

Trimming the Fat

A widely accepted way to invest in the stock market is to buy into an S&P 500 Index ETF, giving you a balanced diversified investment in 500 of the most established companies on Wall Street. Indeed, that has been a wise strategy in the past, but it is not right now. Although the S&P 500 Index is comprised of 504 stocks of reputable companies, each of the 504 stocks is not weighted equally. Each holding is weighted according to its capitalization (the number of shares outstanding multiplied by the price of the stock). This weighting has caused 9 stocks to dominate the S&P 500 Index and comprise 29 percent of the Index, as opposed to 1.8 percent if they were equally weighted. This means that the S&P 500 Index is not a balanced diversified investment.

These 9 stocks have had a huge rally in recent months, sparked by exuberance over AI (artificial intelligence). This run-up has raised the average price/earnings (P/E) ratio of these 9 stocks to a lofty 97, based on their trailing 12-month earnings. This is an extremely high ratio by historical standards and anticipates an unrealistically high growth rate. Any growth slow-down or other disappointments will bring these stocks crashing down. These 9 stocks and their respective P/E ratios are as follows:

- Apple with a P/E ratio of 32
- Microsoft with a P/E ratio of 37
- Amazon with a P/E ratio of 316
- Nvidia with a P/E ratio of 220
- Alphabet Class A (Google Class A) with a P/E ratio of 27
- Alphabet Class C (Google Class C) with a P/E ratio of 27
- Tesla with a P/E ratio of 77
- Meta Platforms Class A with a P/E ratio of 35
- Berkshire Hathaway Class B with a P/E ratio of 100

To gain a perspective on how much the additional weighting of these 9 stocks influences the overall S&P 500 Index, we can plug in the assumption that each of the 504 stocks increases by, say 1.0 percent. That would cause the weighted S&P Index to increase by 1.31 percent, or 30 percent more than if each stock were evenly weighted.

The weighted S&P 500 Index has become the standard. The weighting factors are not readily evident because it is simply referred to as the S&P 500 Index. The implication is that it is a diversified balanced index, but it is not. There are times to invest in this Index, but now is not one of them. The distorted rise makes it unattractive currently. Bloated by the 9 Wall Street darlings gives it a great deal of hidden risk with limited upside. With this Index at 4,450, the P/E ratio for the whole Index is 25.25. Since the beginning of the last bull market in 2009, this P/E ratio has averaged 21.4. One standard deviation from the average is 5.0, which means this P/E ratio has been within plus or minus this amount 68 percent of the time, for a range of 26.4 to 16.4. The current P/E is near the high end of the range.



Gray Emerson Cardiff,
Editor Since 1988

For 2022, the *Sound Advice* model portfolio gained 4.02% versus a loss of 19.44% from the S&P 500.

Since 1999 through 2022, the *Sound Advice* model portfolio more than doubled the return of the S&P 500.

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The Sound Advice Risk Indicator

Another sign that the weighted S&P 500 is inflated is revealed from our **Sound Advice Risk Indicator** (page 10), which compares the (weighted) S&P 500 index to house prices for more than 125 years. The latest reading for June was 2.39 which is significantly above the high-risk watermark of 2.0.

The Sound Advice Diffusion Indexes

Our **Sound Advice Diffusion Indexes** (page 11) have had a trustworthy track record over the last 47 years. All market crashes have occurred during “Caution” signals. When the stock market was not crashing, the S&P 500 either meandered, climbed moderately, or declined in an extended bear market, recording an average decline of 0.6 percent. Conversely, during “Aggressive” signals, the S&P 500 climbed an average of 31.5 percent, and the market never crashed. These have been times of declining or low interest rates, along with declining or low inflation.

At the beginning of 2022, our **Sound Advice Diffusion Index of Lagging Indicators** was in “Caution” mode. Once again, this warning proved prophetic. The S&P 500 Index ended the year down 19.4 percent. In addition to telling us the general direction of stocks ahead, the “Caution” signal told us where to invest, such as areas that would benefit from rising inflation and interest rates while hedging for downside profits. As a result of heeding our caution signal and positioning our holdings accordingly, the *Sound Advice* portfolio gained 4.02 percent in 2022.

As we began 2023, we had a completely different situation. Our **Sound Advice Diffusion Index of Leading Indicators** dropped to zero in December 2022 (page 11). This signal revealed that the economy had softened sufficiently to allow room for interest rates to decline. This meant the end of the Federal Reserve’s interest rate hikes was visible, and we removed our “Caution” signal.

Our trustworthy **Sound Advice Diffusion Indexes** are telling us we are in a bull market now and have been since the beginning of the year. This makes investing in the S&P 500 stocks a good idea, but there is a much better alternative to the weighted index.

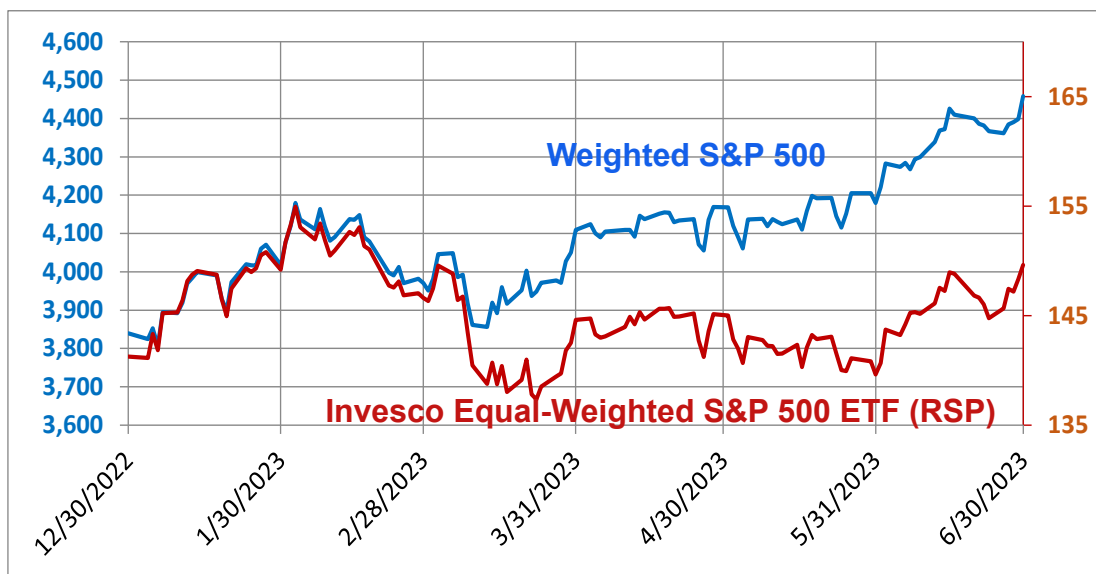
The Best S&P 500 ETF Now

Oddly, there are not many ETFs that invest in the S&P 500 stocks on an equally-weighted basis. But there is one good one. We are adding the **Invesco S&P 500 Equal Weight ETF (ticker symbol RSP)** to the portfolio. As its name implies, this ETF invests in all of the S&P 500 stocks but on an equally-weighted basis. RSP rebalances its portfolio each quarter to maintain its equal weights. This rebalancing process preserves value by reducing stocks that have recently outperformed while adding recent laggards.

The chart below shows the weighted S&P Index since the first of the year (in blue) and RSP which reflects the equally-weighted S&P 500 Index (in red).

The weighted S&P Index has increased significantly this year while the equally-weighted S&P 500 Index has increased only marginally, which is typical of the portfolios of most investors. However, that is not likely to be the case from now on.

S&P 500: Weighted Versus Unweighted



As the bloated 9 stocks that dominate the weighted S&P 500 languish or decline, the rest of the market is bound to rise as the bull market continues, which will give the equally-weighted version of the S&P 500 a superior performance.

Since its inception in 2003, RSP has outperformed the weighted S&P 500 Index during periods when technology bubbles imploded. The portfolio is currently light in technology stocks and heavy in mid-cap industrials, which is where we want to be. The P/E ratio of RSP’s portfolio is currently 19, which is 24 percent less than the P/E ratio of the weighted S&P Index. RSP trims the fat and offers a far better value.

The Sound Advice Model Portfolio

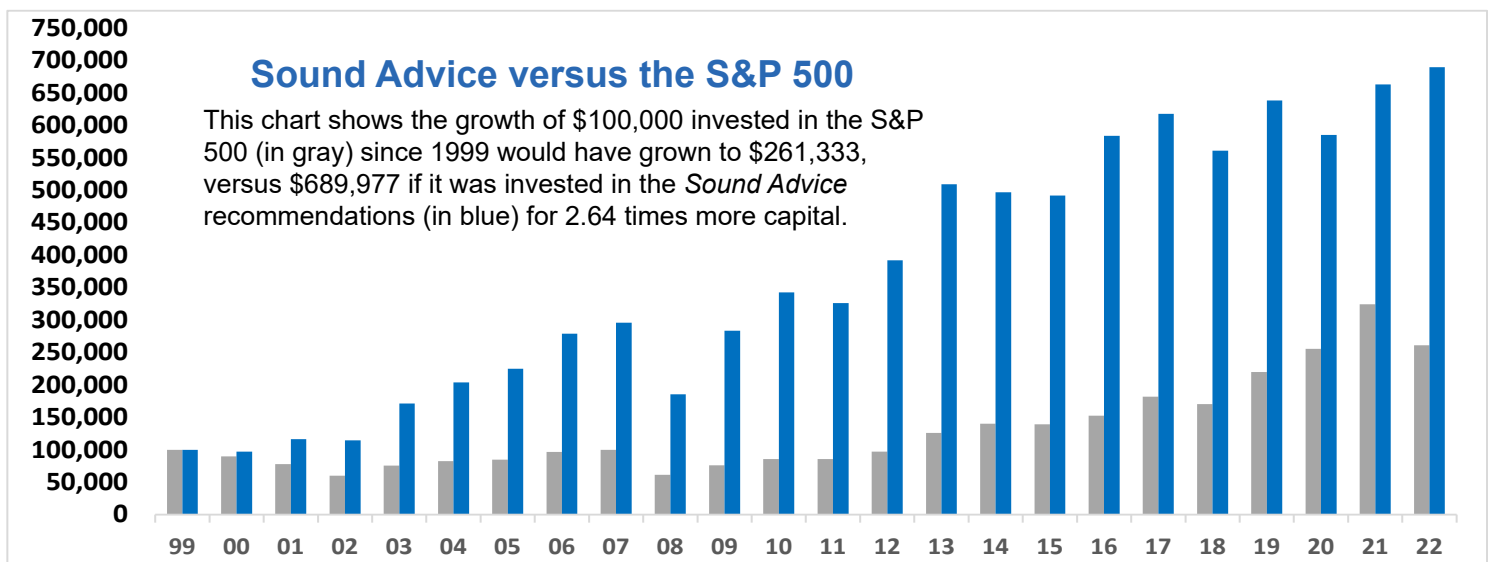
Our individual stock recommendations are special situations offering a compelling value proposition. We are also recommending liquid electronically traded funds (ETFs) investing in sectors that are bound to benefit in the months and years ahead. All of the recommendations, as well as their dividend yields, and buy/hold/sell recommendations, are summarized in the table on page 9 and sorted by investment objective categories and then in alphabetical order.

We eat our own cooking at *Sound Advice*. The editor and affiliates are investors in the [Sound Advice Diversified Growth Fund](#), which invests exclusively in all of the *Sound Advice* Model Portfolio recommendations. The editor is the manager and is also an investor in this Fund, on a side-by-side basis with other investors. You can request a prospectus on the log-in page you used to download this issue of *Sound Advice*.

A Downside Hedge

We include a downside hedge as part of the portfolio because it reduces risk and dampens volatility, especially during adverse market conditions. As our downside hedge, we have been using the [ProShares UltraShort Russell 2000 \(TWM\)](#) which short-sells the Russell 2000 Index. However, based on the reasoning discussed above, the we are switching our downside hedge to the [ProShares UltraShort S&P 500 \(SDS\)](#) which is designed to produce two times the daily fluctuations of the weighted S&P 500 Index. A decline of say, 1.0 percent in the Index will cause SDS to increase by 2.0 percent. Conversely, an increase in the Index will cause SDS to decline in the same fashion.

The Sound Advice Model Portfolio



ETFs for Rising Bond Yields

We have made large profits in these ETFs in recent years, However, we are likely near the peak of short-term interest rates because the economy is bound to be softening in the months ahead as the Federal Reserve maintains its battle to quell inflation, A softening economy, and certainly a recession, will be a downward force on long-term interest rates in the months ahead. **Therefore, for the time being, we are divesting of our two ETFs designed to benefit from rising long-term Treasury bond yields:**

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

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

Special Situations

The following stocks of individual companies presenting extraordinary values within their respective industries. Here they are in alphabetical order:

Apple (AAPL) was added to the portfolio in 2016 at \$29.08 per share (adjusted for the 4:1 split in 2020). When the price/earnings ratio (P/E) expanded, we recommended holding but not buying AAPL because high (P/E) ratios anticipate high growth rates which is a disaster waiting to happen. We are recommending buying under \$135 per share. This price target puts the TTM P/E at 22 which is on the high side for most stocks but a reasonable value for AAPL.

Cisco Systems (CSCO) introduced two new AI-focused networking chips in June, the Cisco Silicon One G200 and G202, which are uniquely positioned with advanced features to optimize AI workloads while lowering the cost, power, and latency of a network. Cisco is a direct beneficiary of the major upgrade cycle into the fifth generation (5G), which can download data 100 times faster than the previous generation of 4G. Operating in 5G requires upgrading to faster equipment. The rollout of 5G is just beginning which means several years of growth prospects are ahead.

Cisco is transitioning from a network equipment seller into a contractual subscription and services company that generates recurring revenues from the equipment it sells, leading to a more reliable income stream. During the past five years, CSCO's annual recurring subscription revenues and services have more than doubled and now represent close to one-half of total revenues.

Crown and Castle International (CCI) presents a relatively low risk way of investing in this high-tech area because of its unmatched portfolio of hard assets comprised of 40,000 towers, 115,000 small cells, and 85,000 route miles of fiber concentrated in the top US markets. Moves to 5G is increasing demand because it requires a higher density of large and small cell sites and related infrastructure. These assets are difficult to create because of scarce locations in urban areas, zoning and governmental regulations, and sheer cost. Furthermore, income is secure, and growth is assured because these assets are leased to credit-worthy tenants with pre-determined escalating rent clauses.

JP Morgan Chase (JPM) is a good value for what is considered to be the world's highest quality banking enterprise with diversified businesses and prudent underwriting policies. JPM became an even better value when it acquired most of the assets of the failed First Republic Bank during the last weekend of April. JPM has been taking substantial quarterly charges against earnings to anticipate and cover adverse circumstances that may lie ahead. The annual dividend is \$4.00 for an attractive yield.

Moderna (MRNA) is a pure investment play on Messenger RNA (mRNA) technology. This revolutionary technology is certain to provide solutions for not only vaccines, but cures and treatments for the most deadly and debilitating diseases haunting humanity.

The company has 48 programs in development, including 36 in ongoing clinical trials, and increased its 2023 R&D budget to \$4.5 billion. Moderna's strong balance sheet with essentially no debt should sustain the transition to new revolutionary vaccines and treatments, which offer tremendous upside potential.

Data continues to be promising regarding Moderna's personalized cancer vaccine used in combination with Merck's monoclonal antibody Keytruda. The personalized cancer vaccine uses cells from the patient's tumor and subjects them to RNA sequencing. They are designed to prime the immune system so that a patient can generate a tailored anti-tumor response specific to their tumor's mutation signature. The result of a phase 2 study was announced in June that a personalized cancer vaccine reduced the risk of cancer metastasis or death in melanoma by 65 percent on 157 patients with high-risk stage III/IV melanoma. A phase 3 study is on track to begin.

Also promising is Moderna's vaccine for the Respiratory Syncytial Virus (RSV), a lower respiratory tract disease, a highly contagious seasonal respiratory virus and a leading cause of lower respiratory tract infections and pneumonia.

Another significant development in the works is a new vaccine for the Cytomegalovirus (CMV) which is the leading cause of birth defects in the US. Potential revenues would be in the range of \$2 to \$5 billion annually.

Valero Energy (VLO) makes its money from the "crack spread", which is the profit margin derived from purchasing crude oil, turning it into refined products such as gasoline and jet fuel, and selling those refined products. Valero has the unique ability to achieve discounts for its crude oil feedstocks because it has the ability to refine a variety of crude oil types. This flexibility and access allow Valero to capture the highest margins among its competitors because it can take advantage of the temporary gluts of crude, whether it's low or high-quality crude, or light sweet (low sulfur) or heavy sour (high sulfur) crude, and receive the best available discounts for its feedstocks. The company's refineries also have access to the US pipeline network for delivery to its gulf coast locations.

VLO has declined recently over recession fears. However, the \$4.00 solid dividend is bound to put a floor under the stock in the vicinity of the current price and provide a buying opportunity.

Environmental policy-driven mandates have led to substantial closures of refining facilities in the US and Europe in recent years. This has reduced overall refining capacity dramatically, leaving shortages of refined products for the foreseeable future. Instead of reducing oil refining capacity, Valero is diversifying to a "green" company through its joint venture with Diamond Green Diesel, which is producing renewable diesel at large profit margins. 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 as the material originally contained. It does not gel at low temperatures which means it can be easily transported through pipelines. Cash flow from diesel production turned positive in 2016 and is increasing. Use for Sustainable Aviation Fuel (SAF) is expected to be a primary escalating demand factor. Valero's Port Arthur plant is being upgraded to produce close to 50 percent of the plant's current renewable diesel production capacity to Sustainable Aviation Fuel. After completion in 2025, this plant is expected to be one of the world's largest Sustainable Aviation Fuel manufacturers.

Real Estate

Our three cumulative preferred stocks provide very attractive high yields and are inherently safe because any unpaid dividends must be retroactively restored first before any common dividends can be paid. In addition, these preferred stocks have a "liquidation preference" which must be paid out in full in the event of a liquidation of the company before any proceeds are paid to common stockholders. There is substantial equity in the respective common stocks, evidencing that the market does not expect liquidation to be plausible. In all three cases, the value of each company's real estate portfolio would have to drop precipitously by an unprecedented amount from its current value before any portion of the liquidation preference would be jeopardized.

These preferred stocks are trading below the company's call price (the right of the company to purchase the preferred at a certain "call" price), or have no call feature at all, which is very unusual for preferred stocks. These preferred stocks have a small number of outstanding shares, which is typical for preferred stocks in general. Accordingly, we recommend using limit orders rather than market orders.

Hersha's Preferred D (HTPRD) was recommended when the stock price was under \$4.00 a share as the pandemic was gaining momentum in early 2020 and the company suspended all dividends to preserve liquidity. We believed that the eventual resumption and payment of preferred dividends would propel this stock back close

to its call price and liquidation preference value of \$25. In April 2021, the company resumed the dividends on its preferred stocks and made up for unpaid preferred dividends of \$1.64 per share annually. The price of this preferred recovered since the restoration of the dividend, but is still below its call price and liquidation preference of \$25, offering an attractive discount and high current yield.

This is one of three preferred stocks. The total dividends for all three preferred stocks were only 10.2 percent of the company's cash income in 2022. Accordingly, this income is secure because it could only be jeopardized by an unimaginable catastrophe.

Hersha Hospitality Trust is a real estate investment trust (REIT) which owns and operates luxury and lifestyle hotels in urban gateway and regional resort markets. The Company sold off 9 of its 33 hotels at good prices and reduced its debt from \$1.1 billion to \$405.2 million at the end of 2022. This debt reduction made Hersha one of the lowest-leveraged hotel REITs and increased the security of its preferred stocks.

RLJ's \$1.95 Series A Cumulative Convertible Preferred (RLJPRA) is RLJ's only preferred stock, and it cannot be converted into common stock until the price of the common stock is significantly above \$100 per share. This means that the preferred is essentially not callable without an astronomical rise in the price of the common stock (RLJ). This preferred stock has a liquidation preference of \$28.50 per share.

The dividends for this preferred was only 10.0 percent of the company's cash income in 2022, making this income secure.

RLJ Lodging Trust is a hotel investment company that owns premium-branded, high-margin, focused-service and compact full-service hotels. The Company's portfolio consists of 96 hotels with approximately 21,200 rooms located in 23 states. During the first half of this year, operating revenue from its hotel portfolio recovered beyond the pre-Covid level, and the company no longer has financial covenants requiring minimum financial performance measurements.

This is an opportunity to lock in a safe extraordinary current yield. It is hard to imagine that this yield will remain this high indefinitely, which means this preferred stock has upside potential.

RPT Realty 7.25% Series D Cumulative Convertible Perpetual Preferred (RPTPRD) is simply not callable by the company. This means that we can lock in a very high yield for as long as we desire. It pays an annual dividend of \$3.62, for a high current yield. This is the only preferred stock for RPT Realty. This is a convertible preferred stock, convertible into 3.796 shares of the common stock (RPT) at the holder's option, which offers long-term upside growth potential. This preferred stock has a liquidation preference of \$50 per share.

The dividends for this preferred were only 3.9 percent of the company's cash income in 2022, making this income secure.

RPT Realty is a real estate investment trust (REIT) that owns 57 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. RPT Realty substantially upgraded the quality of its portfolio over the past year, which resulted in strong leasing activity. Management believes the pandemic has washed out the weakest retailers and left the strongest who have right-sized their footprints, which will lead to increasing rents in the years ahead. Excluding recent acquisitions and properties under development, the occupancy of the company's 50 shopping centers held for one year or longer is 91.2 percent.

Sector ETFs

We are also recommending the following electronically traded funds (ETFs) investing in sectors that are bound to benefit in the months and years ahead from fundamental changes in geopolitical, medical, and economic landscapes. These ETFs contain a portfolio of stocks, much like a mutual fund, and they are liquid and trade like stocks with their own ticker symbols. Their prices are determined by the value of the portfolio of stocks they hold.

Artificial Intelligence

Global Robotics and Automation Index ETF (ROBO) is investing across the entire ecosystem of robotics and automation, aiming to capture automation as a mega trend. Close to 60 percent of the portfolio is in robotics technologies, and 40% is in the technology underneath the robots -- the sensing and computing actuation, AI, and integration. ROBO invests the whole ecosystem of automation because while growth in automation is relentless, it's not necessarily moving sector by sector in lockstep. ChatGPT, the open, generative artificial intelligence (AI) chatbot, is giving us a glimpse into the next technology frontier. Artificial intelligence will only grow smarter and play a greater role in the way we live our lives and the way companies around the world operate.

Since its inception in 2013, ROBO has essentially matched the return of the S&P 500 Index which is commendable considering the rise of the S&P 500 Index and the infancy of AI and robotics over that period. Based on the growth prospects of its holdings, this ETF is bound to out-perform the S&P 500 in the future.

Biotech ETFs

Biotech companies offer the most explosive profits because they are the source of the world's top breakthrough vaccines and treatments. Their stocks are often volatile, making diversification essential. This can be accomplished by investing in a diversified electronically traded fund (ETF) investing exclusively in a portfolio of biotech companies. We are recommending two offering timely buying opportunities.

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. Technological breakthroughs in artificial intelligence and other high-tech 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 many 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 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.

Balanced ETFs

The following ETFs rebalance their holdings quarterly to equalize the values, which ensures a greater degree of evenly weighted diversification and adds stability as well as safety to a portfolio. This practice often provides a superior performance because it offers exposure to many stocks that are under-weighted in most other portfolios and are therefore targets for new capital.

Health Care

One of the main criticisms of most health care ETFs is that they are dominated by a relatively small number of large companies, such as Johnson & Johnson, which distort the performance of the typical health care ETF portfolio. The remedy is to invest in an ETF that spreads its sections evenly on a percentage basis, rather than by the capitalization of the holdings. Historically, this equal-weight approach has worked well and provided a more stable and superior investment return. **Invesco's S&P 500 Equal Weight Health Care ETF (RSPH, formerly RYH)** tracks the S&P 500 Equal Weight Health Care Index, which tracks 65 health care stocks represented in the S&P 500, but weights each holding evenly. Both the Index and RYH are rebalanced quarterly. This approach has given RYH a better performance than the large health care ETFs over the last 10 years.

Health care stocks have several traits that make them desirable investments. They are well-suited for an aging population, which exerts disproportionate demands on the industry. As the world's population continues to age, this trend is inexorable, making the health care sector defensive in nature and more insulated from economic cycles than other sectors.

Consumer Staples

Invesco S&P 500 Equal Weight Consumer Staples ETF (RSPS, formerly RHS) invests consumer staple stocks within the S&P 500 Index. Consumer staples are 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.

US Infrastructure

The bi-partisan infrastructure bill enacted in November 2021 will benefit both of the following two ETFs for many years.

Invesco S&P SmallCap Industrials ETF (PSCI) is based on the S&P SmallCap 600 Capped Industrials Index which is designed to measure the overall performance of the securities of US industrial companies with small capitalizations (caps). These domestic companies are engaged in the business of providing industrial products and services, including engineering, heavy machinery, construction, electrical equipment, aerospace and defense, as well as general manufacturing. They will reflect the positive impacts more strongly than larger companies from an increase in infrastructure spending. Small cap construction companies are also typically domestic companies operating inside the US. It is likely that a government-sponsored program will stipulate that US companies are to be employed to perform the services. Even absent such stipulations, construction projects tend to employ local companies as subcontractors even when general contractors are national companies.

Invesco S&P 500 Equal Weight Materials ETF (RSPM, formerly RTM) invests in the common stocks that comprise the S&P 500 Equal Weight Materials Index. The portfolio contains prime examples of basic materials companies outside of the oil and gas industries. Basic materials companies are bound to benefit substantially in the years ahead with increased infrastructure spending. China's economic reopening from its Covid lock-down will also be exerting new demand for basic materials.

Portfolio Summary Table

Income with Growth	Symbol	Price / NAV	Yield	Action	Limit
Hersha Hospitality Trust - Preferred D *	HTPRD	\$19.75	8.20%	BUY	\$22.00
RLJ Lodging Trust - Preferred A *	RLJPRA	\$24.09	8.09%	BUY	\$28.50
RPT Realty 7.25% Preferred D *	RPTPRD	\$49.00	7.40%	BUY	\$50.00
Growth with Moderate Income					
Cisco Systems	CSCO	\$51.74	2.86%	BUY	\$54.00
Crown and Castle	CCI	\$113.94	5.49%	BUY	\$119.64
Invesco Consumer Staples ETF	RSPS	\$167.42	2.72%	BUY	\$173.00
JP Morgan Chase	JPM	\$145.44	2.75%	BUY	\$149.00
Valero	VLO	\$117.30	3.48%	BUY	\$123.00
Growth					
Apple	AAPL	\$193.97	0.42%	HOLD	\$135.00
Genomic Revolution Multi-Sector	ARKG	\$34.97	0.00%	BUY	\$36.50
Golbal Robotics & Automation ETF	ROBO	\$58.56	0.20%	BUY	\$62.00
Invesco Basic Materials ETF	RSPM	\$162.28	2.73%	BUY	\$167.00
Invesco Health Care ETF	RSPH	\$298.02	0.77%	BUY	\$310.00
Invesco Small Cap Industrials ETF	PSCI	\$104.10	0.96%	BUY	\$109.00
Moderna	MRNA	\$121.50	0.00%	BUY	\$130.00
S&P 500 Equal Weight ETF	RSP	\$149.64	2.17%	BUY	\$155.00
Virtus LifeSci Biotech Products	BBP	\$52.52	0.00%	BUY	\$55.00
ETFs for Rising Bond Yields					
ProShares Short 20+Treasury - 2X Leverage	TBT	\$29.40	2.76%	SELL	
ProShares Short 20+Treasury - No Leverage	TBF	\$21.69	2.63%	SELL	
Hedges					
ProShares UltraShort Russell 2000	TWM	\$13.97	1.57%	SELL	
ProShares UltraShort S&P 500	SDS	\$34.27	2.36%	BUY	\$36.00

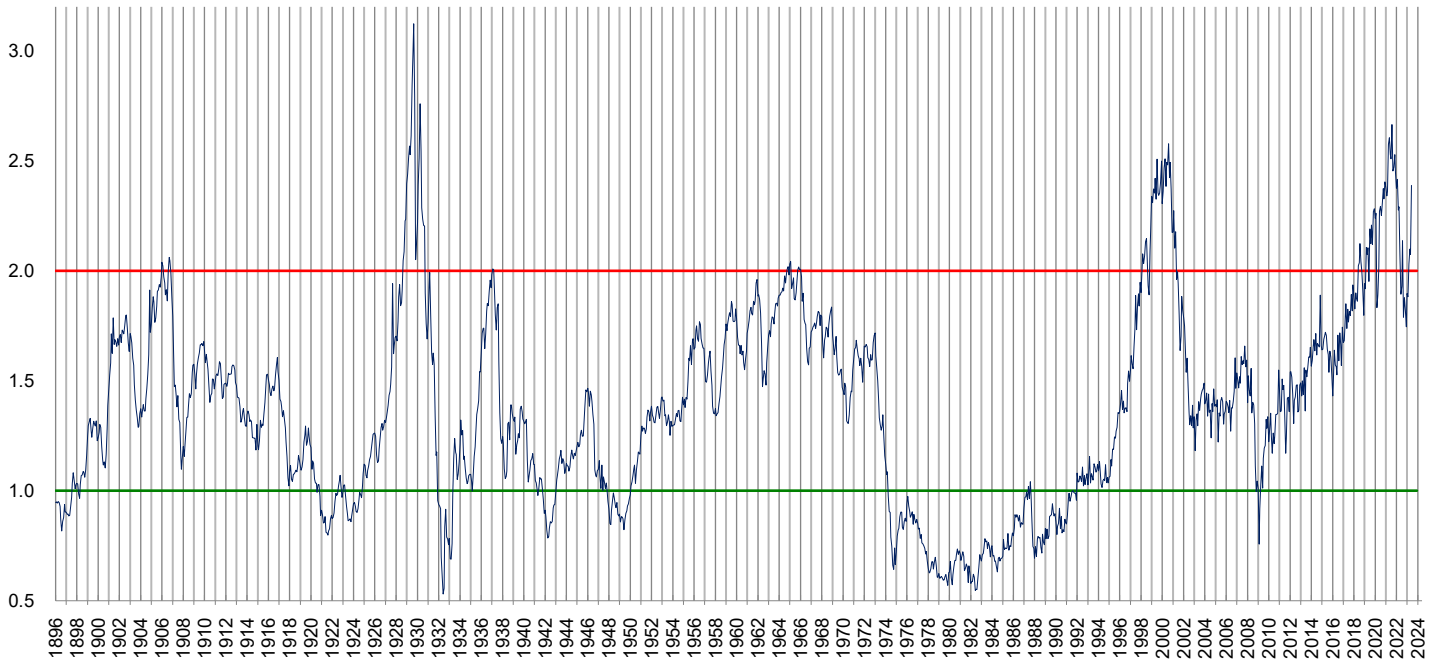
Note to the table: The right hand column is the highest recommended price limit for purchases.

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

If you are picking and choosing, you can focus on the sector of the portfolio that matches your investment objectives. 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 \$558 million versus \$26 million by simply holding stocks through the ups and downs, or 23 times more money.

With the latest median house price at 402,400 in April 2023 (the latest data) and with the S&P 500 averaging 4,351 in June, the **Sound Advice** Risk Indicator read 2.39.

The New York Times

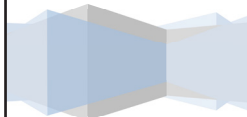
“Cardiff’s equation reveals an elegant financial minuet as each market takes turns outperforming the other.”

SoundAdvice

The Science of
Making Money in
the Stock Market

By Gray Emerson Cardiff

"Cardiff's equation reveals an elegant financial mirror
as each market takes turns outperforming the other"
-Dr. John Williams



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Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

The Risk Indicator reveals long macro cycles. An analogy can be made to the way radio waves work. Long radio waves have frequencies which are assigned to various radio stations, allowing you to distinguish them on your radio. Riding along the path of these long waves are short waves that produce the sound you actually hear on a particular station. These short waves are like the bull and bear markets revealed by the Diffusion Indexes.

While the path of the long cycles revealed by the Risk Indicator may be in a certain direction, there are bull and bear markets along the way. Of course, these relatively short bull and bear markets are significant during our investing careers. Even during times when the Sound Advice Risk Indicator is above the "low risk" reading, such as it is now, there have been substantial bull markets. We will rely on our Diffusion Indexes to reveal when that will be.

The data we need is contained in the leading and lagging economic indicators. 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.

To construct our *Sound Advice* Diffusion Indexes, we observe changes in each of our selected indicators over a five-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 five 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 December 2008, 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.

A Powerful Overriding Force

Most of the time, the Diffusion Indexes are excellent detectors of the natural business cycle and a path to the science of making money in the stock market. However, the forces of the natural business cycle can be dominated by extraordinary changes in monetary policy during emergency situations.

The COVID-19 pandemic was the most recent example. In mid-March 2020, the Federal Reserve declared the institution of its fourth "Quantitative Easing" (QE) program whereby it dropped the Federal Funds rate to zero and commenced buying massive amounts of US Treasury bonds. With its mighty power, the Fed drove down interest rates and infused massive amounts of liquidity into the US economy. The money supply mushroomed.

Track Record of the SoundAdvice Diffusion Indexes

Drumming the last 47+years, after each “Aggressive” signal, the S&P 500 climbed an average of 31.5 percent. During “Caution” signals, the S&P 500 either crashed, meandered, or climbed, recording an average decrease of 0.6 percent.

Signal Dates (Month-Year)			
Aggressive	S&P 500	Caution	S&P 500
Sep-74	68.12	Apr-76	101.9
Jul-76	104.20	Dec-76	104.7
Oct-78	100.58	Jun-79	101.7
Nov-79	100.00	Oct-83	167.7
Aug-84	164.48	Jun-85	188.9
Jul-86	240.18	Aug-87	329.4
Feb-88	258.13	Jun-88	270.7
Mar-89	280.00	Mar-93	449.7
Mar-95	493.15	Dec-98	1,141.0
Jun-00	1,429.40	Dec-00	1,320.3
Jun-03	974.50	May-05	1,191.5
Jun-06	1,276.66	Mar-08	1,325.4
Dec-08 (1)	865.58	Apr 10 (2)	1,197.3
Sep 10 (3)	1,122.08	Jun 12 (4)	1,359.8
Sep-12 (5)	1,437.82	Nov 14 (6)	2,044.6
Mar-15	2,079.99	May-15	2,111.9
Sep-17	2,492.84	Feb-18	2,705.2
Mar-20 (7)	2,761.98	Nov 21 (8)	4,667.4
Dec-22	3,912.38		
Ave +/-	31.5%		-0.6%

Quantitative Easing (QE) Overriding Signals

- (1) QE-1 announced 4 months before Aggressive signal
- (2) QE-1 terminated into existing Caution signal
- (3) QE-2 announced but already in Aggressive mode
- (4) QE-2 terminated into existing Caution signal
- (5) QE-3 announced, changed to Aggressive mode
- (6) QE-3 terminated into existing Caution signal
- (7) QE-4 announced, changed to Aggressive mode
- (8) QE-4 terminated into existing Caution signal

At times like this, we need to ignore readings from the Diffusion Indexes. Interest rates are dropping by the Federal Reserve’s mandate, just as if the Diffusion Index of Leading Indicators had plunged to zero. Conversely, whenever the Federal Reserve declares an end to its QE program, we return to our Diffusion Indexes to follow their readings. If the Diffusion Index has moved to a “Caution” signal during the QE program, we should follow that reading. This is the most likely pattern of events because the economy will likely have strengthened in order for the Federal Reserve to end its QE program.

The impact of the Federal Reserve’s four QE programs on existing Diffusion Index signals are noted in the footnotes under the track record table.

Current Status

Our current “Aggressive” mode was established by a zero reading for the Diffusion Index of LEADING Indicators in December 2022 based on the leading indicators for November 2022. This index dropped to zero again in March. It read 67 percent in May based on latest leading indicators.

Our next signal will be a “Caution” signal from a 100 percent reading from the Diffusion Index of LAGGING Indicators which recorded zero percent in May (the latest reading).