator that is still above its level of six months ago is building permits. The latest reading is 1,323. A drop below 1,248 would cause a zero reading next month, and a decline to 1,240 would cause a zero reading in two months. Although weakness in real estate markets has appeared recently, a drop to 1,248 would be a large drop based on historical month-to-month changes. A smaller drop to 1,264 in three months would also cause a zero reading. Of course, we will be watching changes in all three of the economic indicators that comprise our Diffusion Index of Leading Indicators.

Staying Cautious

When we see a zero reading from our Diffusion Index of Leading Indicators, we can expect a major upswing in stock prices. As usual, the atmosphere will be scary, and stocks will have been battered. Until then, we are continuing to recommend that you have a substantial amount of cash on the sidelines. Our portfolio recommendations are made regarding the money you have allocated to the stock market, and in accordance with our current cautionary mode. We believe that they are exceptionally strong values, trading at a significant discount to the rest of the market, which should give them buoyancy in both good and bad market conditions over the longer term.

The 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.

Until we get our next signal from the Diffusion Index of Leading Indicators, we will be in a Caution mode, and we continue to recommend hedging your portfolio with this reverse ETF.

Energy & Natural Resource Selections

US oil producers became the largest oil producer in the world in 2019, outpacing Saudi Arabia and Russia. Now that large oil firms have begun drilling for shale, production is projected to rise another 11 percent in 2019.

One to 1.5 million barrels a day was supposed to be choked off world markets by US sanctions against Iran after November 4, 2018, but the sanctions were delayed at the last minute by 180-day waivers for

China, India, Greece, Italy, Taiwan, Japan, Turkey, and South Korea. Upward pressure on oil prices is inevitable as the end of the waivers approaches. Beyond the end of the waivers, the curtailment of international investment will lead to a significant reduction of Iran's natural gas output for many years because Iran does not have the expertise to develop its resources alone. There is also pressure on Saudi Arabia to reduce production because it needs \$83 a barrel to support its public spending. In the last week of January, Saudi Arabia cut imports to the US in half. Oil prices jumped 2 percent on the news.

Late in 2018, the US just became a net exporter of oil, which will also help alleviate the over-supply of oil. We are still importing nearly half of our oil needs because most US refineries were constructed prior to the US shale boom and designed to process imported crude oil which is a heavy (thick) and sour (high sulfur) grade. Additionally, refineries on the east and west coast do not have access to the US crude oil pipeline network, so they must rely on imported oil arriving in US ports for their supplies. Meanwhile, US storage tanks in Cushing, Oklahoma, are brimming with the light sweet crude fracked from US shale which is now available for exporting.

For the above reasons, the worst of the glut should be behind us. The stabilization of the global oil market is bound to translate to recoveries in this sector in the months ahead.

Adams Natural Resources (PEO) is a closed-end fund, which means it trades like a stock and can be bought and sold during market hours. The price of PEO is not tied directly to the NAV of the underlying portfolio, so it can trade at a discount or a premium. This is an advantage now because PEO is currently trading at a substantial discount to its NAV. Although PEO has typically traded at a discount over the last several years, the discount now is as large as it gets, at 16.9 percent. In addition, PEO also has a lower expense ratio of 0.78 percent, versus the industry average of 1.14 percent.

PEO is a candidate for steady income. This fund has

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been in operation since 1929 and has 80+ years of distribution history. PEO has an objective and recent history of making quarterly distributions that add up to at least 6 percent annually. These distributions are usually a mix of dividends and long-term capital gains. Occasionally the distributions contain a portion of a return of capital in order to meet the 6 percent goal.

Fidelity Select Natural Gas Fund (FSNGX) is a diversified way to participate in the growth of the natural gas industry through strong companies. This is an open-end fund which means it trades at the NAV of its portfolio set at the close of the market each day.

Natural gas provides the same energy as oil for pennies on the dollar, and natural gas is more environmentally friendly. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. However, with the current market price for natural gas at \$2.83 for one million BTUs, 5.8 million BTUs will cost \$16.41. Thus, with a barrel of Brent crude oil costing \$62, the same amount of energy is available for approximately 26 cents on the dollar if it is in the form of natural gas rather than oil.

The updated chart shows the historic relationship between the costs of these two forms of energy. The red line shows the price of a barrel of oil since the mid-1970s. The blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. The fact that natural gas provides energy for pennies on the dollar will translate into an expanding natural gas industry.

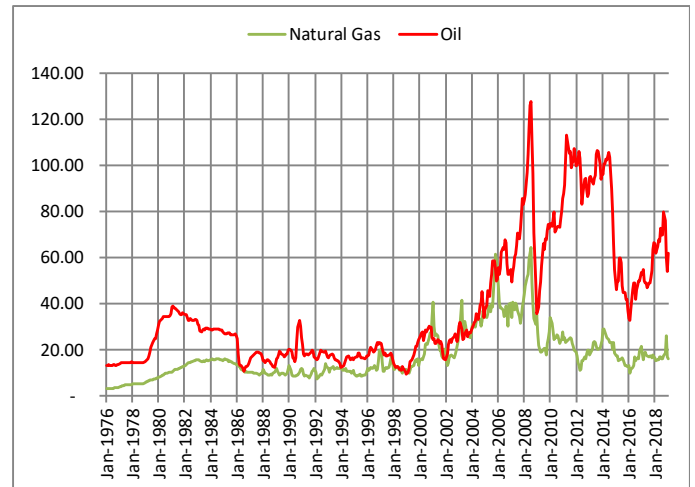
Chesapeake Energy (CHK) is currently trading at a forward P/E ratio of 4.4, a substantial discount from the industry's average of 10.7.

In 2018, asset sales generated more than \$2 billion which was used to reduce the company's debt by approximately \$1.8 billion. The divested daily oil volumes associated with the sale of the Utica shale in Ohio represented 10% of oil production, but it was replaced by increased production from the company's South Texas Powder River Basin where production is projected to double in 2019.

The company has secured strong hedge positions for gas and oil which provides stability and certainty in cash generating capability. The merger with WildHorse Resources is on track which will further strengthen the portfolio's growth prospects.

Chevron (CVX) reported fourth quarter earnings of \$1.97 per share, exceeding expectations and

The Cost of Energy Equivalents of Oil and Natural Gas



170 percent higher that the same quarter one year ago. As we expected, oil and gas production volume increased, primarily from the two large Australian facilities, Gorgon and Wheatstone, along with increases from the premium basin.

In addition to its (upstream) oil and gas production, which earned 68 percent more that one year ago, Chevron also refines products. The refining operations (downstream) tend to benefit from lower oil prices while the downstream production benefits from rising prices. Downstream earnings were \$0.8 billion in the fourth quarter, four times higher than one year ago. This diversification adds financial stability during times of volatile oil prices.

CVX has an attractive annual dividend of \$4.48 per share. The company's dividend is sacrosanct and has a history of increasing annually through thick and thin. At a price of \$50 per barrel of oil, because of its diversified and low-cost operations, Chevron can generate enough cash to pay the current dividend, fund its capital spending plan, and buy back some of its stock which is planned at \$3 billion per year.

Valero Energy (VLO) reported impressive earnings at the end of January of \$2.12 per share, far above expectations. Earnings for 2018 totaled \$7.37, up 48.6% from the previous year. At \$88 per share, VLO remains cheap with a trailing P/E under 12. VLO raised its annual dividend to \$3.60 per share, which brings the current yield close to four percent.

VLO has the flexibility to refine substantial quantities of both US light sweet as well as heavy sour crude.

It also has access to the US pipeline network for delivery to its gulf coast locations. This flexibility allows VLO 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.

Real Estate Selections

We continue to be selective when choosing real estate stocks because commercial real estate prices are historically high as low interest rates have pushed down real estate capitalization (cap) rates to historically low levels (like bond yields). The *Sound Advice* portfolio only includes real estate stocks offering an extraordinary value now.

Our two recommended REITs in the hospitality industry offer an excellent value. Both have new growth trends and pay attractive dividend yields which also reduces risk by putting a floor under the stock price. A major drag on the industry was the proliferation of Airbnb and similar competition. However, this is changing in major metro areas. New York City is the most recent to pass a measure prohibiting transient rentals of fewer than 30 days at a time without the host being present. San Diego, Los Angeles, San Francisco, Boston, Washington DC, Philadelphia and Miami have also passed similar measures.

Both of our selected hospitality REITs have reported several hotel transactions in recent years at cap rates ranging from 4.9 to 6 percent. Hersha recently sold the Hyatt House in Gaithersburg MD, and the Holiday Inn Express in Chester NY, at a combined capitalization rate of 4.9 percent. So far this year, RLJ sold three legacy FelCor assets: the Fairmont Copley Plaza in Boston, the Embassy Suites Marlborough, and the Philadelphia Sheraton Society Hill, for a capitalization rate close to 6 percent. The Philadelphia Sheraton was also sold for \$95.5 million, a 5.6% cap rate.

To be conservative and to anticipate a rise in capitalization (cap) rates along with interest rates in general, we use a cap rate of 7.0 percent for valuation purposes.

Hersha Hospitality (HT) is worth \$26.64 per share which is substantially greater than the current price of the stock. This value should be a conservative estimate because Hersha's two premier hotels in Miami, the Courtyard Cadillac Hotel and the Parrot Key Hotel, were closed because of Hurricane Irma. Bringing them back on line will add substantially to revenues in the next four quarters. The Cadillac Hotel was opened three months ago. The 148-room Parrot Key Hotel & Villas opened in December after an extensive renovation and will ramp up into the high season in Key West.

Hospitality REITs Comparison Table

Company	Symbol	Recent Stock Price	Dividend Yield	Stock Market Cap Rate	Portfolio Value @ 7% Cap Rate (\$Millions)	Stock Value	Discount (-) Premium (+)
RLJ Lodging	RLJ	18.55	7.1%	10.6%	8,174	34.49	-46.2%
Hersha	HT	18.53	6.0%	8.0%	2,466	26.64	-30.5%
Hospitality Properties	HPT	26.66	7.7%	10.0%	11,775	48.26	-44.8%
Host Hotels & Resorts	HST	18.06	4.4%	10.5%	24	28.56	-36.8%
Apple Hospitality	APLE	16.41	7.3%	9.2%	6,628	23.25	-29.4%

The table above shows the "Stock Market Cap Rate" (what the stock price is paying for the underlying real estate portfolio) for several comparable hospitality stocks. The "Stock Value" column shows the current value of the stock assuming the underlying portfolios are valued using a cap rate of 7.0 percent, which is close to the average cap rate on recent hotel transactions. The last column shows the discount or premium at which the stock is trading based on a 7.0 percent cap rate valuation of each company's real estate portfolio.

Hospitality Properties (HPT) is trading at a large discount. However, this company is externally managed by RMR which charges high fees and suppresses value. As long as RMR continues to externally manage HPT, we do not expect to see significant growth. **Host Hotels and Properties (HST)** is very small, with only 749 thousand shares outstanding, which may lead to excessive volatility. Growth may be limited by its small capitalization.

In December, the Board of Trustees authorized a new share repurchase program of up to \$50 million of HT's outstanding common shares in 2019.

RLJ Lodging Trust (RLJ) is worth \$34.49 per share which is also substantially higher than the current price. We anticipate improvement in net operating income (and thus the value of the stock) because of the company's mission to sell its non-core assets since the merger with FelCor, and to renovate and upgrade significant properties.

Third Avenue Real Estate Value Investor Fund (TVRVX) 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. Also, unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities.

This fund is loaded with good values substantially below their net asset values (NAV) with strong growth prospects. Management has a similar approach to ours because it is very price conscious, especially in relation to net asset value. Just as we do at *Sound Advice*, they eat their own cooking – they invest a substantial amount of their personal assets into their funds.

This fund distributed \$2.64 in December, \$2.23 of which was a long-term capital gain and the balance was a dividend.

Medically-Related Selections

Boston Scientific (BSX) has made acquisitions that have added numerous products with significant growth potential, including Claret Medical, VENITI, and Augmenix. The most recent takeover of Millipede is another strategic fit because it is synergistic with Boston Scientific's heart-valve repair and replacement segment. All of these are leaders in high-growth markets and will enhance the company's category leadership strategy and leverage existing capabilities.

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. BSX's medical

products are well suited for an aging population, and the company's stream of new inventions acquisitions add to promising growth prospects.

Stryker (SYK) is best known for its orthopaedic devices for artificial knees and hips. The company also provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products.

The company's strong balance sheet allows it to make strategic acquisitions, many of which are coming to fruition, including the 2016 acquisition of Mako's surgical robots which are now being used in the majority of knee surgeries. With nearly 600 surgical robots around the world, Stryker's robotic surgical system has become the first complete robotic technology used for knee and hip replacement procedures.

Tekla Life Sciences Investors (HQL) is a good way to invest in the most explosive profits in the healthcare industry with a portfolio of biotech companies. Over the last 15 years, biotechnology has become a major industry and the source of the world's top breakthrough drugs. Biotech companies tend to be high risk and high reward investments which makes diversification essential.

Financials

JP Morgan Chase (JPM) announced earnings on January 15 of \$1.98 for the quarter, finishing 2018 with earnings of \$8.99. JPM is very cheap in comparison to the rest of the market. At \$104 per share, the trailing P/E is 11.55. At the relatively modest P/E ratio of, say 14, JPM would be \$126 which is substantially above the current stock price.

Wells Fargo (WFC) also reported fourth quarter earnings in January, capping off 2018 with \$4.28 per share. WFC is also currently cheap in comparison to the rest of the market. At \$50 per share, the trailing P/E is 11.7. At a P/E ratio of 14, WFC would be \$59.90, substantially above the current stock price.

Small Caps

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.

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.

TVSVX distributed \$2.05 in December, \$1.98 of which was a long-term capital gain and the balance was a short-term capital gain.

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) announced financial results in the final days of January for its fiscal 2019 first quarter ending December 29, 2018. The Company posted quarterly earnings per share of \$4.18, up 7.5 percent. Although revenue from iPhone sales declined 15 percent from the prior year, Apple's active installed base of devices reached an all-time high of 1.4 billion, driving AAPL's services business up 19 percent to all-time highs. Revenue from Macs, Wearables, and Accessories also reached all-time highs, growing 9 percent and 33 percent, respectively, and revenue from iPad® grew 17 percent.

The stock has rallied on the earnings report, but it is still down substantially from its peak last year, turning it into a value stock, especially in view of the \$245 billion in cash in the company's coffers. This amounts to \$51 per share. Subtracting this cash from \$165 per share means we are actually paying \$114 per share for the company. Trailing twelve-month earnings are \$11.93 per share, which means we are paying a P/E of less than 10 for one of the premiere growth companies in the world.

Carnival Cruise Lines (CCL) expects 2019 earnings to range from \$4.50 to \$4.80 per share, which puts the forward price/earnings (P/E) ratio

close to 14. During the last 5 years, the median P/E has been 19.

CCL has traded at an average enterprise value multiple of 11 during the last five years. A common practice is to multiply a company's EBITDA (earnings before interest, taxes, depreciation, and amortization) by such a multiple to calculate its enterprise value. Based on the most recent four quarters of EBITDA, an enterprise value multiple of 11 puts the enterprise value at \$87 per share, which is substantially above the current stock price.

CCL is a good value, especially when compared to the rest of the market. Growth prospects are strong because of the company's dominance in the industry, efficiencies of scale, and favorable demographic trends driving a lasting increase in demand.

Intel (INTC) reported fourth-quarter earnings in January of \$1.12 a share, compared with a loss of 15 cents a share one year ago. However, INTC was expected to post adjusted earnings of \$1.22 a share. The stock fell 6 percent on the disappointing news but has since stabilized. While below expectations, revenue rose in all of the company's segments. Intel's largest segment, the Client Computing Group which includes PC chips, rose 10 percent.

INTC has a P/E ratio of close to 10. Such a low P/E anticipates very little or no growth. However, Intel has the size, diversity, and industry dominance to offer 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. A history of established cash flow and an attractive dividend, along with the currently low P/E ratio, diminishes the risk profile of this stock.

Stronger growth prospects make INTC undervalued at its current price because it deserves a higher P/E. At a P/E of say, 12, the stock would be in the mid-50s. At a P/E of 15, which is closer to the rest of the market, the stock price would be \$68 per share.

International Business Machines (IBM) reported earnings in January of \$13.81 for 2018,

slightly above expectations. The stock jumped 10 points on the news. All year long, the company has been saying earnings would be “at least \$13.80 per share”, but the stock has been priced like the market didn’t believe it.

Even after the 10-point jump, the P/E ratio was still a modest 10 times earnings which anticipates little or no growth, which may be the case for 2019 as IBM absorbs the Red Hat acquisition. However, beyond 2019, the prospects are for stronger growth. At a P/E of 12, which is still modest, the stock would be over \$160 per share.

The company is now at an inflection point as the growth portion of the company is more than half of the company’s revenue from its so-called “Strategic Imperatives” which includes cloud-computing revenue, analytics, mobile and security. Within those imperatives is IBM’s cognitive-solutions segment, which includes software, analytics and its artificial intelligence platform, it calls “Watson”, which can “think” like a human. Watson works in ten industries, including agriculture, customer service, human resources, gold mining, supply chain, manufacturing, building management, automotive, marketing and advertising.

The \$6.00 per share dividend now provides a yield of 5 percent. This is a good time to invest in this long-term growth company at a good value.

NCR Corp (NCR) makes automatic tellers (ATMs), retail point-of-sale (POS) workstations, self-service kiosks, and other self-service checkout systems. 485 million people use NCR products every day, and there is room for substantial growth in the US and around the world.

NCR owns nearly three-quarters of the burgeoning self-checkout market and is well-positioned to benefit. Using their smartphones, or a handheld scanner provided by the store, customers scan items from the shelves as they add them to their cart. At checkout, they input either device into the register, and it spits out the tally.

In January, NCR introduced newly integrated

Equinox Luxe devices for NCR Connected Payments, a secure payment route for retailers, ensuring complete data and transmission security from PIN pad to processor.

NCR remains a good value. The Company confirmed its 2018 earnings per share estimate of \$2.55 to \$2.75. This puts the current P/E under 10, a considerable discount to the rest of the market.

Symantec (SYMC) reported quarterly earnings at the end of January of 44 cents per share, driven by growth in its consumer business, beating expectations of 39 cents. Symantec benefited as corporations increased budgets by 20 percent in 2018 to shield against cyber-crime. The company also increased its share buyback authorization to \$1.3 billion.

Symantec is the world’s leading cyber security company offering organizations strategic, integrated solutions to defend against sophisticated attacks across endpoints, cloud, and infrastructure. Symantec operates one of the world’s largest civilian cyber intelligence networks, allowing it to see and protect against the most advanced threats. Our mantra with this stock has been, “If there ever was a more certain growth industry, protection from cyber espionage is it.”

ETFs for Rising Bond Yields

Although short-term interest rates may remain low in the immediate months ahead, long term interest rates are historically low and are bound to be moving up in the months and years ahead. Our recommended ETFs differ in the amount of leverage used. You can choose among them depending on your investment objectives and risk tolerance.

The **Direxion Daily 20 Plus Year Bear 3 Shares (TMV)** uses 3:1 leverage.

The **Proshares UltraShort Lehman 20 Plus Year Treasury (TBT)** uses 2:1 leverage.

The **Proshares Short 20 Plus Year Treasury (TBF)** uses no leverage.

The price action of these ETFs is based on the changes in long-term Treasury bond indexes, only in the opposite direction, and then multiplied by the leverage each ETF uses. For example, a decline of say, 1.0 percent in their respective benchmark bond indexes will cause TMV to increase by 3.0 percent,

TBT by 2.0 percent, and TBF by 1.0 percent.

The Dot Plot

We can project the movements of these ETFs based on any given scenario. We have been using the Federal Reserve’s prediction, which was as good as any. As part of the Federal Reserve’s quarterly Federal Open Market Committee (FOMC) meetings, each of the committee members makes a prediction regarding the future path of interest rates. Those predictions are plotted in the so-called “Dot Plot”.

The most recent dot plot was taken at the December 19 meeting. The median prediction from the members was that the Federal funds rate would be 2.875 percent by the end of 2019.

We are using the Fed’s dot plots of Federal funds as a means to predict changes in long-term interest rates under the assumption that long-term interest rates will move in tandem with them. This should prove to be a conservative assumption because today’s yield curve (the difference between short and long-term interest rates) is unusually flat, offering very little additional yield on longer term bonds. However, in the spirit of trying to be conservative, we can assume that the yield curve will remain as flat as it is today, which means that long-term Treasury bond yields move in accordance with the dot plot and will not rise any faster. Accordingly, long-term Treasury bond yields would climb from 3.0 percent currently to 3.5 percent by the end of 2019.

Here is what would happen to each ETF:

TMV would rise from \$18.11 to \$23.45 by the end of

2019.

TBT would rise from \$34.93 to \$41.49 by the end of 2019.

TBF would rise from \$22.36 to \$24.37 by the end of 2019.

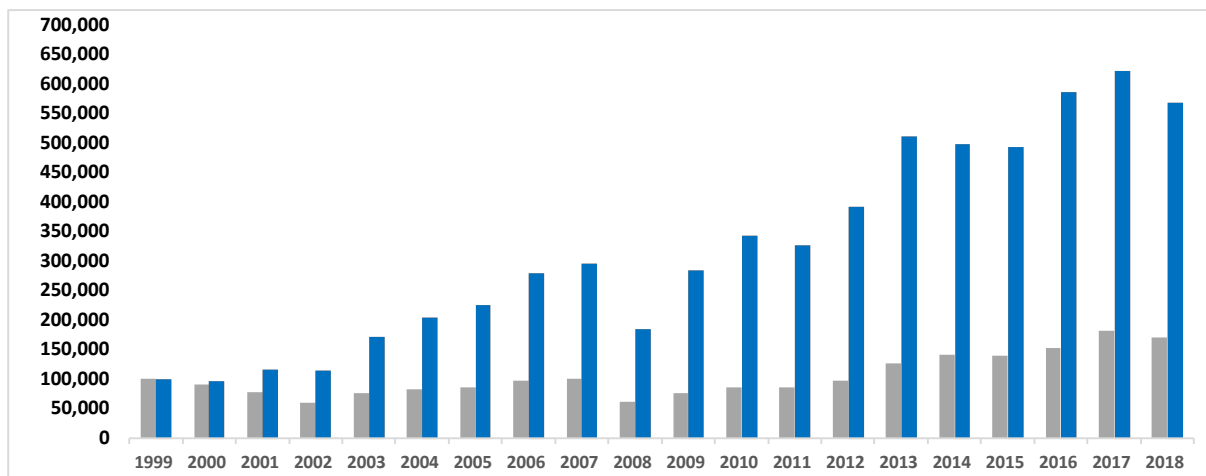
These projections should prove to be conservative because the Federal Reserve has become a seller of Treasuries rather than a large buyer, as it reverses into quantitative tightening after many years of quantitative easing. During quantitative easing, the Federal Reserve’s portfolio of Treasuries swelled by more than 5 times, from under \$900 billion in 2008 to \$4.6 trillion. The Federal Reserve says that it does not need to reduce its portfolio to pre-crisis levels, but it still has a lot Treasuries to sell.

The Erosion Factor

As we point out regularly, these ETFs suffer from erosion because they decline slightly faster than they increase with an equivalent change in bond yields, particularly with higher leverage. To gauge this factor, we can assume that Treasury bond yields simply tread water, rising and falling by an unusually large amount, say, 0.03 percentage points (3 basis points) every day, and thus go nowhere. By the end of 2019, TMV would decline to \$17.45 (3.7 percent), TBT would decline to \$34.30 (1.8 percent), and TBF would decline to \$22.33 (0.6 percent). While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

Sound Advice vs 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 \$170,645, versus \$100,000 invested in the *Sound Advice* recommendations (in blue), which would have grown to \$561,174.



See our website for live pricing and buy limits: <http://www.soundadvice-newsletter.com/members>

Energy/Natural Resources	Symbol	Price / NAV	Yield	Action	Limit
Adams Natural Resource Fund	PEO	\$16.23	7.21%	BUY	\$17.00
Chesapeake Energy Corp	CHK	\$2.85	0.00%	BUY	\$2.99
Chevron	CVX	\$114.65	3.91%	BUY	\$118.00
Fidelity Select Nat. Gas Fund *	FSNGX	\$20.09	0.40%	BUY	\$21.50
Valero	VLO	\$87.82	4.10%	BUY	\$92.00
Real Estate					
Hersha Hospitality Trust	HT	\$18.53	6.04%	BUY	\$19.90
RLJ Lodging Trust	RLJ	\$18.55	7.12%	BUY	\$19.90
Third Avenue Real Estate Value Investor *	TVRVX	\$27.76	1.47%	BUY	\$29.90
Medically Related					
Boston Scientific	BSX	\$38.15	0.00%	BUY	\$39.90
Stryker Corp.	SYK	\$177.57	1.17%	BUY	\$182.00
Tekla Life Sciences Fund	HQL	\$17.48	0.00%	BUY	\$18.00
Financials					
JP Morgan Chase	JPM	\$103.50	3.09%	BUY	\$106.00
Wells Fargo	WFC	\$48.91	3.52%	BUY	\$52.00
Small Caps					
Third Avenue Small-Cap Value Investor Fund *	TVSVX	\$17.49	0.40%	BUY	\$18.50
Special Situations					
Apple	AAPL	\$166.44	1.75%	BUY	\$179.00
Carnival Cruise Lines	CCL	\$57.58	3.47%	BUY	\$59.00
Intel	INTC	\$47.12	2.55%	BUY	\$50.00
International Business Machines	IBM	\$134.42	4.46%	BUY	\$138.00
NCR Corp	NCR	\$26.75	0.00%	BUY	\$27.50
Symantec	SYMC	\$21.02	1.33%	BUY	\$22.00
ETFs for Rising Interest Rates					
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	\$18.09	0.00%	BUY	\$20.00
ETF - ProShares Short 20+ Year Trsry	TBF	\$22.36	0.00%	BUY	\$24.00
ETF - ProShares UltraShort 20+ Year Trsry	TBT	\$34.93	0.00%	BUY	\$38.00
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	\$36.73	0.00%	BUY	\$38.00

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

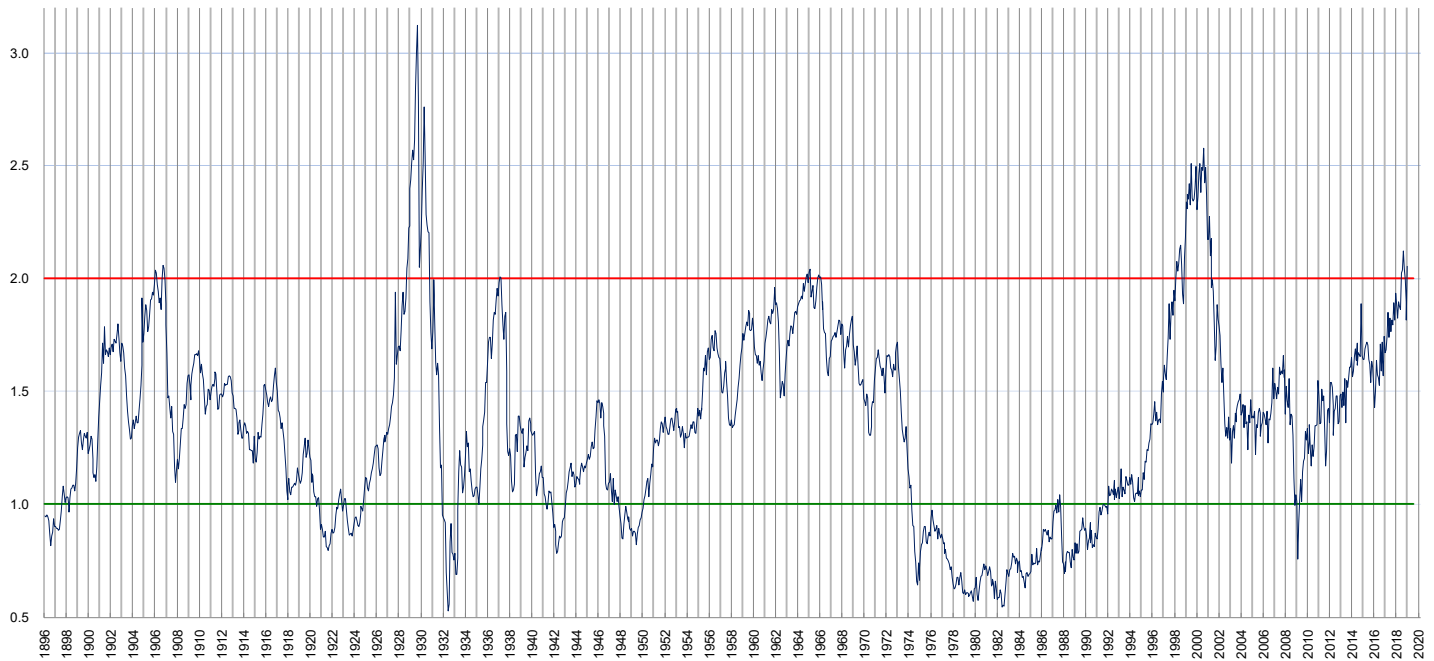
* It is not possible to offer live pricing on our recommended mutual funds.

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 \$391 million, or 26 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 the first quarter of 1907. 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

The New York Times

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

1928, the Risk Indicator rose above 2.0 again. On Tuesday, September 3, 1929, 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 before 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 crash in 1975, 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 down through the 700s 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 123 years, the Risk Indicator rose above 2.0 again in July 2018.**

Based on the latest (preliminary) median house price of \$302,400 for November, and with the S&P 500 at 2704, the Sound Advice Risk Indicator reads 2.05, revealing the risk in stocks is high.

As remarkable as the **Sound Advice** Risk Indicator has been, it does not pinpoint the exact time. In the past 123 years, its signal has ranged from being only one month before the zenith to as much as two years early. While the Risk Indicator has been early, it has never been wrong. An expensive crash was inevitable. A 50 percent decline took a 100 percent recovery just to break even.

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 30.0 percent. During "Caution" signals, the S&P 500 either crashed, meandered, or climbed, recording an average increase of 2.8 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Mar-15	2,080.0	May-15	2,111.9
Sep-17	2,492.8	Jan-18	2,823.8
Ave +/-	30.0%		3.3%

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.

Most of the time, this Diffusion Index has been a timely indicator of oncoming bear markets because a rising interest rate environment is a dangerous time for stocks. The times when this Index has not performed in a timely fashion is when monetary policy has been established and enforced, regardless of fluctuations in economic strength. A prime example is the quantitative easing (QE) programs that were used to bail out the economy from the 2008-09 meltdown. In recent years, the economy has strengthened, sufficiently at times to push this Diffusion Index to 100 percent. However, interest rates did not rise because they were being held artificially low by the Fed's massive QE bond-buying activities. During the QE programs, the Fed's assets grew by more than 5 times, from under \$900 billion in 2008 to \$4.6 trillion.

That has changed now because quantitative easing has been reversed into quantitative tightening. Instead of buying, the Federal Reserve has started reducing its current inventory of \$2.8 trillion of Treasury bonds and \$1.8 trillion of mortgage-backed securities. This means that we will no longer have a QE program holding interest rates artificially low.

Current Status

The Diffusion Index of LAGGING Indicators climbed to 100 percent for December, giving us a new Caution Signal in January, very close to the peak in the market. The latest data for November caused a 100 percent reading.

Our next signal will come from the Diffusion Index of LEADING Indicators, when it drops to zero, which would take a surprising softening in the US economy. The latest reading for this Diffusion Index is 33.3 percent.

Concurrence

There are times when signals from the **Sound Advice** Risk Indicator and the Diffusion indexes are out of sync, when one is signaling caution and the other is not. This occurred in August 1987, when the Diffusion Index of Lagging Indicators switched into caution mode, just prior to the October 1987 Crash that took stocks sharply for a brief period. Non-concurrence also occurred in March of 2008, when the Diffusion Index of Lagging Indicators switched into caution mode, just prior to the 2008-09 bear market crash. Both of these crashes were brutal, but relatively short-lived. Once the Risk Indicator plunged below 1.0, a very profitable bull market followed.

Then there are times when both indicators concur, signaling the same thing at roughly the same time. This happens when the Risk Indicator is above 2.0, indicating the end of a supercycle, and the Diffusion Index of Lagging Indicators switches into caution mode, indicating the end of a business cycle. Of course, this concurrence indicates that a more vicious and potentially longer-lasting bear market, or series of bear markets, is bound to follow, eventually taking stock prices down substantially – usually by 50 percent -- until the Risk Indicator falls below 1.0 again. We have this concurrence today.

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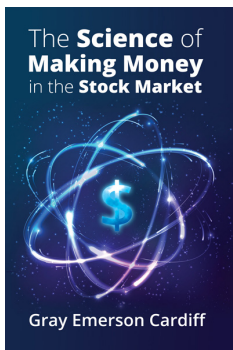
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