

## Greeks Bearing Gifts?



Hulbert's independent rankings of investment newsletters are out. *Sound Advice* made the Honor Roll again – this time for having the best average performance in both up and down markets since August, 1998. This follows our induction into Hulbert's 2011 Honor Roll for having the highest annualized return with the lowest level of risk since June 30, 1998.

I often compare investing with golfing. While both require a certain amount of skill and experience, there is a certain amount of luck involved. One of my favorite golf shots is the "son-in-law" shot – it wasn't what you expected, but it worked out okay.

Such is often is the case with investing. We put a great deal of effort into researching stocks and mutual funds, and I have 3+ decades of professional investing experience, but just plain dumb luck is always welcome.

Whether we have been lucky or good, our results so far this year are fortuitous – up 15.4%. While we don't expect to annualize these results, we are looking forward to more profits ahead.

We still have the green light from our Diffusion Indexes (see pages 10 and 11). While we had some encouraging news on the US economy, we still have a glut of foreclosed houses impeding a robust recovery (see pages 8 and 9). And Europe will have a dampening effect. However, all of this is leading to a low interest rate environment – the primary fuel for a bull market in stocks.

As usual, we will have to watch our steps and try to stay in the right stocks and mutual funds. And it will be more fun with a little dumb luck.

*-Gray Emerson Cardiff*

So far this year, the *Sound Advice* portfolio is up 15.4%, more than double the 6.7% rise in the S&P500. Twenty of the 26 *Sound Advice* model portfolio positions are up (14 by 10% or more), four are essentially unchanged, and two are down slightly. We have an average gain of 33% based on the price at which each stock or mutual fund was recommended.

We dedicated last month's Issue (*Sound Advice*, January 5, 2012), to the concerns we had about Europe, and the dampening effect it will have on the US and the rest of the world.

The European Financial Stability Fund (EFSF) has been established to help the weakest countries and their banks. However, we pointed out that the majority of the EFSF is capitalized by the weakest countries. Italy is 17.8% of the EFSF. Adding Greece (2.8%), Ireland (1.6%), and Portugal (2.5%) brings the total from countries in critical mass to 24.7% of the EFSF.

These are the nations we categorized to be in critical mass. Their debt loads are spiraling out of control because the cost of servicing their respective debts are increasing more quickly than their GDPs. If a nation reached this "critical mass", the risk of default is high.

Then there are countries in the danger zone – those heading toward critical mass. Adding countries in the danger zone: Spain's portion of 11.8% brings the total to 36.5%, France's portion of 20.3% brings the total to 56.8%, and adding Belgium's portion of 3.4% brings the total to 60.2%.

Since last month's Issue, S&P downgraded credit ratings for nine Eurozone countries: one-step downgrades were given to France, Austria, Malta, Slovakia, and Slovenia, and two-step downgrades were given to Italy, Portugal, Spain, and Cyprus. The reasoning for the downgrades was based on inadequate policies to address the systemic problems and not enough emphasis on growth. S&P also downgraded the EFSF by one step from AAA to AA+. We think that chances are high that more downgrades are coming.

The markets took these downgrades in stride for 3 probable reasons: (1) it was expected, (2) good news on the US economy dominated the headlines, and (3) the European Central Bank (ECB) has been very accommodating and is providing the European banking system with the liquidity it needs. European quantitative easing is ongoing and another quantitative easing program is scheduled for 2/29/2012 (leap year).

However, now that Greece's austerity program must be implemented in earnest, we will likely see some air pockets directly ahead. The Greek Parliament just approved the austerity

### The SoundAdvice Portfolio



### SoundAdvice vs S&P 500

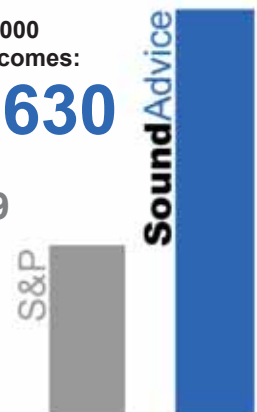
Since 1/1/2000  
\$25,000 becomes:

**\$79,630**

VS

**\$28,449**

with the  
S&P500



package - a gift of good faith. However it was amidst burning buildings set afire from demonstrators. The Greek labor minister resigned to protest the new austerity measures, and Greek union leaders warn that there will be a social uprising, starting with strikes. Unemployment is 21% and close to 50% for Greek youth. Elections for a new regime are in April and no one knows whether the new government will abide. It has been proposed that the €130B rescue funds be put into escrow to ensure austerity measures are taken.

Given the amount of sovereign bond funding needed in the immediate months ahead, the plight of the Eurozone will not be smooth nor painless, and likely to take more time than anyone wants. There will be many months, if not years ahead of major negotiations and adjustments that will likely erupt from time to time in economic and political turmoil. Several nations are currently in the grasp of severe recessions, and a total Eurozone recession of some degree seems unavoidable, especially given the austerity measures taking place. The only question is how long and deep it will run.

This doesn't mean that we should abandon US stocks. We are operating under the green light from the *Sound Advice* Diffusion Index of Leading Economic Indicators given in March 2009, very close to the bottom turning point of the market. Since then, our portfolio recommendations have produced an annualized return of 15.8%. Accordingly, we remain bullish on the market. We just need to be careful regarding our selections. We have pruned our portfolio of those companies and mutual funds with substantial exposure to the uncertainties of the Euro-zone.

## Portfolio Updates

Here is a progress report on our recommendations since the first of January.

**Agrium (AGU)** is up 23% this year, extending our profit to 582%. It is tempting to take such a large profit, but this stock is still strong and the fundamentals still look good.

This is North America's largest manufacturer of nitrogen-based fertilizers with more than 1,000 retail centers and the largest agricultural retailer in the United States. High prices for agriculture are driving farmers around the globe to invest in the products which aid them in growing their crops. Rising demand for agricultural commodities from developing countries has put rising pressure on land resources, pushing the need for fertilizer higher.

In North America, Australia and Western Europe, but especially here, the scientific use of fertilizer is commonplace. Elsewhere farming techniques often resemble what we used to do 40 years ago, or worse. Compare the situation in the US to that of China. The US accounts for 5% of the world's population but has 13% of its arable land. China, which holds 21% of the world's people has only 9% of its arable land. If emerging markets

are to meet their populations' need for food, they will either have to import foodstuffs from the more advanced countries or, better for the fertilizer industry, use fertilizer to improve their crop yields. Either way means more use of fertilizers.

Agrium's production facilities are located almost entirely in western Canada, where the cost of natural gas, the primary feedstock for producing nitrate-based fertilizers, is cheaper than in other areas of North America. Competitors elsewhere have higher costs.

Earnings more than doubled to \$9.40 per share in 2011, and are expected to increase strongly for the next several years. Although still a relatively low yield, the dividend quadrupled in 2011. At the current price, the stock has a price-to-earnings less than 10, which is attractive in view of the growth prospects.

**Leucadia (LUK)** is up 29%, bringing our profit to 42%. This is a holding company with a portfolio in excess of \$9 billion of assets that is as focused as the wide-ranging eyes of its two principals, Ian Cumming and Joseph Steinberg, who have been compared to Warren Buffett in their success at identifying lucrative investments that can be purchased substantially below their intrinsic value. In fact, Buffet has teamed up with the Leucadia team on joint venture investments.

We think that Leucadia is valued well below the market prices of its disparate parts. Cumming and Steinberg don't always get it right, but their successes far outweigh their errors. Owning shares in Leucadia is the best way we know of participating in the private equity market without paying outrageous fees to managers with mediocre performance. Instead, you get world class smarts at a very reasonable price.

**Transocean (RIG)** is up 28% this year. It operates the largest fleet of ultra deepwater drilling rigs in the world. Although high energy prices are generally a plus for Transocean, the company can flourish when oil prices remain above \$70 a barrel, a level that energy companies consider sufficient to justify aggressive exploration and development programs. However, the stock has been hammered for a number of reasons. The most notable was the disaster in the Gulf of Mexico because it was Transocean's ultra-deepwater drilling platform that was being used by British Petroleum.

Although the platform was covered by insurance, a cloud of uncertainty remained over the company regarding potential liabilities. However, in early January it was ruled by a federal judge in New Orleans that RIG was not liable for the clean-up costs. Rig could still face punitive damage claims and fines under the Clean Water Act, but this ruling substantially reduces Transocean's potential legal exposure and should facilitate a settlement with BP.

Another well disaster in Macondo goes to trial later this month but RIG's contracts with BP and Halliburton

indemnifies RIG except for gross negligence and willful misconduct, and RIG claims it did neither.

In addition, RIG has had to make costly upgrades to their equipment. As a result, RIG reported losses in two of the past four quarters, including an unexpected third-quarter loss of \$71 million (compared to a \$368 million profit a year earlier).

The stock is down nearly 50 percent from its March 2011 high of \$85.98 and has been trading in the low 40's for several months now. At the current price, the stock has an attractive dividend of 6%+ which should stabilize the stock price, and it has seemed to find a bottom in the midst of the plethora of bad news. Earnings are expected to continue to be poor this year. However, this bad news is temporary and will pass. A brighter day ahead means a recovery is in the offing. We think there are gains ahead as this stock recovers.

**CommonWealth REIT (CWH)** is up 23% on no significant new news other than it paid its quarterly dividend of 50 cents per share, which annualizes close to 10%. CWH owns 44 Central Business District office properties, 266 suburban office properties, and 179 industrial & other properties along with 17.9 million square feet of leased industrial and commercial lands located in Oahu, Hawaii, and 1.8 million square feet of office and industrial buildings located in Australia.

The market value of the real estate in this REIT translates to \$50 per share, more than double the current depressed price of the stock. There are plenty of funds from operations (FFO) to cover this extraordinarily high dividend. This is the best real estate bargain on the Street.

**Comcast (CMCSA)** is up 14% increasing our profit to 47%. This is considered the best managed cable company, and with its acquisition of AT&T's vast cable assets in 2004, and then its joint deal with Time Warner to acquire bankrupt Adelphia's cable business, it also became the largest cable company with 21.5 million subscribers. More recently Comcast has agreed to purchase a controlling interest in GE's NBC Universal division, which in addition to TV stations owns several lucrative cable channels as well as other content assets. Unlike the merger between AOL and TimeWarner, Comcast's purchase of media makes sense, since it has the transmission system to magnify the value of these assets.

**Tetra Tech (TTEK)** is up 12.6%, extending our profit to 58%. This is a turnaround story. We have followed the company's decline since 2003. It announced in early 2005 that it would terminate its exposure to the fiber optic telecommunications industry and would take significant write-downs. It was after that when we got interested.

TTEK had built its success—and it was a very successful company and stock for many years—on its design and engineering expertise in the areas of water reclamation and

environmental cleanups. In the late 1990s, management fell under the spell of the telecom revolution, and began to acquire small to medium-sized companies that designed and installed fiber optic systems. That was a great idea provided the rosy expectations that dominated the industry and Wall Street. As we all know, they did not materialize.

We like TTEK for its core businesses, and we also like TTEK's healthy balance sheet. But most of all we think that water and environmental remediation are growth industries both here and internationally.

Because Tetra Tech designs and engineers water and other projects that are potential targets for terrorists, the company is incorporating security infrastructure into its work, and believes this could be a lucrative business. In addition, TTEK has gotten involved in Iraq, clearing explosives from battle fields, which is an extension of work it does for the military.

But we think the biggest potential business for TTEK lies outside the United States in countries like China and India, where environmental concerns have been at best an afterthought. Only now are their governments starting to recognize the consequences. As governments around the world make this a priority, Tetra Tech should be a prime beneficiary.

Since our last Issue, TTEK was just awarded an \$18.6 million contract to improve energy efficient practices in Colombia.

**Stryker (SYK)** is up 10%, bringing our profit to 30%. It is best known for its orthopedic devices: artificial knees and hips, but it's much more. Stryker currently generates 45% of sales from its orthopedics division, 38% from its medical and surgical equipment division and 17.2% from its neurotechnology and spine segment. We expect this last category to expand most rapidly. Management has been buying back shares, and we agree.

**Maxim Integrated Products (MXIM)** reported earnings since our last issue that met expectations on revenue but beat expectations on earnings per share. It is up 5% this year, extending our profit to 37%. MXIM designs and distributes mixed-signal semiconductors, and is known for its sophisticated design of analog circuits. It has also carved out a position in high-volume chips for the handset market, where its power-management chips manage battery lives.

The company is in excellent financial health with \$1.0 billion of cash and plenty of cash flow to support operations and pay its quarterly dividend of \$0.22 per share (a 3.6% yield at the stock's current price). Even if MXIM's price ratios merely rise to the valuations of its average years, the share price will triple.

**UnitedHealth Group (UNH)** is up 3% extending our profit to 61%. It is among the largest Health Maintenance Organizations (HMO) in the United States, and continues

its strong recovery. UNH recently reported fourth quarter earnings that were 24% above the prior year quarter. Optum, its services business, is expanding at close to 9 percent per year. With only 6 percent of the market share, there is plenty of upside.

The company's strong financial position should facilitate expansion through investment in technology, research and development, and strategic acquisitions. Although we have a good profit, we are sticking with it for now. This year's earnings should be close to \$5.00 per share, so the stock has a P/E close to 10 which is attractive for a company with growth prospects.

**Symantec (SYMC)** is up 13% this year. As the world moves to smart phones, hackers are starting to find security holes. SYMC, the dominant supplier of software for computer security, is the company to plug them. This is a relatively new arena for Symantec products. It's difficult to gauge how lucrative this new dimension will be, but we expect at some point this facet will catch investor interest. Meanwhile, the shares are cheap on a relative basis.

**Boston Scientific (BSX)** is up 11% this year after being severely battered. The stock is scraping the bottom of its historical price ratios. Price to sales has not been this low for the last decade, nor has price to book value. International sales are picking up both in first world economies such as Japan but also in emerging economies in Asia and Latin America. Also, a new generation of stents is being introduced abroad (and shortly here in the US. Problems with the cardiac rhythm are being resolved, new products for minimally invasive procedures are rolling out and at some point Wall Street will take notice.

**Paychex (PAYX)** is up 5% this year. We have a small profit of 14% but expect more ahead. The company's core business is payroll services and focuses on small to medium sized companies, so its revenues and earnings directly mirror the employment situation. Naturally, the stock took a beating when the economy tanked. However, the company has kept sales and earnings stable, which has pushed valuations to very attractive levels.

The wonderful aspect of investing during economic downturns is that to find bargains, you have your pick among excellent companies with strong futures. Paychex is as good as they get: a dominant player in the payroll services sector, a debt-free balance sheet, and loads of potential for future growth.

For value-oriented investors who understand the business cycle, even at its current price, PAYX is trading at very attractive valuations. Going back to 1990, every standard price ratio currently is well below its historical average: Price/Sales is at 4.9 versus an average low of 6.4. Price/Cash Flow is at 17.5 versus an average low of 24.8. Price/Earnings is at 20.6 versus an average low of 30.7. Price/Book is at 7 versus an average low of 8.8. The current yield, another value metric, one that we can put in

our pocket, is at 4.6%.

This is a classic "buying straw hats in winter" opportunity that offers considerable potential for capital appreciation as well as a nice yield.

**Retail Opportunities Investment Corp (ROIC)** is essentially unchanged for the year so far. This REIT merged as an IPO in October 2009, a relatively odd moment to come to market. The REIT sector had just been decimated by the 2008 melt-down. This is precisely what attracts us to this REIT because it started with a fresh slate in a real estate market replete with bargains. It started with \$400 million in cash, no debt, and no problem legacy properties. As new cash flow is added by additional properties and tenant upgrades, the dividend continues to rise. It now stands at 48 cents for the year, and should continue to plump up along with the price of this REIT.

**Associated Estates Realty Corp (AEC)** is also essentially unchanged for the year. This is a good value because the price of this apartment REIT is 30% below the equity value of its portfolio, and the yield is 4%. AEC owns apartment properties, one of the most successful REIT sectors over the last two years as demand for apartments has surged thanks to the abrupt fall in home ownership, which in turn has been fueled by two factors: first, millions of homeowners find themselves unable to make their mortgage payments or find them too onerous given the drastic drop in home values and second, the whole idea of owning a home has lost its luster. Rents are rising and residential real estate investment trusts have outpaced other REIT sectors.

**Xerox (XRX)** is also unchanged. For a time, XRX teetered on the edge of bankruptcy due to excruciatingly poor management. The collapse of its bread-and-butter businesses that centered on black and white copiers was caused by its own missteps as well as the aggressiveness of competitors (primarily Japanese and Korean).

Today, XRX has new management, and a new focus that builds on the company's hardware which has always been innovative. Xerox has plenty of opportunities to maximize revenues and profits. Its commercial printing presses (called "digital printing") represent the next-generation for the printing industry, and allow for the production of high quality, full color, small individualized runs that have great appeal to companies dealing with consumers. After having survived a near-death experience, the stock is cheap. But earnings are growing again.

**Johnson & Johnson (JNJ)** is also essentially unchanged for the year. JNJ can be seen as a mutual fund for healthcare, since its multitude of divisions (200 and counting) dominate most of the businesses in which they operate.

JNJ's fall from grace (it was once one of the fastest growing healthcare stocks) results from several factors: first, healthcare stocks, especially those with a

pharmaceutical bias, have been out of favor for the last few years; second, JNJ disappointed Wall Street as medical devices and pharmaceutical revenues stagnated. Lately, as its consumer products division repeatedly has recalled products for a range of reasons, some benign, some modestly difficult, the shares have gotten knocked down. Finally, all mega-cap stocks have been in Wall Street's doghouse for the last five years, and JNJ certainly is among the most mega.

Looking at valuations, all are flashing bargain. Even in recession, this company is cheap. Compared to valuations during the last recession (2002), JNJ is markedly cheaper today. The balance sheet is bulletproof, one of the best in America. All the product safety issues they have had recently will be behind them, and they have a strong pipeline of products.

We like situations like this, since we think that Wall Street's moodiness about JNJ's problems accounts for the stock price weakness, but has nothing to do with JNJ's future. The news ahead can only get better.

**Pfizer (PFE)** is down 3% this year, reducing our profit to 22.5%. Pfizer continues to develop new drugs and to supplement in-house products. It is also partnering with other companies, especially junior firms long on new products but short on funds as well as marketing muscle, to complete drug testing and market these products.

For instance, Pfizer now owns a hunk of Elan, an Irish drug maker, to conclude development of a drug to blunt Alzheimer's Disease. We expect that PFE can double over the next few years thanks to its own efforts and an improving market for its products both here and at home. An aging population and international expansion are creating new markets.

## Mutual Funds

**CGM Real Estate Fund (CGMRX)** is up 10.5% this year, bringing our gain to 55%, and we think more profits are ahead. This fund put on quite a fireworks show between 2003 and 2007 (+89.7%, +35.5%, +27%, +29%, +34.4%). We made a 145% profit during that period.

The fund's manager, Ken Heebner, who has run the fund since inception in 1995, is known as "The Mad Bomber" because he has never been considered cautious. He either outperforms or underperforms significantly, and this fund can be volatile.

But Heebner's good years are really good, We watch his portfolio choices closely, so that we can judge whether the holdings make sense to us. We got back into it again after the 2008-09 crash in REIT prices. Heebner has shaped his portfolio for maximum profits. His biggest bets are in residential (26% of his portfolio and retail at 21%).

**The Fidelity Select Natural Gas Fund (FSNGX)** is up 7% this year but still stands at less than half of where it

traded in June 2008. Our rationale for moving to FSNGX starts the historically wide gap between natural gas and oil prices, and presumes that current spot prices for natural gas are too low. Historically West Texas Intermediate Crude oil relative to Henry Hub Natural Gas natural gas has traded at about 10:1. The super-surge for energy in 2008 drove that ratio down to 6:1 as natural gas prices spiked even higher than did the price of oil. Today, that ratio is close to 27:1. Were the historical ratio the measure today, natural gas should be trading at around \$9.77 per thousand BTUs (British Thermal Units), which is more than double its current price.

Considering its environmental superiority to oil and coal as well as its rock-bottom price, natural gas, should play catch up to oil. We do not have a profit yet but we expect one because producers are cutting back on production which will lead to higher gas prices.

**Hambrecht & Quist Life Sciences Fund (HQL)** is up 17 percent this year, extending our profit to 32%. This is a closed-end fund (CEF), which means it trades not at its Net Asset Value (NAV) but at whatever price the market sets, which can create a discount or a premium to NAV. HQL at the end of 2011 was trading at a discount to 9.7% from as low as 8% in late spring. We think HQL is a superior way to gain exposure to biotech, which admittedly is a volatile sector. However, the most explosive profits in the entire healthcare industry can be found here. HQL is an attractive way to participate on a diversified basis, especially given the larger discount from NAV.

**Columbia Seligman Premium Technology Fund (STK)** is up 15.4% this year. This is a closed-end fund, that enjoys an admirable pedigree but also has a conservative twist that provides some cushion from the tech sector's often rough ride.

Technology investing over the last two decades has been a feast or famine experience. Feast during the 1990s. Famine from 2000 to 2003 and again in the 2008-2009 meltdown. During the most recent recovery that dates back to March 2009, the Nasdaq, which is heavily populated by tech stocks, has led the other benchmarks.

This fund sells covered options against its portfolio which lowers volatility and produces cash income. This fund just declared its first quarter distribution of 46.25 cents per share, which is a 10 percent annualized yield.

**Third Avenue Focused Credit Fund (TFCVX)** is up 6.2%, bouncing off the low end of its trading range and sporting a 7.5% yield. TFCVX prides itself on its research and risk management, and in a difficult market such as 2011 it was busy making its portfolio more defensive by increasing its cash position and by selling off equity positions acquired when some of its holdings reorganized their debt, swapping equity for debt. But it was not passive when it came to deploying cash. It put \$190 million into existing positions that were selling at 68% of par, and

selling off positions that had risen above its upper limit (108% of par). We do not have a profit here yet, but we think there are rich opportunities in distressed credits.

**USAA Precious Metals & Minerals Fund (USAGX)** is up 10 percent this year, extending our profit to 35%. This fund is widely recognized as the best diversified way to invest in precious metals. Lipper, for example, rates it as the best performer in its sector over the past ten years, and it regularly has been included among the top-performing funds over shorter durations. *Morningstar* also puts it first among precious metals funds over the past three, five and ten year periods. And there's more, or should we say less: USAGX has accomplished this without taking on oversized risk. As *Morningstar* observes: "Over the past 10 years, the fund's standard deviation is only slightly higher than that of its peer group over the same period". So, this fund has posted the best returns in the category accompanied by slightly above-average volatility". *Morningstar* gauges that the fund has outdistanced other precious metals funds by 4.4% annually over the last decade.

Mark Johnson, who has managed the fund for the past 17 years, has shown a talent at making the right decisions during his tenure, and, since we consider funds managed by industry veterans superior to index funds, we cannot think of a better way to play gold and precious metals than this fund.

## Action Items

**Masco (MAS)** is up 21.5% since the first of January, increasing our gain to 71%. This stock has risen above our buy limit of \$11.6, so we advise waiting for a dip. MAS manufactures a wide range of products for home construction and remodeling. Masco covers everything from kitchen cabinets and faucets to windows and paint. Its brands such as Delta, Milgard, and Behr are well known to anyone who spends time at the hardware store. Not surprisingly the shares got hammered during the downturn. Management has been through tough times before, and began cutting costs even before the housing sector went into free-fall.

We added MAS to the *Sound Advice* portfolio in October last year at \$7.49, when it was languishing in the doldrums. Masco offered several attractions. For example, the price to sales ratio had not been that low in over a decade. Although losses had wiped out earnings, a significant portion of those losses represented the writing off of goodwill, which represented the price paid for acquisitions in excess of their tangible book value. However, we believed that the worst was over and the risk was out of the stock.

**For the reasons we discuss below, this is an excellent time to add both Tellabs and AHM Healthcare to your portfolio. If you already own these stocks, we are recommending you add them again to your position.**

**Tellabs (TLAB)** is down 5% this year, which is about the same as our loss since its inclusion into the portfolio. Tellabs designs and manufactures hardware for the telecommunications industry, which in a world of exploding demand for wireless communications should be a bonanza of a business. However, Tellabs has been slow to move its product lines as telecom service migrates into wireless, and has been one of the worst performers in the S&P.

Now, however, Tellabs is fast-tracking development of new products for wireless service. There's no question that the explosion of smart phones, tablet computers and wireless communication is testing the limits of telecom infrastructure. Tellabs should be able to gain a significant portion of that market.

Even if it should fail to complete the transition in its products, it remains an attractive takeover candidate. Consider that Tellabs' balance sheet holds \$2.91 per share in cash and cash equivalents (short-term government debt or commercial paper) with no long-term debt. Other assets and liabilities on the balance sheet offset each other. Subtract that \$2.91 from the current share price and you are buying the entire business for 92 cents - practically nothing.

At its current share price, the shares trade cheaply. If we look back over the last 23 years and calculate valuations at the shares' highs and lows each year, we can get a sense of how much or little investors have been willing to pay for Tellabs.

Price-to-Sales over the last 23 years, which includes the bubble years when the ratio ran as high as the low teens, has had an average historical low of 2. Currently Price-to-Sales stands at 1.07. Price to Cash Flow over the same period has averaged at its high 33.8 and at its low 14.2. Currently P/CF is 11.7. As for Price/Book Value, historically it has run as high as 12; its average high has been 5.3 and its historical low average has been 2.8. Currently it's 0.9. TLAB seems to have found a floor at around \$3.80 to \$4.00 per share. We think there is very little downside risk at the current stock price and loads of upside.

**AHM Healthcare (AHS)** is up 23% this year but it is still cheap. This company provides temporary health care staffing services to the healthcare industry, ranging from nurses to physicians. When we first recommended this stock in early 2011, it rocketed 45% in three months compared to a 3% gain for the Wilshire 5000 and 10% for the XLV, the SPDR healthcare ETF. The share price has since pulled back, affording another buying opportunity.

That run up in price provides a roadmap for how we expect AHM will play out. At that time, the shares tracked optimism about the economy, and especially job creation. As we explained: The rationale for buying AMN Healthcare is a two-fer. AMN is not just an opportunity to invest in healthcare, which is traditionally a non-cyclical industry, but it is also a chance to buy into a health care business

Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Associated Estates Realty Corp	AEC	NYSE/Nasdaq	16.05	4.24%	18.25	BUY
CommonWealth REIT	CWH	NYSE	20.45	9.78%	22.00	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	11.99	3.34%	13.50	BUY
Diversified Growth						
CGM Realty Fund	CGMRX	800-343-5678	29.62	0.88%	-	BUY
Comcast	CMCSA	NASDAQ	26.98	1.67%	28.00	BUY
Johnson & Johnson	JNJ	NYSE	65.22	3.50%	71.00	BUY
Leucadia National Corp.	LUK	NYSE	29.33	0.85%	30.00	BUY
<b>Masco</b>	<b>MAS</b>	<b>NYSE</b>	<b>12.73</b>	<b>2.36%</b>	<b>11.50</b>	<b>HOLD</b>
Paychex	PAYX	NASDAQ	31.60	4.05%	35.00	BUY
Pfizer	PFE	NYSE	20.94	4.20%	23.00	BUY
Stryker Corp.	SYK	NYSE	54.66	1.56%	60.00	BUY
UnitedHealth Group	UNH	NYSE	52.09	1.25%	53.00	BUY
Xerox	XRX	NYSE	7.96	2.14%	9.00	BUY
Energy/Natural Resources						
Agrium	AGU	NYSE/TSE	82.38	0.55%	90.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	32.52	0.17%	-	BUY
Tetra Tech	TTEK	NASDAQ	24.32	0.00%	28.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	34.09	0.24%	-	BUY
Aggressive Growth						
<b>AMN Healthcare</b>	<b>AHS</b>	<b>NYSE</b>	<b>5.46</b>	<b>0.00%</b>	<b>7.00</b>	<b>BUY</b>
Boston Scientific	BSX	NYSE	5.91	0.00%	8.50	BUY
H&Q Life Sciences Fund	HQL	NYSE	13.45	8.03%	15.00	BUY
Maxim Integrated	MXIM	NASDAQ	27.40	3.21%	29.00	BUY
Seligman Premium Tech Fund	STK	NYSE	18.08	10.23%	20.00	BUY
Symantec	SYMC	NASDAQ	17.63	0.00%	19.00	BUY
<b>Tellabs</b>	<b>TLAB</b>	<b>NASDAQ</b>	<b>3.82</b>	<b>2.09%</b>	<b>5.00</b>	<b>BUY</b>
Third Avenue Focused Credit Fd	TFCVX	800-443-1021	10.11	7.50%	-	BUY
Transocean	RIG	NYSE	49.41	6.40%	60.00	BUY

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

that will benefit from a recovery in the economy.

When you need medical care for a serious issue—unlike wanting a new HD TV or dreaming about a vacation to Maui—you spend the money to take care of that need. But in a tight economy and job market, not only have many postponed elective or non-urgent medical care, which diminishes demand, but also many nurses, doctors and other skilled professionals who in better times might retire, take leaves or move on to new positions to hold on to their current jobs. And when medical facilities have to reduce staff, the first to go usually are the temporary workers. In short, AHM is a healthcare stock that will benefit from a recovery in the economy. Meanwhile, at current valuations, we see very little downside risk.

Over the last decade, Price to Sales at today's 0.2 has never been lower, and only in recessionary 2008 has

Price to Book (1.3) been smaller (1.0). Due to write-offs of goodwill, both earnings and cash flow have been vaporized, but we expect both earnings and cash flow to return in future quarters. Looking forward, a recovering economy augurs well for AHM's future. Looking backward at historical valuations, we see the shares as deeply undervalued. Finally, the shares' performance between February 2011 and July, as investors first anticipated a more robust economic recovery and then gave up that perspective, shows us what AHM can do.

Since our last issue, AHS completed the sale of its home healthcare business to allow sharper focus on its core business of supplying healthcare professionals into temporary and permanent positions. We see a lot of upside in this stock.

The rising swell of home foreclosures began in 2007 as a symptom of faltering real estate markets across the country. But as the swell turned into a tidal wave, falling real estate prices have compromised the assets of the US banking system and the fabric of the US and worldwide economies. Indeed, the state of the nation's real estate markets and the economy have become one and the same. Clearly, the recession cannot be fully put behind us and a recovery kick into full gear until the inventory of foreclosed homes stops overhanging the market.

We have seen all this before. It was back in the 1980s. After years of loose and questionable lending practices, regulators were forced to liquidate hundreds of savings and loans and dump their foreclosed real estate onto an already-depressed real estate market. As values dropped, the downward spiral continued until most of the real estate was sold at steep discounts. The crash was worse in some parts of the country, but the damage to the whole US economy was substantial. Does this sound familiar?

We have the same situation today. It's like the old good news/bad news jokes, except this is no laughing matter. The bad news is that today's crash has been damaging to both real estate prices and the national economy.

The good news is that we have the tools to determine when the bad news will be over. This will give us a tremendous opportunity not only to invest in real estate for pennies on the dollar at the right time, but also in other investments as well as those that benefit from a recovering economy.

**The Key Indicator**

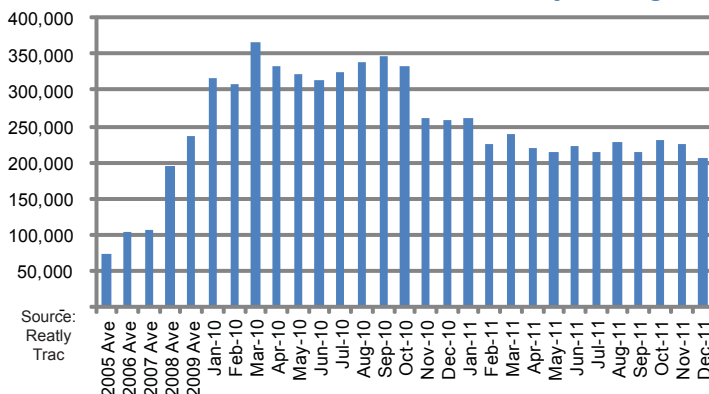
The secret is to focus on foreclosure rates. Realty Trac in Irvine, California has an extensive database. You can access foreclosure information on local markets from their website [www.realtytrac.com](http://www.realtytrac.com). We use some of their data here to gauge the state of the nation and its real estate, and plan to continue to do so in future issues of **SoundAdvice**.

What we are looking for is a significant decline in the number of foreclosures. When this happens, the bulk of the overhanging inventory of foreclosed properties will have been digested, and the real estate recovery can then begin as well as in the economy. In the late 1980s, this was the best indicator for knowing when the recovery was near. As foreclosure rates dropped, the ensuing recovery began. For nearly two decades, fortunes were made from real estate purchased for pennies on the dollar during the S&L Crises of the 1980s.

The following chart shows US foreclosure rates. In 2005, foreclosure rates averaged 74,892 properties per month. In 2006 and 2007, foreclosures were slightly above 100,000 per month. However, by January 2010, foreclosures climbed to over 300,000 per month, and foreclosures continued at over 300,000 each month through October.

We saw the beginnings of a decline in the 2010 fourth quarter. At first, the decline was due largely to a freeze in foreclosures by several major lenders. The downtrend continued as Federal and state foreclosure prevention efforts allowed distressed homeowners to stave off foreclosures.

**US Foreclosure Rates - Monthly Averages**



However, foreclosure rates remained stubbornly high throughout 2011.

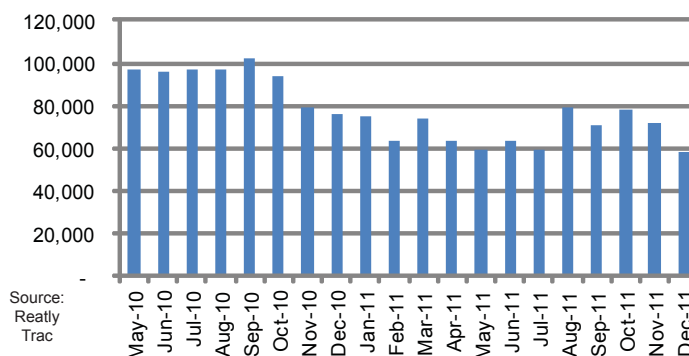
**Dissecting the Foreclosure Process**

It's important to keep in mind that the foreclosure process is comprised of three distinct stages: new default filings by lenders; then auctions as lenders attempt to sell these properties; and finally, bank repossessions of those properties not sold through auctions. The sheer number of foreclosures is actually the aggregate of the number of properties in each of these three stages.

We can get an early glimpse of a change in trends by focusing on changes in the first step of the foreclosure process: new default filings. After all, a significant change in the first step of the foreclosure process must ultimately lead to a significant change in the aggregate number.

The following chart shows new default filings in the US by month since May 2010. Through October 2010, new default notices were hovering around 100,000 per month. However in November 2010 they began declining. However, new default rates have remained relatively high, bouncing between 60,000 to 80,000 per month.

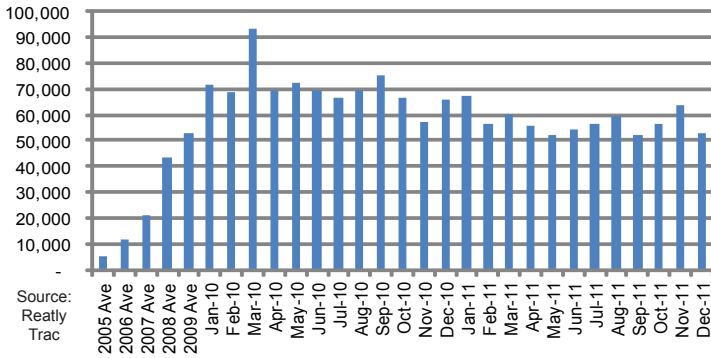
**US New Default Notices**



One fourth of the nation's foreclosures have been in California for the last few years. The following chart shows all stages of the foreclosure process in California (including auctions and bank repossessions).

In 2005, California foreclosures averaged 5,138 properties per month. Foreclosures doubled in 2006, and again in 2007, and again in 2008. By 2010, foreclosures

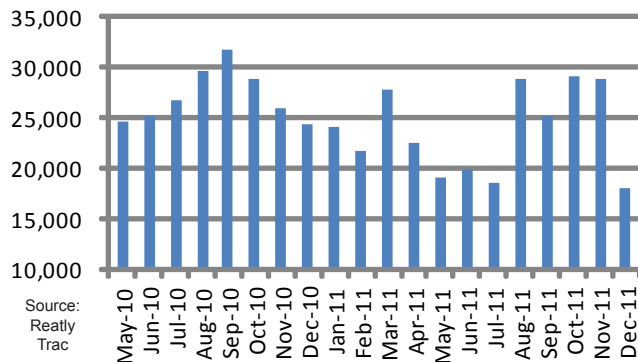
California Foreclosures - Monthly Averages



were close to 70,000 each month, with a spike of 93,000 in March. Foreclosure rates remained high in 2011.

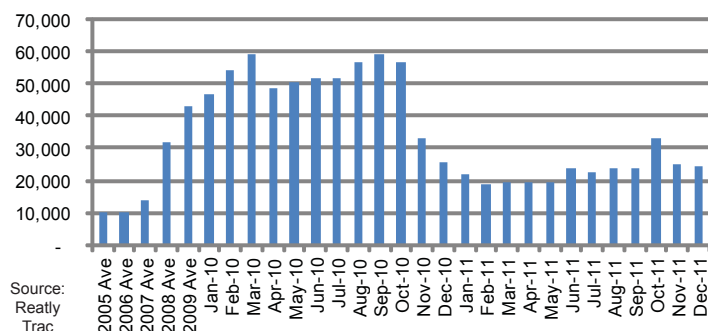
Below is a chart of new default notices in California. In August 2011, new default notices in California jumped a whopping 55 percent to 28,961. After a decline in September by 13 percent, new default notices in California increased in October to 29,240 and in November to 28,897, but then dropped sharply in December. However, one month does not make a trend.

California New Default Filings

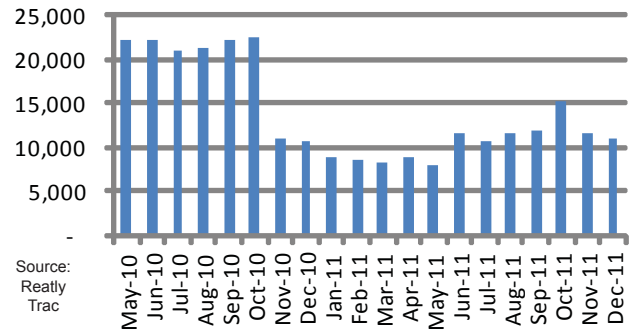


Florida is the next highest foreclosure state with 11 percent of the nation's foreclosures. See the chart below. Foreclosure rates climbed from 10,000 per month in 2005 and 2006 to 47,000 in January 2010, and stayed in the 50-60,000 range through October. Then the monthly rates dropped sharply through May 2011. However, foreclosure rates have been creeping up again, and spiked in October.

Florida Foreclosures - Monthly Averages



Florida New Default Filings

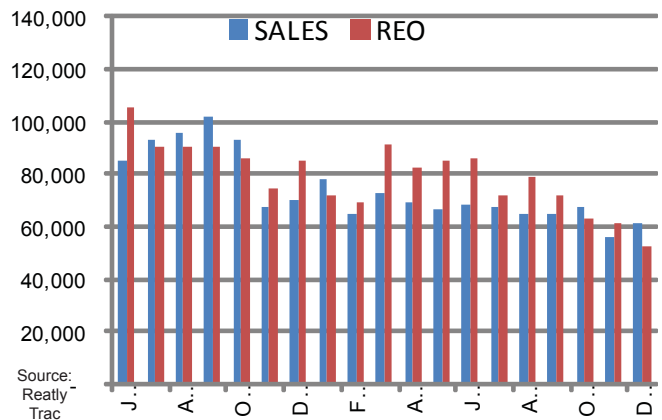


As an indication of what lies ahead, new default notices have been increasing in Florida during the second half of 2011, with a spike in October.

The Inventory

At the other end of the foreclosure process is what the banks have not been able to sell. This inventory is called "real estate owned", or REO for short. Each month more REO is added to the inventory. However, each month there are a number of properties sold from the inventory. Below is a chart of the REO (in red) and sales (in blue) since June, 2010.

On balance, there have been 98,429 more properties sold than have been added to the REO inventory, or 7.5 percent of the current inventory of 1,346,080 foreclosure properties listed for sale.



Conclusions

Not much REO is selling. The decline of new default filings in California is encouraging. But it is only one month - December - and a seasonal month, which could be a fluke. Otherwise, there is no conclusive evidence that the crisis is getting any better.

We will be tracking foreclosure metrics closely both nationally and in key states in these pages of SoundAdvice to be among the first to know when the end of the foreclosure crisis is at hand. Stay tuned.

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

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

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

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

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

What is too high? When stock prices are very high relative to house prices, the 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 Risk Indicator has oscillated back and forth, revealing the ongoing struggle between Stocks and houses for investment capital. We have labeled these long vacillations Supercycles.

The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$7,897,588 in stocks and to \$1,118,617 in houses.

But though an investment begun with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the Risk Indicator he would have made \$313,896,694, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the Risk Indicator would have provided.

These figures illustrate why it is so important to remain aware of the Supercycles that are at work within markets. A recent example was during the 1998-2000 stock market mania, when most investors were chasing high-tech stocks, our *Sound Advice* portfolio was buying Real Estate Investment Trusts (REITs.) Most investors got killed with 75 percent-90 percent losses during the ensuing decline. However, REIT shares during the same period soared 25 percent, and had locked in nearly double-digit dividends. When the bear market ended in late 2002 and tech stocks recaptured some of their losses, REITs rolled to mind-boggling highs as speculation drove them to excess that climaxed in 2007.

### The SoundAdvice Risk Indicator

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

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



## Business Cycles and Stocks: The **SoundAdvice** Diffusion Indexes

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

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

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

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

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

giving us an "Aggressive" signal.

An "Aggressive" signal coming at a time when the Risk Indicator is close to 1.0 reveals that Supercycle 5 has come to an end, and that Supercycle 6 is born. The current reading of the Diffusion Index of Leading Indicators is 50 percent, which does not change our market perspective. That will change only with a signal from the Lagging Indicators.

**The Diffusion Index of Lagging Indicators** gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading which would reveal an overheating economy with immediate inflationary pressures ahead. Our next signal will come from this Index. This Diffusion Index currently stands at 66.7 percent.

### Track Record of the Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 produces an annual average return of 23.7 percent. During "Caution" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased at an annual rate of only 1.62 percent during caution periods.

Aggressive	S&P	Caution	S&P
Sep-74	68.12	Apr-76	101.90
Nov-79	100.00	Oct-83	167.65
Dec-84	164.48	Jun-85	188.89
Jul-86	240.18	Aug-87	329.36
Mar-88	265.74	Jun-88	270.68
Mar-89	280.00	May-89	313.93
Oct-89	347.40	Mar-93	449.74
Feb-97	798.38	Dec-98	1,141.00
Oct-00	1,429.40	Dec-00	1,320.28
Jun-03	974.50	May-05	1,191.50
Jul-06	1,276.66	Mar-08	1,325.43
Apr-09	865.33		

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

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