



Mark Hulbert, the mind behind and the name in front of The Hulbert Financial Digest, the only independent tracker of investment newsletter performance, also compiles sentiment data for the same set of newsletters. As a contrarian, Hulbert when he notes newsletter writers are too bullish gets worried and when they become too bearish, he gets greedy. Last week, he noted that a subset of short-term, trading-oriented-market timing letters was 62.8% bullish, up from just 13.8% four weeks before.

The last time this short-term index was this high occurred in January as the market got ready to fall 8% and before that it was at the peak of the 2007 bull market. I wonder how subscribers to such letters respond to Hulbert's warning. Do they bail, or just presume that their letter will get it right?

At the same time as short-term traders are bullish, mutual fund investors remain stubbornly bearish about equities but bullish for bonds. But that's better than what went on during most of the bull market after March 9, 2009. But that is changing ever so slightly. Over the last two weeks, as stock prices rebounded, \$165 million went into U.S. stock funds, though during the previous two weeks, when the market was still falling investors pulled \$2.23 billion out and even after prices had begun to recover, pulled another \$4.75 billion out. By comparison, over the last five weeks investors poured \$34.2 billion into bond funds, a pattern that has persisted for more than a year. Frankly, we're encouraged by retail investors' reticence about equities. Short-term, perhaps Hulbert has it right. Longer term, we still like our chances.

-Gray Emerson Cardiff

The New Normal?

Has the U.S. economy entered unknown territory where all of the old expectations and guides are obsolete? That seems to be the mood most have accepted, and is being summed up with the catchphrase, "The New Normal." TNN gained popularity on Wall Street last year and continues to spurt out into the general population, though it has floated around for at least the last eight years. It took the disorienting events of 2008-2009 to turn it into a password for the "Poor Us Society."

Business writers can't resist terms that suggest they are on the cutting edge, so lately we're getting titles like *Advantage: Business Competition in the New Normal* published this month and *The New Normal: Everything Old is New Again After a Decade of Quick Fixes, Fake Money and Made Up Rules* that will debut in July. To sense how promiscuous use of TNN has become, Google "New Normal" and click the News tab. The earliest use of these words we found during a not very scientific search is the title of a 2002 recording, *The New Normal, A Spiritual Response in Words and Music*, which addresses the aftermath of 9/11.

No group has done more to promote TNN than Pimco, the richest and most influential fixed-income managers on the face of the earth. Bill Gross, nominally the Managing Director but the real Pimco capo, has been playing with TNN since last spring. Mohammed El-Erian, Pimco's CEO and co-CIO, in May 2009 summarized what TNN means for Pimco: "a growing realization that some of the recent abrupt changes to markets, households, institutions, and government policies are unlikely to be reversed in the next few years. Global growth will be subdued for a while and unemployment high; a heavy hand of government will be evident in several sectors; the core of the global system will be less cohesive and, with the magnet of the Anglo-Saxon model in retreat, finance will no longer

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be accorded a preeminent role in post-industrial economies. Moreover, the balance of risk will tilt over time toward higher sovereign risk, growing inflationary expectations and stagflation.”

We are being told that something essentially new and different has transformed society, that risk and reward are no longer the same and most of all that we should be very afraid. At the risk of riling up those who despise all things French, our view begins from the polar opposite: “Plus ça change, plus c’est la meme chose.” There is nothing new under the sun.

TNN, in fact, reminds us of another catchphrase that was ubiquitous as recently as 2000 but now is so disreputable that no one in his right mind would use it: “It’s different this time.” The obvious difference is that those who chanted “It’s Different This Time” in the late 1990s passionately believed that they were witnessing a brave new world in which the business cycle with its expansions and contractions had ceased to exist—at least for tech companies—and traditional measures of value like revenues and profits were less important for investors than New Era metrics like “eye balls,” while those who invoke “The New Normal” see a bleaker, less prosperous future. We suspect the disorientation, the malaise that TNN represents, is just as off the mark. But it is less dangerous to your wealth, since those who followed the Pied Piper of New Age Investing over the cliff never climbed back up. While you can glimpse from current prices where the Dow and the S&P 500 rose to during that rally, the Nasdaq wallows around half of that high. TNN adherents, if they hold an excessive pessimism, just will miss the next bump up in the economy and the market.

In any normal market, whether it was the old over-leveraged market or the new deleveraging market, there always will be aberrations and thus opportunities. To use the language of statisticians, in terms of leverage, we are seeing a reversion to the mean that when the process ends will put us back somewhere between the extremes represented by

the free-money economics of 2001-2007 and the tight-fisted economics of 2008-2009. Even after the monster rally we’ve had investors are skittish about stocks.

Sound Advice when we marked in May 2009 the start of a new Supercycle, the sixth since the end of the 19th century, did acknowledge the start of a new episode, though we do not think it’s a New Era. Instead it is simply the replay of the same cycles that the U.S. economy and stock markets have run through five times for more than a century. Within that larger cycle, we have the opportunity to profit from successive rotations of the business cycle, the first of which we are now going through.

Consider the data we use to construct our leading and lagging indicators, which respectively now stand at 100% (leading) and 33% (lagging). Last May, we got final confirmation of a buy signal when all four leading indicators hit zero, reflecting an economy deep in recession (we’d informally told you two months before that, at the bear market’s March bottom that effectively, if not officially, we were going to buy mode). Now each of these leading indicators has reversed course. This doesn’t constitute an end to our buy signal. It remains in place until our Diffusion Index of Lagging Indicators turns red. Now only one of that diffusion index’s three indicators, the Consumer Price Index for the Service Sector, which six months ago was wallowing below 1, reflects expansion. The other two that express consumer credit and duration of unemployment have a ways to go before they turn, especially the duration of unemployment figure.

Undoubtedly without the gale of credit that drove tech stocks in the late 1990s, then real estate until 2006 and then energy and metals until mid-2007 to unsustainable levels, the follies, at least for the near term, will be less exuberant, but the market will exhibit the same fantasies and fears that create opportunities for the skeptical. If you need a test case for this thesis, consider U.S. Treasuries. We do, starting on the next page. [SA](#)

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Short Treasuries

We've been making the argument for more than a year that U.S. Treasuries in late 2008 were priced irrationally and, after that extreme aberration subsided, that their yields were still extraordinarily low even for a recession. We warned subscribers to steer clear of what would be a two-stage slaughter of the innocents once the market turned on these securities. Anyone who owned long-duration Treasuries at the end of December 2008 has been severely injured.

Now we're taking this argument from defense to offense, and want to recommend a way to profit from what happens when interest rates begin to rise from their recession levels. The recommendation is simple and quite mechanical, a leveraged Exchange Traded Fund (ETF) that shorts longer-duration Treasuries. The rationale, though straightforward, takes up most of what follows.

Democracies have difficulty with austerity except in time of war, but even that, at least during the last decade, no longer is true. Faced with wars, one that began during recession and deep social anxiety after 9/11 and the other that began as a consequence of those anxieties, Washington borrowed heavily, which was to be expected. But unlike any war-time government in American history, Washington during those years rather than calling on a patriotic nation to shoulder the burden financially, instead slashed rates, pushing the costs for those wars into the future. Also, the pharmaceutical benefit for Medicare recipients, passed in the midst of these wars, represented the largest single expansion of Medicare in history. That cost also has been financed through more debt.

Coincident with that public debt accumulation, policies both at the Federal Reserve and in Congress encouraged a mammoth expansion of consumer debt, particularly in housing, as well as commercial and financial debt creation. The economic distortions resulting from public and private credit irresponsibility crested in the 2008 financial collapse and recession. This time Washington opened the credit spigot full enough to prevent a bank collapse, eventually to bring recovery to the credit and equity markets, and to start a fitful recovery from recession. And this time raising taxes was not an option.

We today are far from any meaningful revival of our

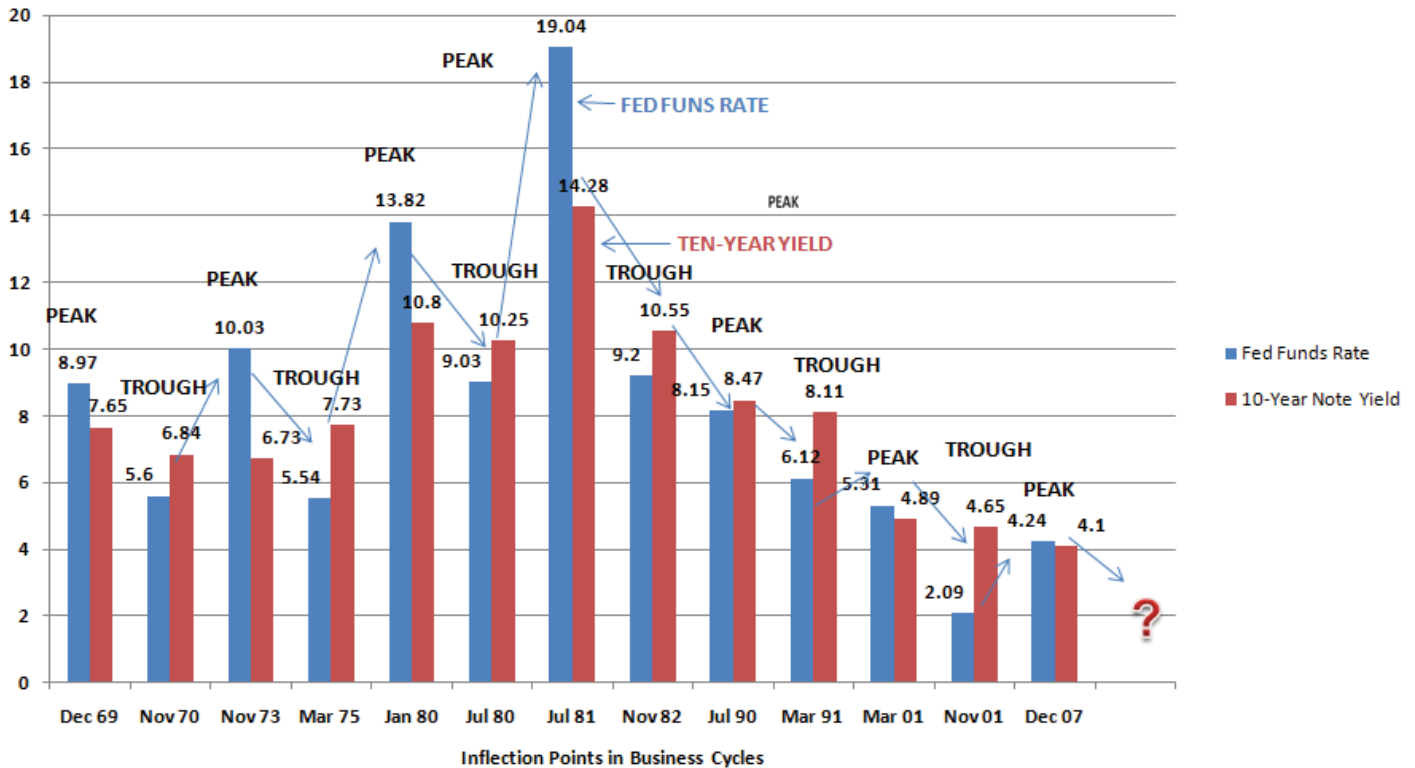
economy, which means that the Federal Reserve will keep short-term interest rates low and, perhaps, again rely on Quantitative Easing, the purchase of longer-term notes and bonds, to restrain longer-term rates. More stimulus programs, none as large as the 2009 package, are also possible. Again expect Washington to put this on the American credit card.

Sound Advice has asked how prudent investors can profit from what this combination of slack revenues and debt financed government activities will do to interest rates and to the rate of inflation. It's difficult to imagine that the Federal Reserve will be able smoothly to drain the trillions of dollars worth of new money and credit it pumped into the U.S. economy to mitigate the recession and to keep other banks from tumbling down the Lehman rat hole. If for no other reason, the Federal Reserve's extraordinary measures to spark economic recovery in general and to juice bank profits in particular will have to be unwound, and when that happens current interest rates must rise and bond prices must fall. In the aftermath of any recession, interest rates normally rise. After the mammoth measures taken this time, the move upward in interest rates should be significant. This recalibration of interest rates need not be helter-skelter nor even explosive (though it's likely to be both) to devastate portfolios anchored in Treasuries. How can investors avoid that? One obvious response is to short government debt.

Inflation Or Deflation?

Before we suggest how you can profit from rising interest rates, it's worth noting that what seems so unavoidable to us, that interest rates must rise and that significant inflation will coincide, is not universally believed. The Fed, it's safe to say, is more concerned about the economy lapsing back into recession than tumbling into a period of inflation. Consider that after the Federal Reserve returned its Discount Rate to its normal 1% spread above the far more significant Federal Funds Rate, the credit and stock markets had an anxiety attack that this might begin the end of free money for banks. Ben Bernanke went out of his way in testimony before Congress on the following day to say that given current economic conditions it is "likely to warrant exceptionally low levels of the federal funds rate for an extended period," which most observers

Yields At Peaks and Troughs 1969-2007



interpret as until the winter 2010 and perhaps into 2011. The Federal Open Market Committee after its January session noted that because the economy remains so weak, inflation will remain below 2% for the foreseeable future. Note that the Consumer Price Index for January clocked in well above 2%. The lack of response from the Fed suggests it sees lackluster economic expansion ahead. Indeed, some economists and market participants believe the U.S. economy will experience deflation, a persistent drop in prices that would put upward pressure on bond prices and drop yields. Frankly the only reason I can imagine such complacency would be if deflation did occur. We believe there has been too much credit creation for that. Bloomberg last month quoted a bond fund manager as follows: "I see a return to disinflation or deflation. I don't need any protection against inflation."

To judge by continued market support for Treasuries with yields that are modest by historical standards, persistent low interest rates, and the lack of any strong anticipation of inflation, complacency characterizes the consensus. But there are dissenters. Warren Buffett in his 2008 letter to shareholders (sent on 2/28/2009) observed: 'When the financial history of this decade is written, it will surely speak of the Internet bubble of the late 1990s and the housing bubble of the early 2000s...But the U.S. Treasury

bond bubble of late 2008 may be regarded as almost equally extraordinary.' Even more blunt is Nicholas Taleb, whose 2007 book *The Black Swan: The Impact of the Highly Improbable*, won him seer-like status when the post-Lehman credit meltdown illustrated his thesis. At a conference last month in Moscow, Taleb put the case for shorting Treasuries starkly: "Every single human being should have that trade, short Treasury bonds in the U.S." For a speculative play, he recommends buying "way out of the money puts on Treasury bonds."

We think Taleb is on to something. The only reason we'd shy away from shorting Treasuries would be if everyone did take his advice. But that seems unlikely given continuing demand for longer-duration Treasuries at current prices.

Other than anecdotal evidence, consider this simple gauge for investor expectations of inflation: the difference between a standard Treasury security's current yield and the base yield of a Treasury Inflation Protection Securities (TIPS) of the same duration. TIPS' initial or best interest payments reflect what the Treasury projects will be the real rate of inflation (that is, the nominal yield less the rate of inflation), while conventional Treasury notes and bonds pay a fixed interest payment. TIPS' distributions fluctuate

according to the change in the rate of inflation as gauged by the Consumer Price Index, which provides some protection of principal against inflation. Subtract the current yield on a TIPS from the current yield on an equivalent conventional Treasury security and you have a rough measure of what the market believes the rate of inflation will be over the duration of these securities.

Currently CPI stands at 2.63%, while the spread being between the 10-Year TIPS Treasuries and standard Treasuries stands at 2.24 percentage points. In short, the TIPS spread implies that investors believe inflation will decrease over the decade from its current level. (Though chaotic market conditions can distort the reliability of this gauge -- for example, during the late 2008 credit market panic, anxious investors in search of "safe" places for their investments bought standard Treasuries regardless of price—the spread dropped so far that the 10-Year TIPS yielded 23 basis points more than the comparable conventional 10-Year Treasury Note).

However, the very reason so many investors are complacent about where interest rates and inflation will go offers the most basic reason to disagree with their assumptions. Quiescent inflation, high unemployment, less than fully utilized industrial capacity, all the usual characters in any recession, are not permanent. When economists and investors do recognize the recession is over, most if not all of these brakes on interest rates will be over as well. Look at the chart on page 4 to see how the yield on the Fed Funds Rate and the 10-Year Treasury Note change as the economy moves from recession's trough to expansion's peak. The current 10-Year Note's yield, 3.71%, is unlikely to withstand even a weak economic recovery.

How To Short Treasuries

The average investor, if asked how to protect his portfolio against the risks of higher interest rates, probably would look at TIPS, which would be an error. Though TIPS do offer protection against price inflation, they do not directly address interest rate risk. Indeed, in a rising interest rate environment, TIPS will suffer some, if not all, of the pain inflicted on conventional Treasuries. And don't get us started on whether the CPI that govern TIPS is even a truthful measure of price inflation.

Certainly there is a correlation between interest rates and inflation, but the two are essentially different. If you want to take advantage of what we believe are an overbought Treasury market and thus unsustainably low interest rates, the answer rests with shorting U.S. Treasury securities.

Before discussing how to short Treasuries, let's get clear on the relationship between bond prices and their yields. The most basic principal is that as the prevailing interest rate changes, the market prices of bonds move in the opposite direction. For example, a 30-Year Treasury Bond issued in February 2000 carried a 6.25% yield, which means that each year bond holders received in two semi-annual payments \$625 for every \$10,000 in face value. Today, 10 years later, the prevailing interest rate on a new 30-Year bond is 4.67%, which explains why \$10,000 worth of that February 2000 bond, now with 20 years until maturity, trades for around \$12,000. But a decade from now, should prevailing interest rates rise from the current 4.67% to, let's say, 6.27%, a bond with the same duration would trade for about 20% less than its face value. In both cases, investors ask themselves, how much should a bond be worth if prevailing interest rates are X and total annual interest distributions are Y? For Treasuries, unlike any other sort of debt, there is no risk of default. In the worst case scenario, even were there no revenues from which to service its debt, the United States Treasury literally could just print more money to cover interest and repayment obligations. The only considerations are how long until the debt matures and how have current interest rates impacted the market price for a specific duration note or bond.

What Happens Next?

Buffett's warning about a bubble that had formed by the end of 2008 already has been validated. Rates bottomed during the panic that followed the September-November 2008 Wall Street implosion and climaxed with the bankruptcy of Lehman Brothers, the "rescue" of AIG, and the forced sales of several other major financial players.

In response, not only had the Fed dropped short-term rates to near zero, but even more important, investors rushed to the safety of Treasuries regardless of how little these securities paid, driving the yield on the 30-Year bond down to 2.58% on December

30th. If we look at an ETF built around long-duration Treasuries, the iShares Lehman 20+ Year Treasury Bond Fund (TLT), the aftermath of that lemming-like rush are evident: from the mid-December 2008 high through March 2009, these ETF shares (adjusted for distributions) have fallen 23%. One question, of course, is whether that peak of high bond prices reached during the late 2008 panic might be the extent of any adjustment in Treasury yields and prices? We think that drop only resolved the panic pricing. Consider that over the last 48 years the average daily yield for the 10-Year has been 6.88% and for the Fed Funds over nearly the last 56 years 5.51%. We believe that interest rates have nowhere to go but up over the next couple of years. If you agree, here is what we recommend.

Short Bond Funds

Exchange Traded Funds

continue to proliferate to meet investors' appetites for new ways to speculate. Indeed, because ETFs unlike mutual funds trade throughout the day and can be shorted, they appeal to fast money traders who are trend driven. Naturally, traders' participation is likely to distort pricing regardless of market direction. We do not view this investment as a quick trade, and are willing to tolerate significant volatility, especially because we are recommending a leveraged ETF to short Treasuries. Two firms, ProShares and Direxion, are responsible for the six ETFs that short Treasuries. You can choose from shorting Treasuries with durations of 7-10 Years (PST) with 2:1 leverage, 10-Years with 3:1 leverage (TYO), 20+ years with 2:1 leverage (TBT), or 30-Years with 3:1 leverage (TMV). Two funds debuted in April 2008, relatively early in the Treasury bubble, while the others started trading in April 2009 after the bubble had peaked. Just last week, a 3x leveraged ETF that shorts the two-year Treasury debuted.

We're recommending the **ProShares UltraShort 20+ Treasury ETF (TBT—NYSE)**. This ETF is leveraged 2:1 meaning that it aims to return double the inverse daily return of a portfolio of long-duration Treasury securities. The leveraged results are created not with borrowed funds but through the use of derivatives (futures contracts and swap agreements) that amplify the daily changes in its portfolio.

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Note our use of the word "daily." At the end of each day, the fund managers revise the portfolio to bring it back into line with its 2:1 leverage model. Though returns do compound over time, the portfolio at the start of each trading day does not carry over the effect of the previous day's trading. The required daily rebalancing also increases transaction costs. Currently the fund charges a 0.95% annual operating fee. However, we view the fee as nominal in view of the potential returns we expect from this ETF.

If you are averse to leverage, there is an unleveraged ETF (TBF—NYSE), but we accept TBT's higher volatility in exchange for what we believe will be a higher return.

Is this a No-Brainer?

As anyone who has spent enough time in its company knows, the market never offers a sure thing. However, with a view over the longer term, we think this comes close. There are those who are long bonds, believing that the current set of conditions will last indefinitely: benign inflation and the Fed's willingness to keep short-term interest rates in place and, if necessary more quantitative easing to keep longer rates in check, will keep interest rates low and prevent the bond market from falling abruptly.

While we acknowledge that this set of conditions can last for a while longer, we do not believe it is sustainable. We are looking at what even after a recovery from the ultra-low yields the panic of 2008 created are still unnaturally low interest rates. We believe that a combination of a recovering economy and the unintended consequences of last year's money creation to avoid market collapses and a replay of the Great Depression, will eventually force interest rates higher than they are today.

Needless to say, this is not a Bet-The-Farm recommendation, but a way to diversify your investments. Also, needless to say, if we are right, being long Treasuries as the U.S. economy comes out of recession will exact a huge price for their perceived "safety." If you do nothing else after reading our recommendation, give serious thought to whether you should be holding U.S. government fixed-rate bonds as investors realize the recession does have an end. SA

Portfolio Updates

We priced the February issue on 2/5, the first upday after the market reversed what had been a three-week and 8% decline from the January 19th high. Since then the Dow has added 5.5%, the S&P 6.8%, the Nasdaq 8.7% and the Wilshire 5000 7.8%. The *Sound Advice* portfolio is 8.5% to the good. We were then—and remain—constructive about where the market is heading because our indicators still are positive. It's so easy to get caught up in the media's horse-race financial journalism or the CNBC he-said-she-said coverage that passes for analysis. These opinions change from day to day, the result of knee-jerk responses to the most recent news. We're not suggesting that you dismiss as noise everything the media presents but we are asking you to accept that economic recoveries—or for that matter any process—are never linear, moving in one direction without deviation. To quote a bit of well-worn Wall Street wisdom that we believe: "Markets climb on a wall of worry." There always is disquieting news to challenge optimism. You could try to trade in and out depending on headlines or some CNBC seer's anxiety or confidence, but we don't recommend it. What do we see now? Not only is there evidence of an economic recovery in the U.S. and abroad but also fiscal and monetary policies won't tighten until real evidence of job creation is obvious rather than merely hinted at. That won't be happening soon. We're in what should be a sweet spot for equities: economic recovery and government policies intended to keep it going.

Third Avenue Focused Credit Fund, the February recommendation that specializes in the debts and obligations of distressed companies, advanced 1.5%, which seems modest until you contrast that with how U.S. Treasuries performed over the same period, down 1.9%.

International Speedway, the January recommendation, got off to a rough start after reporting another weak quarter, crashed in its first month in SA, but has regained 7.8%. Puzzling is that since the February letter, the shares rose both on a day poor Consumer Confidence numbers were reported and on a day that featured disappointing employment results. Since our thesis has been that ISCA will rise as consumer confidence and

jobs improve, how the shares responded to what should have been discouraging news mystifies us.

Our best performers since the February letter are weighted toward natural resource stocks and funds, which fits with a more positive attitude toward economic growth. There might be a difference in what is driving



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commodities now compared to what had been a primary fuel for price increases. Since the March 2009 bottom, commodities and stock prices in general have moved inversely against the dollar. For that matter, there's been a correlation between a rising dollar since the market started its fall in autumn 2007 until the start of the 2009 rally. What is remarkable about the latest market turn upward is that it has not coincided with a steep decline in the dollar. Since the market began to recover last month, the dollar is essentially flat. Whether this is just a statistical blip remains to be determined, but one interpretation should this pattern persist is that expectations of new demand are replacing the currency translation that had fueled earlier rises on metals and energy prices.

The two biggest movers in commodities were the **Fidelity Select Natural Gas Fund** and **Agrium**, the Canadian fertilizer company, both of which added 15.3%. Oil moved above \$80 again, and though natural gas lagged, it was enough to take the exploration & development stocks in the FSNGX portfolio along for the ride. Fertilizer stocks run higher when investors anticipate greater market for food, which fits with global economic recovery, but the story is murkier. Agrium is caught up in a takeover soap opera that gets more complicated



This table is updated with live prices, charts & buy limits on our website:

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

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
HRPT Properties	HRP	NYSE	\$7.12	6.74%	\$7.50	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$67.94	0.16%	\$72.00	BUY
Boston Scientific	BSX	NYSE	\$7.89	0.00%	\$12.00	BUY
CarMax	KMX	NYSE	\$23.30	0.00%	\$27.00	BUY
CGM Realty Fund	CGMRX	800-343-5678	\$21.92	2.63%	N/A	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$31.94	7.05%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$99.41	1.83%	N/A	BUY
Fastenal	FAST	NASDAQ	\$45.70	1.53%	\$50.00	BUY
Gabelli Global Telecom Fund	GABTX	800-422-3554	\$18.42	1.79%	N/A	BUY
Honeywell	HON	NYSE	\$41.91	2.89%	\$46.00	BUY
International Speedway Corp.	ISTA	NASDAQ	\$27.45	0.51%	\$31.00	BUY
Johnson & Johnson	JNJ	NYSE	\$64.09	3.06%	\$68.00	BUY
Leucadia National Corp.	LUK	NYSE	\$24.95	0.00%	\$30.00	BUY
Mattel	MAT	NASDAQ	\$22.50	3.33%	\$24.00	BUY
Microsoft	MSFT	NASDAQ	\$28.58	1.82%	\$33.00	BUY
Molson Coors Brewing	TAP	NYSE	\$42.81	2.24%	\$52.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$17.69	0.00%	\$19.00	BUY
Perrigo	PRGO	NASDAQ	\$50.73	0.43%	N/A	SELL
Stryker Corp.	SYK	NYSE	\$55.04	0.73%	\$60.00	BUY
Superior Industries	SUP	NYSE	\$15.28	4.19%	\$18.00	BUY
Tetra Tech	TTEK	NASDAQ	\$21.11	0.00%	\$30.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$46.28	2.46%	N/A	BUY
United Parcel	UPS	NYSE	\$59.49	3.03%	\$70.00	BUY
UnitedHealth Group	UNH	NYSE	\$33.74	0.09%	\$38.00	BUY
Wal-Mart Stores	WMT	NYSE	\$54.14	2.23%	\$60.00	BUY
Xerox	XRX	NYSE	\$9.87	1.74%	\$11.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUKY.PK	PINK SHEETS	\$20.21	0.00%	\$25.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$28.05	0.00%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$36.79	4.57%	\$43.00	BUY
PowerShares Water Resources ETF	PHO	NYSE	\$17.31	0.46%	\$19.00	BUY
Transocean	RIG	NYSE	\$84.29	0.00%	\$100.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$34.45	0.03%	N/A	BUY
Aggressive Growth						
AOL Inc.	AOL	NYSE	\$25.74	0.00%	\$28.00	BUY
Comcast	CMCSA	NASDAQ	\$17.43	2.18%	\$21.00	BUY
Davis Financial Fund	DFIBX	800-279-0279	\$22.46	7.92%	N/A	BUY
Ford Motor Convertible Pfd	F.PRS	NYSE	\$47.87	7.27%***	\$50.00	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$9.99	0.00%	\$11.00	BUY
Liberty Global	LBTYA	NASDAQ	\$28.27	0.00%	\$32.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$19.02	4.21%	\$22.00	BUY
Symantec	SYMC	NASDAQ	\$16.97	0.00%	\$20.00	BUY
Third Avenue Focused Credit Fd****	TFCVX	800-443-1021	\$10.71	1.10%	N/A	BUY
Time Warner	TWX	NYSE	\$30.54	2.49%	\$34.00	BUY
UltraShort 20+ Treasury ProShares	TBT	NYSE	\$48.13	0.00%	N/A	BUY

* Prices as of Friday, March 5th, 2010

** Yield represents all income during previous 12 months divided by current share price. Note that all fund distributions fluctuate annually.

*** Dividend Deferred

*** Covers distributions from Aug 31 - Dec 31, 2009

BUY, HOLD, SELL OR LIMIT IN BOLD INDICATES A CHANGE IN ACTION OR LIMIT

each week. First there was a triangular relationship between Agrium, which wanted to acquire CF Industries, which had no interest in Agrium's overture but did want to acquire Terra Industries, which had no interest in a deal. Then CF refused to pay what Terra demanded and quit, after which a Norwegian energy company made a friendly offer for Terra, which brought CF Industries back in as a suitor. Got that? Does this mean Agrium is definitely done with wooing CF shareholders? Who knows? For reasons that escape me, despite being the only one of this trio of unrequited lovers that is not the object of someone else's acquisitive affections AGU has been the best performer over the last 12-months, up 109% compared to the other two up respectively 70% and 80%. Since the sector bottomed in November 2008, AGU is close behind Terra (+192% vs. Terra's +207%). **Anglo-American**, the mining holding company, added 12.3% and **Leucadia**, the opportunistic holding company with significant exposure to copper and iron ore mining companies, added 13.7%. **Transocean**, the ultra-deepwater driller, gave shareholders whiplash over the last few weeks. First RIG said it is instituting a regular dividend, something it has not done since May 2002 when it was 12 cents a year or about 0.3%. The new dividend, which works out to about 3.8% based on RIG's price the day the \$3.11 dividend was announced. In addition, Transocean says it intends to buy back \$3.5 billion of its outstanding shares, or about 12%, which should have a tonic effect on valuations. The market's response was sour. On a day that saw energy service stocks jump, RIG fell back. Why? The standard answer is that investors expected even more from Transocean, and in disappointment sold their shares. Then toward the end of the month, RIG announced less than amazing results for the last quarter. Since the last letter, RIG is flat (+0.4%). We've not soured on RIG. **Plum Creek Timber**, the lumber REIT, rose 2.2% as concerns about the homebuilding industry discouraged investors. **USAA Precious Metals & Minerals Fund** moved 10.9%.

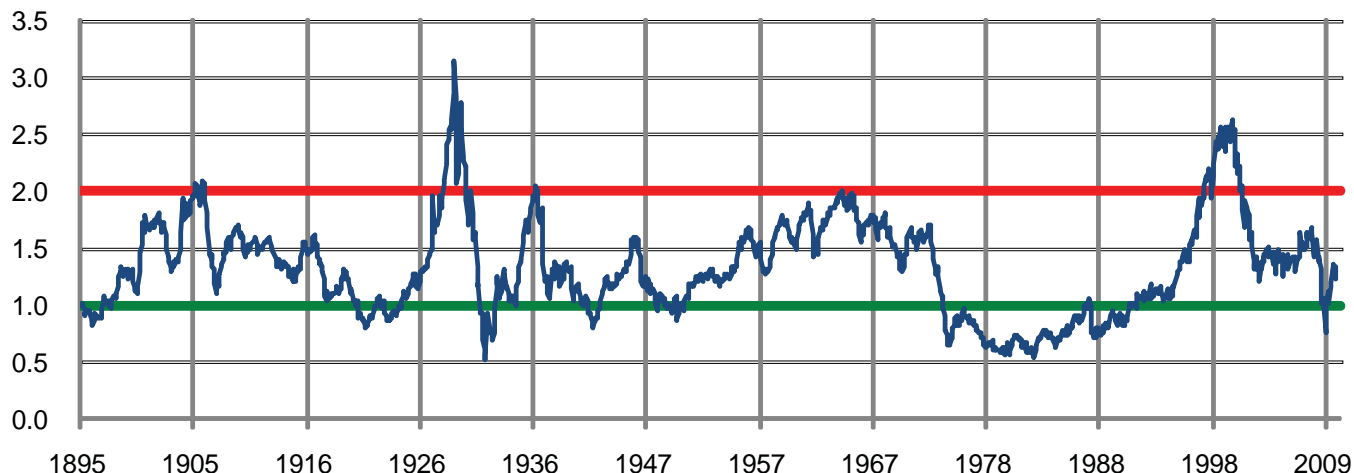
Media stocks also had a good month with **Liberty Global** (+16.3%) after selling its 38% interest in a Japanese cable business for \$4 billion, which management is using to increase its ownership of Germany's Unitymedia to 100%. This shifts decisively LBTYA toward a Eurocentric market. **Comcast** added 13.4%. **Time Warner**, which spun off its cable assets last year as well as **AOL** moved up 13%. AOL, despite being one of the most reviled Internet plays, is up 8.8% for the month, and 10.6% year to date.

We can't decide whether Wall Street is betting that any healthcare reform bill is dead or will become law. If we characterized the fertilizer sector as a soap opera,

what can be said about healthcare? With the vaudeville show in Congress, healthcare remains an enigma. Nonetheless, with the exception of **Boston Scientific** (-3.9%), which Wall Street has abandoned after its mega-settlement with **JNJ**, the sector is prospering. **Odyssey Healthcare** (+20.6%) is this month's best performer not just because it surpassed quarterly expectations but also because investors might be warming to the concept that hospice care as an alternative to ultra-expensive hospitalization during the last months of life is not a death panel sentence but realistic, humane and less expensive. **UnitedHealth** and the insurers are seen as the most likely to suffer damages from any reform from Washington, and added only 4.3%. **Stryker**, the orthopedic device and hospital supply company, added 7.8%. **Perrigo**, which has the least riding on healthcare reform, jumped another 12.1% but receded from what was an all-time high. We've nearly doubled our June 2009 investment. **We think it's time to take our profits here**, but hope to have another chance at the shares when Wall Street's love affair cools. **Johnson & Johnson** lagged (+3%) and **Hambrecht & Quist Life Sciences Fund** edged up only 2.6%.

Industrial and consumer discretionary stocks also did well. **Ford** has become a market favorite thanks to its own progress and Toyota's woes. The preferred added another 14.1% and this does not take into account the deferred dividend payments that at some point will be reinstated. **Superior Industries**, a supplier to the auto companies, tacked on 9.5% and **CarMax**, the chain of used-car dealerships, 14.6%. **Fastenal**, the connector manufacturer and hardware retailer to commercial accounts, added 9.8% and **PowerShares Water Resources Fund**, which also has exposure to industrial manufacturers, added 11.3%. **Honeywell** was up 12.7%. **Tetra Tech**, which is part of that ETF's portfolio, was up only 1.2%. **We think it has significant recovery potential** after getting beaten up for the past few months. Technology was a mixed bag. **Xerox**, which is not perceived as a cutting edge tech name, outperformed tech with a 16.5% increase, while **Symantec**, the security and data management company, slipped 1%. **Maxim**, the chip maker, moved 8.8% but **Microsoft** could only muster a 2.5% increase.

REITs are having a good month. **CGM Realty Fund** is up 11.7% and **HRPT Properties Trust**, the office/light industrial REIT, added 5.2%. One driver for CGM is its big position in Developers Diversified Realty, which last year seemed to be on the road to zero when Heebner was buying. The shares are up 30% in the last few weeks. SA



See *The Science of Making Money in Turbulent Stock Markets* for a full explanation of the Risk Indicator and the Diffusion Indexes. Median home prices have been flat for the last ten months, so the risk indicator is primarily a reflection of stock prices. The latest reading is 1.34. This reading reveals that stocks are still below their average relative to house prices, and present a good value. February’s reading of 0.79 likely marked the low for this cycle as well as the beginning of Supercycle 6.

The SoundAdvice Diffusion Indexes

The Diffusion Index of Leading Indicators gives “Aggressive” signals when all four of its individual leading economic indicators drop below their respective levels

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 return of 20.4 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.

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		

of six months earlier, providing a zero percent reading. This reveals a soft economy and a ripe atmosphere for a lasting decline in interest rates.

As far back as February and March we were projecting that our Diffusion Index of leading indicators would hit zero in March, 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. See *The Science of Making Money in Turbulent Markets* (which you received with your subscription) for a history of Supercycles. You will also receive an updated copy when you renew your subscription.

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. This reveals a strengthening economy and inflationary pressures ahead. Our next signal will come from this Index. The Commerce Department has not released the underlying indicators at this writing. This Diffusion Index currently stands at 33 percent.

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