



In my early days in the investment world, I often wondered how markets get so crazy. I read history to find the answer, only to discover history is riddled with a constant procession of extreme cycles in financial markets, replete with bubbles that were inevitably followed by huge reversals - times that look positively idiotic in hindsight. I would wonder: What were investors thinking?

And then I moved from electrical engineering to a major Wall Street firm, and became a "Wall Street professional". Only then did the answers start to become clear.

Wall Street professionals are faced with the endless task of investing money for others. Not just when things look particularly good, but immediately.

Take long-term Treasury bonds. No Wall Street professional believes that an investment for the next 30 years for 3 percent annually could possibly be a good investment for the next three decades. However, for the capital that needs to be invested right now for the best possible return, this is one of the better alternatives right now in view of the paltry returns available elsewhere.

There are very few mavericks, stepping out of the mainstream of popular investments, where mistakes or imprecise timing would be lethal to their careers. By running with the crowd, mistakes will not stand out.

It is the correction of these extreme distortions that provide fabulous investment opportunities - the kind that only come around a few times in a lifetime.

By contrast, individual investors like us do not have an endless source of capital, and we are not forced to invest right now. We have nest eggs, and they can only be invested a limited number of times. So we need to be more patient, and wait for those fabulous investments opportunities.

*-Gray Emerson Cardiff*

## It Was A Very Good Year

The *Sound Advice* portfolio was up 27.9 percent in 2012. This compares to 13.4 percent for the S&P 500. We have an average gain in the *Sound Advice* Model Portfolio of 45.8 percent based on the prices at which each stock or mutual fund was recommended.

In this Issue, we update all of our current recommendations. We begin with our "No-Brainers", the reverse ETFs that will benefit strongly from a rise in yields on long-term Treasury bonds. We then update all of our other recommended positions in alphabetical order. The table on page 7 details buy limits and other information on each recommendation.

Our No-Brainer ETFs advanced since our last issue dated December 4, 2012:

The most responsive ETF, the **Direxion Daily 20 Plus Year Bear 3 Shares (TMV-NYSE)** which uses 3 to one leverage, was up 8.9 percent.

The **Proshares Ultrashort Lehman 20 Plus Year Treasury (TBT-NYSE)** which uses 2:1 leverage, was up 6.1 percent.

The **Proshares Short 20 Plus Year Treasury (TBF-NYSE)** which uses no leverage, was up 3.1 percent.

These ETFs climbed in proportion to the leverage they mirror.

Our last issue was titled "Your Last Chance?" because if Congress and the Administration got their act together and made a deal on the Fiscal Cliff, it was likely to be your last chance to buy these ETFs at the prices then.

Well, they didn't exactly get their acts together. But, some resolution was made which boosted yields on Treasury bonds and the prices of our No-Brainer ETFs.

They did the easy part - extended lower tax rates for those with adjusted gross incomes less than \$400,000 (\$450,000 for families). They left the hard part for later - cutting spending. They kicked the can to February 28 for the new deadline on the sequestered cuts that were part of the fiscal cliff.

The debt ceiling is projected to be hit in March, and on March 27th, the Continuing Resolution will be due for a vote, which allows for the government to be funded. No doubt that all of this will come to a head at the last minute.

Whether they can cut spending significantly remains to be seen. Even if they do, the cuts will be over many years. We still have a whopping deficit and national debt to service.

If they do not cut spending, we are off to the races - again. Federal deficits will be lined up as far as the eye can see. In either case, more Treasury bonds will need to be sold to finance deficits.

Meanwhile, the Federal Reserve is printing money by pumping \$90+ billion a month into the economy through purchases of mortgages and Treasury securities. There are many signs that the economy is gaining strength - rising home prices, increasing consumer sentiment, and positive trends on many industrial and purchasing manager's indexes. Even in December, in the face of the fiscal cliff uncertainties, the ISM Manufacturing index rose above 50 percent which indicates that the economy was expanding. When the economy gets visible traction and starts recovering in earnest, inflation will become a problem.

On December 12, the Federal Reserve announced it is changing the terms of QE3, its third monetary quantitative easing program. Instead of promising

to continue to make massive purchases of Treasury securities to keep their yields low into 2014, it will now stop these purchases when the unemployment rate reaches 6.5 percent or inflation looks set to exceed 2.5 percent.

As we mentioned on that day's blog, this is huge. The path of monetary policy is now tied to the behavior of the economy rather than the calendar. This is how monetary policy has been decided historically, and for good reason. It has only been in the last few years that we have had extraordinary measures (Operation Twist, QE1, QE2, and QE3).

We have said repeatedly in the pages of *Sound Advice* that these extraordinary measures are temporary, and when they end, interest rates and yields on long-term Treasury bonds will rise sharply. It was inevitable sooner or later; it was only a matter of time. The December change in the Federal Reserve's policy means it will likely be sooner rather than later.

With bond yields still near historic lows (see the chart on the opposite page), the greatest and most explosive movement in Treasury bond yields will be upward. The rise in Treasury bond yields is bound to be breathtaking, but the profit potential is enormous even with a moderate rise.

Take a look at the chart showing 30-year Treasury bond yields from January 20, 2009 to June 10, 2009. This is the most recent time Treasury bond yields rose. We chose January 20, 2009, because 30-year Treasury bond yields were 2.95 percent, exactly where they were on December 31, 2012. They rose to 4.75 percent by June 10, 2009.

Our No-Brainer ETFs did not exist in 2009 during this entire period, so we don't have a historical track record to view, but we can model them to get an idea of the profit potential. We can use the daily history of percentage changes in 30-year Treasury bond yields during that period, and apply them to our No-Brainer ETFs with the appropriate amount of leverage each one uses.

Starting with the December 31 price of each ETF, here is what would happen if long-term Treasury bond yields rose as they did in that approximate 6-month period in 2009 from January 20 to June 10:

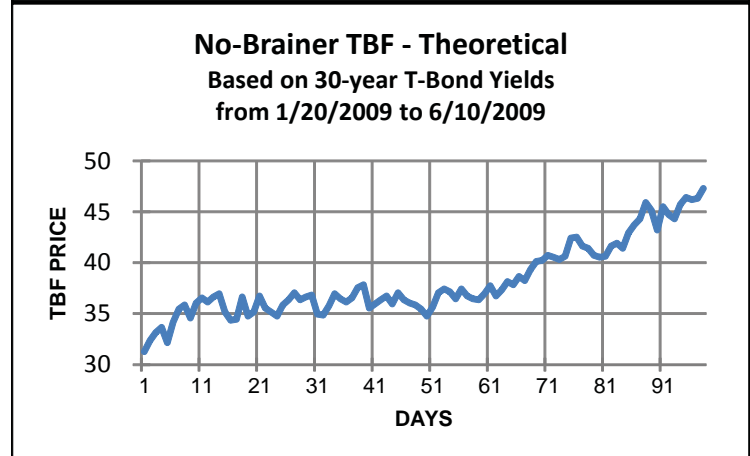
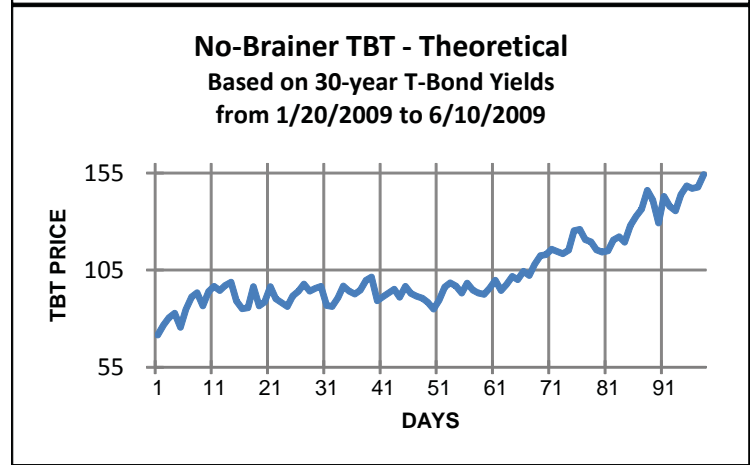
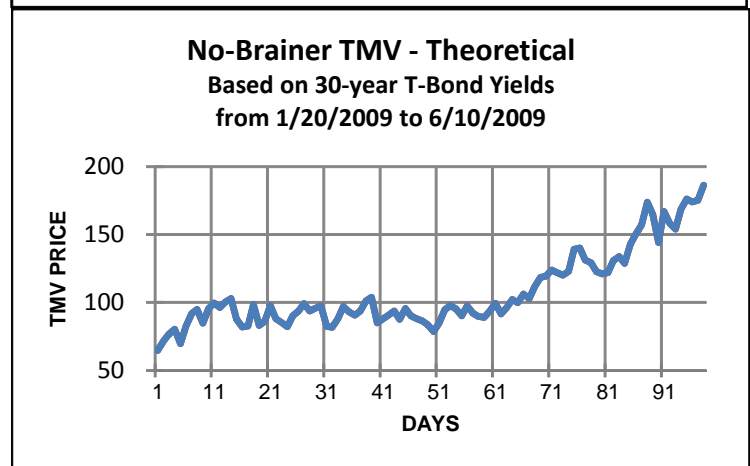
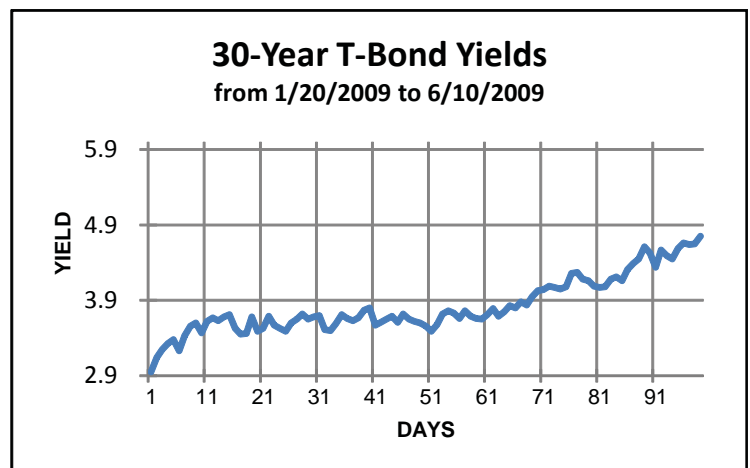
TMV (3:1 leverage) would climb from \$54.25 to \$186.45, for a 244 percent gain. See the chart.

TBT (2:1 leverage) would climb from \$63.45 to \$154.15, for a 143 percent gain. See the chart.

TBF (1:1 leverage) would climb from \$29.38 to \$47.31, for a 61 percent gain. See the chart.

From the chart on the opposite page showing the history of 30-year Treasury bonds since 1980, we can see that even 4.75 percent is still historically low. There is no reason the climb should end there. In fact, the odds are that it won't.

In the aftermath of any recession, interest rates always



## The History of 30-Year Treasury Bond Yields



*This graph shows the yields of 30-year Treasury bonds since 1977. As you can see, the recent lows are historic. Yields have been close to the recent lows only once before -- after the 2008-09 meltdown as systemic risks in the banking system fueled a capital flight to safety.*

*Source: Yahoo! Finance*

rise. It is as simple as that. This will be especially true for yields on long-term Treasury bonds because their yields carry the highest premium for the uncertainties of inflation for the upcoming decades.

Here are updates on the rest of our recommendations, in alphabetical order. See the table on page 7 for buy limits and other information on each recommendation.

### Portfolio Updates

**Agrium (AGU)** was up 48 percent in 2012, extending our profit to 736 percent. This is the largest farm products retailer in North America and a wholesaler to the rest of the world.

AGU has pulled back about 6 percent recently as India began negotiating with Russian and North American producers for a price cut for the crop nutrient, potash, a mineral used to strengthen roots and protect against droughts.

In addition, China has delayed regular shipments and are likely to begin negotiations later this month or February. These negotiations have left the farmers of these two most-populous to rely on inventories of the mineral. India has no domestic potash resources and has enough inventories to satisfy demand until early March.

Producers have responded with production cuts. The world's largest shipper in Russia plans to cut output by half between December and March.

The recent pull-back in AGU has brought the price under 10 times the 2013 earnings estimate of \$10.60 a share. That is cheap for any stock, especially one with growth prospects. AGU's revenue growth rate has averaged 30 percent annually over the last five years and is bound to continue to grow.

In the longer run, emerging market nations will have to import foodstuffs from the more advanced countries or use fertilizer to improve their crop yields to meet their needs. Either way means more worldwide use of fertilizers.

In addition, the 2012 Midwest drought led to lower crop output which means fertilizer demand for the next planting season will rise in the US.

AGU recently announced it has doubled its dividend to \$2.00 annually and switched to paying it quarterly.

**AMN Healthcare (AHS)** was up 160 percent last year, bringing our gain to 117 percent.

AMN Healthcare provides temporary healthcare staffing services to the healthcare industry, ranging from nurses to physicians. The rationale for buying AMN Healthcare was a two-fer. AHS 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 healthcare business that will benefit from a recovery in the economy.

Growth expectations are high for AHS because an estimated 10,000 people are now turning 65 every day in

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the US. As the aging of the population continues, healthcare will grow substantially from the current 18 percent portion of the GDP. We have seen projections that 40 percent of GDP will be healthcare by 2050. Georgetown University's Center on Education and Workforce estimates that 5.6 million new healthcare jobs will be needed by 2020.

Adding to growth expectations was the selection in October of Staff Care, an AMN company, to be the single-source provider for temporary physician staffing by Novation, the healthcare industry's supply chain and contracting company for the members of VHA Inc., UHC, Children's Hospital Association, and Provista. Most of the company's 5300 healthcare professionals are doctors and nurses which are always in short supply and command a premium for temporary positions or for permanent placements.

However, these growth expectations have caused the stock to rocket to the point where the price is now close to 25 times 2013 earnings estimated at \$0.45 a share. This price/earnings ratio is at a hefty premium to the average of its peer group. We think this stock has gotten ahead of itself and recommend holding for now while waiting for a pull-back to invest more.

**Associated Estates Realty Corp (AEC)** is the most undervalued apartment REIT in the sector. The equity of its apartment portfolio translates into a stock value of \$27 per share. So the stock is trading at a steep discount. It pays a nice yield as well. We have a small profit, and expect more ahead.

AEC was once a low-income apartment REIT but that is no longer the case. AEC has disposed of all of its older properties and has replaced them with class- A apartment properties.

AEC recently added three more class-A apartment properties to the portfolio, two in North Carolina and one in Dallas, Texas. The company's properties are showing high occupancies (97.3 percent) with increasing net operating incomes. Funds from operations (FFO) ended the third quarter 18.5 percent higher than one year ago.

In December the quarterly dividend payable in January, was increased to \$0.19 per share which brings the yield close to 5 percent.

**Boston Scientific (BSX)** is a classic turnaround story. It has had flat earnings this year due to lower demand for surgeries that require the company's devices produced by its cardiology and cardiac rhythm management segments.

BSX expects to see growth from its Subcutaneous Implantable Defibrillator (S-ICD) which is implanted under the skin without touching the heart or blood vessels. These devices recently received approval from the FDA and they are currently being used widely in Europe. There are vast new markets for ICDs in India and China. The company's oncology product recently launched two well-received products: the Renegade HI-FLO Fathom microcatheter and guidewire system, and the Interlock - 35 Fibered IDC Occlusion System for peripheral embolization.

We do not have a profit in BSX, but expect to over the

longer run. BSX is buying back its own stock in an aggressive share-repurchase program.

A brighter day is bound to be ahead. Based on the depressed price of this stock, gains from the current low price should be substantial.

**CGM Real Estate Fund (CGMRX)** was up 9 percent last year, extending our profit to 55 percent. We got back into it again after the 2008-09 crash in REIT prices.

CGMRX is not your average REIT fund. Ken Heebner, has run the fund since its inception in 1995 and is known as "The Mad Bomber" because he has never been considered cautious.

Heebner tends to hold roughly ten percent of the 270 stocks in the average REIT fund portfolio. In addition, he invests substantially more in his top 10 holdings. Heebner will also venture out of pure real estate investments from time to time. As a result, this fund outperforms or underperforms significantly, and it can be volatile. However, Heebner's good years are really good. CGMRX 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.

We watch his portfolio choices closely, so that we can judge whether the holdings make sense and whether this fund is worth recommending.

**Chesapeake Energy (CHK)** is up slightly since it was included in the portfolio earlier this year and we expect a large profit.

We added it because it has natural gas assets far exceeding the equity in the stock. The shares were cheap for three reasons: low natural gas prices, poor corporate governance, and a cash shortfall. There has been substantial progress on all of these aspects.

First, natural gas prices have climbed significantly since our recommendation. Secondly, regarding corporate governance, Carl Icahn bought a 7.5 percent stake in September, 2012, and has been instrumental in removing the founder, Aubrey McClendon, as chairman of the board and replacing several other board members. Mr. Icahn and his related entities subsequently added about 9.6 million shares (\$951 million) to increase his portion to 8.98 percent. Icahn's activity is putting pressure on the board to maximize shareholder value. And finally, CHK has sold \$11.6 billion of \$14 billion in targeted divestments to straighten out its cash squeeze,

CHK's remaining natural gas and oil assets are extensive and offer a large upside. As of December 12, 2012, Morningstar's fair value estimate is still \$26 a share which is more than 50 percent greater than the current price of the stock.

CHK has more than one million acres in the Utica Shale including 87 wells, which is a larger holding than any other energy company.

The Utica Shale extends over six states, from West Virginia to Ohio, across Pennsylvania and into New York. The U.S. Geological Survey (USGS) estimates the Utica

Shale contains about 38 trillion cubic feet of undiscovered natural gas, 940 million barrels of oil, and nine million barrels of natural gas liquids like ethane and propane.

The Utica Shale lies approximately 2000 feet below the Marcellus Shale which is the largest known shale formation in the US. The Utica Shale slopes up closer to the surface in Ohio, allowing for cheaper drilling and production and where CHK stands best to gain. Natural gas production increased 19% year over year.

CHK is also a play on the yawning gap between the energy equivalents of oil and natural gas. In comparison to oil, an equal amount of energy in the form of natural gas costs less than 20 cents on the dollar.

**CommonWealth REIT (CWH)** was disappointing in 2012. In a surprise move, the dividend was cut by 50 percent. On December 27, the law firm filed a class action against CWH on behalf of purchasers of CWH common shares during the period from January 10, 2012 through August 8, 2012 (when the Company announced its financial results for the second quarter of 2012).

The complaint alleges that CWH issued materially false and misleading statements and failed to disclose it was experiencing softness in the leasing market (especially in the Company's suburban office segment) that was below internal expectations, and that existing tenants were demanding and receiving significant concessions. As a result, CWH lacked a reasonable basis for their positive statements about the Company's leverage ratio, occupancy rate, and dividend payout.

Following the earnings press release on August 8, 2012, CWH held a conference call with analysts and investors, during which the Company's President and Managing Trustee, Adam D. Portnoy, stated that CWH would likely reduce its dividend because the Company's cash available for distribution payout ratio had increased to 108%. Moreover, the Company revealed that its occupancy rate fell to 84.5%, as of June 30, compared to 84.8% on March 31. In reaction to these announcements, the price of CWH fell to \$15.67 per share. On October 9, 2012, CWH announced a 50 percent reduction in the dividend for common shares.

The law firm of Robbins Geller is a large firm and has a good track record of successful class action victory. While we have recommended this stock because of the underlying assets, we are not fond of the management's compensation structure or particularly its recent conduct.

The reasons for cutting the dividend were sudden and out of the blue, and not within the normal industry practice. Funds from operations (FFO) of a REIT is the normal source of funds for the payment of dividends. Prior to the

cut, FFO was well in excess of the dividend. However, in the conference call following the earnings press release on August 8, management cited the company's cash available for distribution (CAD) as a source for paying the dividend. Unlike FFO, cash available for distribution includes capital expenditures (which include tenant improvements, leasing costs, building improvements, and development activities). Normally, capital expenditures are amortized over a number of years, which is why they are not included in the FFO calculation and dividend coverage.

While we would love to see a substantial payout, realistically, we are not optimistic that stockholders will see much, if anything. Generally, law firms are the generally the primary beneficiaries of class actions suits as defendants settle to avoid the cost of litigation while not leaving a significant balance for stockholders.

In any case, perhaps this class action suit will bring more of management's attention toward improving shareholder value. That would be highly beneficial because the stock is selling at a whopping discount to the equity in the underlying real estate portfolio. Based on the most recent quarter's results, the equity in the underlying real estate portfolio works out to be \$32.76 per share, even using a 9 percent capitalization rate (which is conservative these days) to evaluate the real estate.

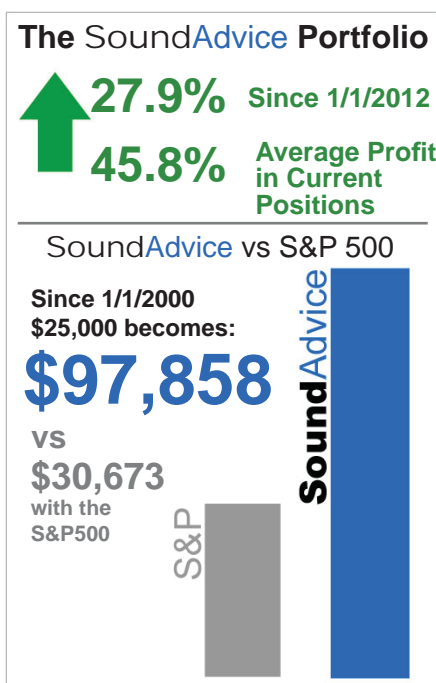
Share prices have considerable upside from here and should start to move when sustained growth in FFO begins to materialize. The third quarter saw net operating income from the real estate portfolio increase by 1.2 percent over the previous quarter, and FFO increased by 1.6 percent. The quarter's CAD was comfortably higher by \$5.9 million than the dividend payment of \$20.9 million.

**Comcast (CMCSA)** climbed inexorably in 2012 and was up 57 percent, extending our profit to 107 percent.

2012 saw steady in growth cable and high-speed data. The shift away from DSL to fiber optic lines is helping CMCSA capture more of the internet provider market as users are demanding higher speeds. The "xFinity blast" now offers download speeds of 50Mbps at no additional cost, up from 25 Mbps. "Extreme 305" customers now receive speeds up to 305Mbps at no additional charge. This is the seventh time since 2002 that the company has hiked speeds for its subscribers.

CMCSA is also an indirect play on the real estate recovery. The housing recession has had a dampening effect as foreclosures and the accompanying financial stress has reduced customers. New signs of life in the housing market will be a strong benefit.

CMCSA is likely to continue to return value to shareholders



by continuing the trend of annual dividend increases and repurchasing its shares. Accordingly, the longer term outlook remains positive. However, the rise in the stock price in 2012 brought it to a price/earnings ratio of 16 based on the 2013 estimate of \$2.25. While this is close to the average P/E for the S&P 500, we prefer to snag good companies at better valuations that allow more headroom from profits. Accordingly, we advise holding and waiting for a pullback.

**Fidelity Select Natural Gas Fund (FSNGX)** was essentially unchanged last year. This is the only mutual fund that concentrates on the natural gas industry. It is one of Fidelity's stable of tightly focused sector funds.

Ryan Oldham has been at the helm since mid-2010, and he is no stranger to energy. He worked as an analyst for Canadian energy companies and global exploration and development firms.

FSNGX is a diversified play on the yawning gap between the energy equivalents of oil and natural gas. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. So if a barrel of oil is say, \$100, that is the cost of 5.8 million BTUs of energy.

On the other hand, the market price for natural gas is close to \$3.00 for one million BTUs. To buy 5.8 million BTUs will cost \$17.40 (5.8x\$3.00). So the same amount of energy is available for approximately 17.40 cents on the dollar -- if it is in the form of natural gas.

As the chart shows, this is not a normal situation. The red line shows the price of a barrel of oil since the mid-1970s. The blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. Note that for most of the time (36 years), the two forms of energy are closely aligned. This stands to reason. After all, energy is energy, and it should cost approximately the same regardless of the form in which it comes. However, that is not the case today. Note the current yawning gap between the costs of these two forms of equivalent amounts of energy. For 5.8 million BTUs, it costs approximately \$100 if it is in the form of oil, but only \$17.40 in the form of natural gas.

The US is self-sufficient in natural gas with only 9 percent imported from Canada. At 17.4 cents on the dollar versus oil, natural gas is bound to have a growing role in America's energy needs as well as independence from importing oil.

This fund is well positioned to benefit from an expanding natural gas industry.

**Hambrecht & Quist Life Sciences Fund (HQL)** was up 26 percent last year, extending our profit to 48 percent. The

most explosive profits in the entire healthcare industry can be found here in biotech companies. This is a volatile sector, so diversification is crucial. HQL is a superior way to gain exposure to biotech on a diversified basis. This mutual fund has climbed inexorably in 2012, and should continue to do so. HQL recently declared a year-end stock distribution of \$0.31 per share.

**Leucadia (LUK)** was up 5 percent last year leaving us with a 17 percent profit. This is a holding company with a portfolio in excess of \$9 billion of assets in beef processing, manufacturing, gaming entertainment, real estate activities, medical product development, and winery operations.

Its two principals, Ian Cumming and Joseph Steinberg, 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 continues to team up with the Leucadia team on joint venture investments. Several holdings are directly partnered with Warren Buffett.

Skillful investing has produced double digit growth rates in its assets since 1979. After a bad year in 2008, assets have since grown by 150 percent according to Morningstar. The nature of their most recent investments in start-up biotech and energy companies offer a very large profit potential while affording relatively low risk. We think that LUK is valued well below the market prices of its

disparate parts, with a very low debt-to=equity ratio. LUK's holdings translate into a P/E ratio of 11.2, substantially below the S&P 500 P/E ratio of 17.7.

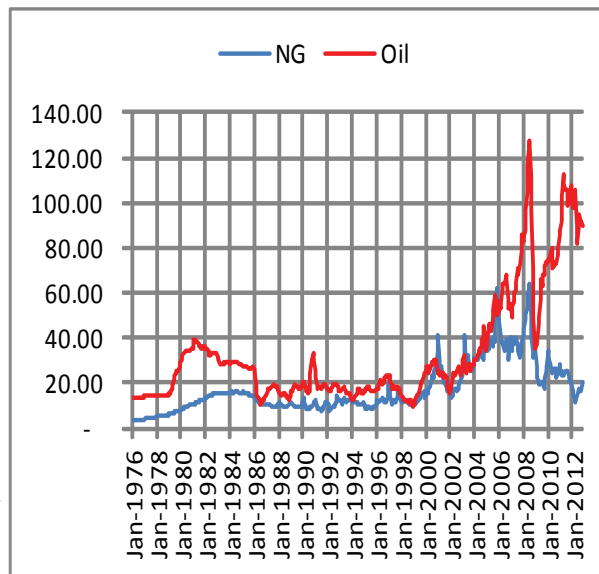
**Masco (MAS)** was up 59 percent last year, extending our profit to 126 percent. MAS manufactures a wide range of products for home construction and remodeling --everything from kitchen cabinets and faucets to windows and paint.

We added MAS to the portfolio at \$7.49 after the shares got hammered during the recession. Masco has been consolidating debt, closing unprofitable plants, and streamlining global supply chains in an effort to save \$150 million of costs.

These efforts are showing up in positive results. Revenues and earnings are growing again. A broadening recovery in the housing market is fueling growth expectations. New home sales are up a solid 15.3 percent from a year ago.

MAS is an excellent way to ride the recovery in the housing market. However, \$16 a share is 26 times 2013 earnings estimates of \$0.60 a share. This high price/earnings ratio is already anticipating a steep growth rate. We would wait for a substantial pull back to invest again.

The Cost of Energy Equivalents of Oil and Natural Gas



<b>Income With Growth</b>	<b>Sym</b>	<b>Exchange</b>	<b>Price</b>	<b>Yield</b>	<b>Limit</b>	<b>Action</b>
Associated Estates Realty Corp	AEC	NYSE	\$ 16.12	4.47%	\$ 17.00	BUY
CommonWealth REIT	CWH	NYSE	\$ 15.84	6.31%	\$ 17.00	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 12.85	3.11%	\$ 14.00	BUY
<b>Diversified Growth</b>						
CGM Realty Fund	CGMRX	800-343-5678	\$ 29.37	0.89%	\$ -	BUY
Comcast	CMCSA	NASDAQ	\$ 37.36	1.74%	\$ 36.00	HOLD
Leucadia National Corp.	LUK	NYSE	\$ 23.79	1.05%	\$ 25.00	BUY
Masco	MAS	NYSE	\$ 16.66	1.80%	\$ 15.00	HOLD
Paychex	PAYX	NASDAQ	\$ 31.10	4.12%	\$ 32.00	BUY
Pfizer	PFE	NYSE	\$ 25.08	3.51%	\$ 26.00	BUY
Stryker Corp.	SYK	NYSE	\$ 54.82	1.55%	\$ 56.00	BUY
Xerox	XRX	NYSE	\$ 6.82	2.49%	\$ 7.50	BUY
<b>Energy/Natural Resources</b>						
Agrium	AGU	NYSE/TSE	\$ 99.87	2.00%	\$ 105.00	BUY
Chesapeake Energy Corp	CHK	NYSE	\$ 16.62	2.11%	\$ 18.50	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 30.85	0.18%	\$ -	BUY
Tetra Tech	TTEK	NASDAQ	\$ 26.47	0.00%	\$ 28.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$ 26.83	0.30%	\$ -	BUY
<b>Aggressive Growth</b>						
AMN Healthcare	AHS	NYSE	\$ 11.55	0.00%	\$ 10.50	HOLD
Boston Scientific	BSX	NYSE	\$ 5.73	0.00%	\$ 6.00	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 54.24	0.00%	\$ -	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 29.38	0.00%	\$ -	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 63.45	0.00%	\$ -	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$ 14.50	7.45%	\$ 16.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$ 29.40	2.99%	\$ 30.00	BUY
Symantec	SYMC	NASDAQ	\$ 18.82	0.00%	\$ 19.00	BUY
Tellabs	TLAB	NASDAQ	\$ 2.28	3.51%	\$ 3.00	BUY

ROWS IN **BOLD** INDICATE A CHANGE IN ACTION OR LIMIT

Prices are as of 12/31/2012. See our website for live pricing and buy limits.

<http://www.soundadvice-newsletter.com/members>

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

**Maxim Integrated Products (MXIM)** was up 13 percent last year, extending our profit to 50 percent. MXIM specializes in analog circuits which are essential for receiving and interpreting digital inputs. A cell phone is a perfect example. After receiving a digital signal, it must be transformed into an analog format so that we can hear it.

MXIM provides all power management, charging, and USB multiplexing requirements for Samsung's Galaxy S3 smartphone. MXIM's products in this successful smartphone is substantially higher than in prior smartphones. The smartphone market is bound to propel MXIM's growth.

MXIM also makes integrated power management chips (PMIC) for portable devices makers to extend battery lives. This is enabling MXIM to command premium pricing and capture more content of its products in smartphones. The importance of Samsung is growing, but MXIM is starting to

sell PMICs to other smartphone makers, aiming for growth in lower-priced handsets in emerging markets.

The investment and resources necessary to develop MXIM's high-performance analog chips is substantial, They take years to develop which is an entry barrier for new competition. These chips have long and profitable product lives.

MXIM is in excellent financial health with \$1.0 billion of cash and plenty of cash flow to support operations, as well as pay its quarterly dividend of \$0.22 per share – for an annual yield of more than 3 percent of the current share price. MXIM is on a strong growth path with essential products and engineering for the new world of technology we are entering.

MXIM recently bought back \$2.1 million of its shares. The dividend was recently increased by 9 percent, and the share repurchase plan is ongoing.

**Paychex (PAYX)** was up 3 percent last year, extending our profit to 16 percent. There is a larger profit ahead with a recovery in the economy. Its core business is payroll services for small to medium sized companies with more than 100 offices serving approximately 567,000 payroll clients. Accordingly, its revenues and earnings directly mirror the employment situation. Downside is limited because the balance sheet is pristine with no long-term debt exposure.

PAYX recently increased its dividend (close to 4 percent) and announced a share buy-back program of \$350 million of the common stock through May 31, 2014.

**Pfizer (PFE)** was up 16 percent last year, extending our profit to 50 percent. PFE became dirt cheap as the expiration date approached on its blockbuster drug, Lipitor. That is when we added it to the portfolio.

The loss of the Lipitor patent was no secret because patents have a limited life, and the expiration dates are visible to the stock market. It is also no secret that Pfizer will also lose its patent protection on three more profitable drugs during the next three years: Geodon for schizophrenia, Celebrex for arthritis, and Detrol for overactive bladder. However, PFE still has a solid foundation of cash flows from a diverse array of patent-protected pharmaceuticals.

Pfizer is the world's largest pharmaceutical firm, with annual sales near \$60 billion. Pfizer's large size gives it economy of scale and the resources to finance the research and development of new drugs. It has more than 80 drugs in the development stage and 90 in the discovery stage.

Among these prospects are several potential blockbusters in the pipeline across several therapeutic areas, including two in the late-stage pipeline: *Eliquis* is a treatment for stroke prevention, and *Tofacitinib* is a treatment for rheumatoid arthritis.

Another drug, *Xalkori*, is proving to extend the lives of lung-cancer patients, without their disease worsening, for twice as long as the standard therapies. In addition, the acquisition of Wyeth gave Pfizer significant patents, including the meningitis vaccine, Prevnar, and the rheumatoid arthritis drug, Enbrel. The acquisition of Wyeth made PFE an even stronger company.

PFE has an extensive salesforce to market its products in nations where growth and increasing wealth is strong, including Brazil, Russia, India, China, and Turkey, and PFE has devoted the resources to arm its salesforce with plenty of data for marketing.

As an indication of the value of this stock, PFE is buying back its own shares.

**Retail Opportunities Investment Corp (ROIC)** was up 8 percent last year, extending our profit to 20 percent. This REIT began as an IPO in October 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains, with no debt and no problems. It is a simple model: buy distressed retail properties with high-quality demographics, refurbish them, and then lease them at a

premium.

On December 28, 2012, ROIC closed on three shopping centers and has a binding contract to acquire a fourth shopping center in a private transaction through a long-standing relationship with the seller. The shopping centers are well-located at major intersections within densely populated communities, and represent steady cash flow from well-established anchor retailers. In 2012, ROIC acquired \$278.0 million of shopping center investments.

ROIC also has contractual rights of first refusal to acquire three additional grocery-anchored shopping centers located in Southern California (Hawthorne, Burbank, and Huntington Beach).

Funds from operations (FFO) more than cover the dividend. As new properties are added, along with tenant upgrades, FFO should continue to rise, along with the dividend and price of this REIT.

**Stryker (SYK)** was up 10 percent in 2012, extending our profit to 32 percent. SYK is best known for its orthopedic devices: artificial knees and hips. But SYK also provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, and neuro-technological and spine products.

Reconstructive implants accounts for 45 percent of SYK's revenues, and more profits are assured by accelerating demand for joint replacements on aging baby boomers. As life expectancies continue to increase, and obesity trends continue, more and more hip, knee, and spinal procedures will be needed.

Stryker's cash-rich balance sheet (with over \$2 billion in net cash) along with piddling debt, and robust cash flow, gives SYK multiple avenues for growth through mergers and acquisitions. Management has been buying back shares and has steadily increased its dividend.

**Symantec (SYMC)** was up 20 percent in 2012, giving us a profit of 13 percent. SYMC is the dominant supplier of software for computer security and protection against viruses and other nuisances. Until 2012, the company has suffered from operational inefficiency and lack of direction. In July, Steve Bennett was hired as the new CEO. Bennett had a successful 23-year career at General Electric and a 7-year role as the CEO at Intuit. Bennett was brought in to streamline operations and give stronger direction. So far, it looks like the change is working. Revenue has increased 4 consecutive quarters.

Strong new markets are opening up as the world moves to increase usage of smart phones and other mobile devices which means expanding business for SYMC's flagship brand, Norton.

Recent acquisitions of Nukona, Inc, a provider of mobile application management, and Odyssey Software, a leading provider of mobile device management, give SYMC the ability to offer mobile apps that protect against hackers by authenticating users and encrypting sensitive files. SYMC is also collaborating with Red Hat to deliver solutions that help

customers deploy agile private and hybrid clouds, as well as create resilient data centers.

SYMC recently announced "Norton Zone" which allows users to safely access, sync and share photos, videos and documents from any of their PC, Mac, Android, or iPhones and iPads. The beta test version is out now and the full-featured version is scheduled to be released this year.

SYMC has a large base of customers that provide recurring revenues of approximately 85 percent of total of revenue, and growth is assured from the expanding use in cloud computing along with the commensurate need for security software.

**Tellabs (TLAB)** paid a cash dividend of \$1.00 per share on December 21st so that stockholders would receive the special 15 percent tax rate effective in 2012. Even after the dividend payout, the company still has current (liquid) net assets of \$2.77 per share.

Adding in its other assets, including properties and equipment (less depreciation), the net assets total \$3.11 per share. In our calculation, we have excluded paper asset entries that are held on the Company's balance sheet which include Goodwill and Intangible assets amounting to \$.035 per share.

The company plans to buy back up to \$224.6 million of TLAB shares which will reduce the float by 20 percent.

TLAB 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.

Now 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.

TLAB remains an attractive takeover candidate. At the current stock price, we are buying the company's current net assets at a discount, and at a larger discount to all of its assets.

An acquirer would be happy to get the company for next to nothing if only to capture its client base. We think there is very little downside risk and loads of upside.

**Tetra Tech (TTEK)** was up 22 percent in 2012, extending our profit to 72 percent. TTEK is a leading company in water technologies and environmental remediation, both of which are definitely growth industries. TTEK also has a healthy balance sheet.

Recent large contracts include a \$108 million contract to provide technical support for the U.S. Environmental Protection Agency (EPA) Office of Water's Assessment and Watershed Protection Division to assist in its efforts to monitor water quality conditions. This watershed protection program is one of the principal technical support focuses of the EPA. Other recent contracts include remediating NASA's Kennedy Space Center and Cape Canaveral Air Force

Station, along with environmental remediation services at U.S. Navy, Marine Corps, and other Department of Defense locations primarily in California and the southwestern United States.

The biggest potential business 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.

**USAA Precious Metals & Minerals Fund (USAGX)** was down 13 percent last year, which trimmed our profit to 8 percent.

When the economy gets traction, USAGX will benefit from the Federal Reserve's QE-3 program which is printing money to make its massive purchases of Treasuries and mortgage-backed securities. All these extra dollars will raise inflationary expectations and cause the value of U.S. currency to continue declining. Precious metals will be a direct beneficiary.

USAGX is the best diversified way to invest in precious metals. It regularly ranks among the top-performing funds. Morningstar also rates it highly.

The fund's management has been effective over the years in shifting the weight of investments to and from large-cap and small-cap companies. After precious metal stocks get battered, small-cap companies present the best values and this fund has moved in that direction. Gains have come from a boom in mergers and acquisitions that followed. After those acquisitions have become fully-valued, management moves out of those and into large-cap companies which provide better returns during downturns. Now, management is moving back into small-caps again, where bargains are better.

Dan Denbow, the co-manager of the fund since 2008, recently replaced manager Mark Johnson, who retired after managing the fund for the past 17 years. We expect Mr. Denbow will carry on the management style. But we will be watching just to be sure.

**Xerox (XRX)** is still focusing on the high end of the color printing market which still rewards technological improvements. However, the company is transforming from a seller of printers and copiers to a company providing services on those machines. The revenue from services is more profitable and less cyclical. Half of XRX's revenues now come from services. XRX is also adding synergistic services markets, including services in conjunction with its copiers as well as business process outsourcing and information technology outsourcing.

XRX is expected to post earnings close to \$1.00 per share this year. The current stock price is close to 7 times earnings, which is really cheap. Any kind of recovery will bring a high capital gain. Morningstar's fair value estimate of the stock is \$11 per share which is 64 percent higher than the current price of this stock.

## 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 the SoundAdvice "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 SoundAdvice 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 SoundAdvice 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 \$8,389,353 in stocks and to \$1,264,362 in houses.

But though an investment beginning 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 SoundAdvice Risk Indicator he would have made \$333,442,321, 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 SoundAdvice 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.

### The SoundAdvice Risk Indicator

The latest reading for the Sound Advice Risk Indicator is 1.41. This reading reveals that stock prices 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 SoundAdvice 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 SoundAdvice 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. The market subsequently climbed 61 percent.

An "Aggressive" signal coming at a time when the Risk Indicator was below 1.0 revealed that Supercycle 5 came to an end, and that Supercycle 6 was born.

**The SoundAdvice 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 reveals that the economy is about to put upward pressures on interest rates. This index hit 100% in March 2012 (reported in April - very close to the peak of the market) telling us to move to a cautious approach.

Our next signal will come from a zero reading from our Diffusion Index of Leading Indicators. The latest reading is 66.7 percent.

Each month we project into future months the current readings for our hand-picked individual leading economic indicators that go into our Diffusion Index of Leading Indicators. We do this to see if a zero reading will be recorded assuming the readings stayed the same. However, due to significant increases in all of the leading indicators, we will not see a new signal (zero reading) in the months ahead unless the leading indicators (and the economy) show significant renewed weakness.

### Track Record of the SoundAdvice 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 climbed an average of 35.1 percent. During "Caution" signals, the S&P 500 declined an average of 1.4 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,445.8
Ave +/-	35.1%		-1.4%

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 paid subscription, and you will also receive an updated copy when you renew your subscription.)

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