**Sound**Advice

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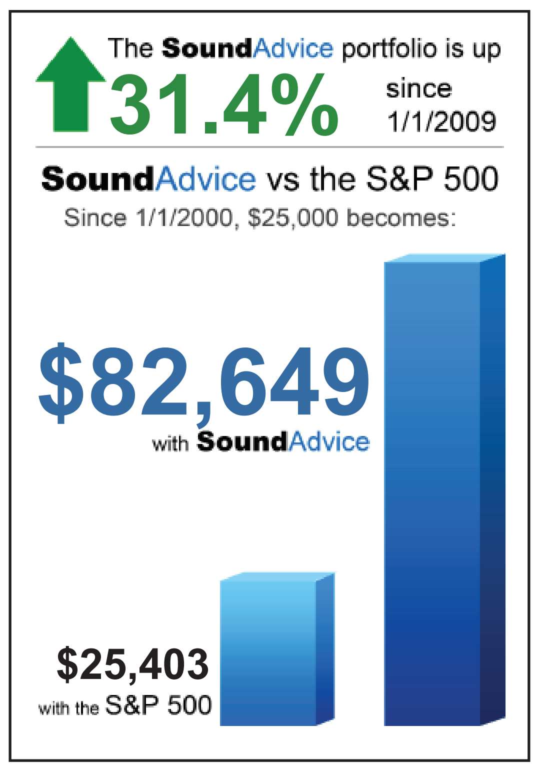
# Foul is Fair

The market continues to echo *MacBeth*'s Three Witches' perspective: "Fair is foul and foul is fair." Unsatisfactory economic news, these days, can rally the market; good economic news, not so much, because what is foul lately convinces Wall Street that the Federal Reserve will continue to spew out torrents of new money in the hope that this time, the economic engine will catch and we will begin to move forward. Indeed, from late April to late August, as the U.S. economy stagnated and stock prices plummeted, fears of sovereign defaults among the weaker links in the European Union and concerns that China was throttling back its economic growth assailed investors. Bad news was bad for stocks. But out of that angst came a counterintuitive reason to buy: the worse things got, the more likely the Fed would intervene and Wall Street is addicted to free money. Fundamentals really had little place. Now we have that intervention and the market's response has been euphoric with stock prices recouping the April-August losses. But don't get too giddy about the witches' greeting. In the short term, MacBeth usurped the crown. In the end, he died disgraced. In an economy that relies on wave after wave of monetary expansion, how to gracefully exit such a world, even presuming the economy does respond, is extraordinarily tricky.

But "Fair is Foul and Foul is Fair" resonates for *Sound Advice* for a less cynical reason. We like to recommend stocks with warts. If not a comfortable strategy, it is effective. *Morningstar* since 1994 has tracked funds invested in loved (funds that had seen the most new cash inflows) versus unloved sectors (funds that had seen the most redemptions), and found that "From 1994 through 2009, the buy-the-unloved strategy produced an annualized 8.1% return, compared with 4.77% for the loved, 6.24% for the S&P 500, 6.96% for the Wilshire 5000, and 5.36% for the MSCI World. This assumes you invest in the unloved categories for three years running and then roll over the oldest group into the new unloved group starting in year four." This year, the




This morning I clicked a link to an essay titled "Can Regular Investors Beat the Market?" but before the page opened, up popped an ad for a penny stock tout service. Was this brilliant marketing or a sly reminder to avoid get-rich-quick schemes? No, the author confirmed, it was just an embarrassing, for her, but brilliant ad placement.

After the punishment the average investor has absorbed over the Lost Decade, two impulses are common: never to even watch the market and how can I catch up? Small investors still are wary of stocks, though marketers, after seeing stocks renew the rally that started early last year, are getting more active. Consider the number of promotional mailers suddenly packing my mail box from "mushroom gurus," who heretofore had no public visibility but overnight explode on the scene as self-described masters of the universe. Someone thinks the small investor is ripe for their inspiring (but ultimately impoverishing) pitches.

But back to the essay, which is skeptical but catalogues approaches such as concentrate on small caps, use low cost funds, have firm buy and sell limits, pay attention to day-to-day market and company specific news, be disciplined etc. Some of this is good advice (small caps), some of it bad (reacting to day-to-day events), but discipline cannot be learned. Either by your nature you are steadfast, or, as is more common, you will abandon ship when the market moves against you—and it will. Why has *Sound Advice* prospered even during the Lost Decade? Not only did we get more aggressive at opportune moments and avoided sectors the market fell in love with but we stuck with our portfolio when the market trashed it. We buy what has a pessimism discount, and then wait. So far, so good.

***-Gray Emerson Cardiff***

loved sectors are Foreign Growth, Foreign Value and Commodities. The unloved are Domestic Large Value, Large Growth and World (=International + U.S.). We'll see.

What a difference a year makes: the 2010 basket we thought would outperform the market did. As a group they increased 16.8% from where we priced them on November 20, 2009, while the Dow added 9.5%, the S&P 12.3%, the pan-market Wilshire 5000 15.2% but missed matching the techcentric Nasdaq's 20.1%. Not as good as last year's extraordinary performance (+78.1%) that outclassed the best of the indexes, the Nasdaq (+41.5%). This year, we had one loser, **Boston Scientific**, which dropped 14.5%, and one laggard, **Johnson & Johnson**, which added 7.1%. **Molson Coors** contributed a respectable 12.9%. The big winners were **Maxim Integrated**, the chip maker (+35.7%) and **Comcast**, the cable network, which jumped 40.5%.

What happened? Though you can't tell from the losers and laggards, we were right about healthcare but wrong about the choices. We've argued ever since healthcare fell into investors' doghouse that the anxiety was overdone and these depressed prices had created real value in the sector. So it made sense to overweight the Five for 2010 portfolio with two healthcare stocks. Had we selected instead positions such as **UnitedHealth**, the HMO, which is up 30.2% or even **Stryker**, the orthopedic replacement and hospital supply company, which is up 8.8%, or **Perrigo** (sold on 3/5/10) up 29.1% or **Odyssey Healthcare** (+76.9%), sold in June after a takeover, this basket of stocks would have performed better. In fact, the *Sound Advice* portfolio in its entirety, including the five recommended positions, had a very good 12 months, and is up 23.5%, outperforming all of the standard benchmarks.

So what went wrong with BSX and JNJ? We'll reserve our remarks about **Boston Scientific** to our Five for 2011 Portfolio, since we are about to stick our head in that same lion's mouth for a second year. As for **Johnson & Johnson**, it was hardly a good year for large pharmaceutical or medical device companies, both prominent parts of JNJ's almost encyclopedic stable of businesses. It was a good year for generic drug and OTC drug companies (e.g. Perrigo), but not for JNJ's divisions. McNeill, which makes JNJ's OTC products, yielded only problems as one recall after another hounded it and tarnished JNJ's reputation. Between relative market disinterest in JNJ's businesses and its own missteps, its modest performance is understandable. We still value JNJ not just for its current yield (3.3%) but also because we suspect it will regain its following on Wall Street at some point.

Successes are often less interesting than failures. Brewers did well, and **Molson Coors**, was no exception. We suspect that TAP, which has now joined in a North American production and marketing alliance with SABMiller that is helping to reduce costs and boost profits, eventually will follow Budweiser into a merger, most likely with SABMiller. BUD, as you recall, surrendered to a very generous buyout from InBev, an international brewing juggerrnaut. The frontier for expansion is not in developed markets where Molson Coors is strongest, but in the emerging markets: Asia, Latin America and Africa. Until that happens, TAP will be a reasonable holding with an above average yield (2.2%).

**Maxim Integrated**'s decision to add semiconductors used in mass market products is starting to work. However, its core business in digital/analog chips has a bright future, and as global demand resumes, will continue to buoy the company.

**Comcast** is in the process of completing a major acquisition, the purchase of NBC Universal, which provides not only cable channels but also valuable entertainment products to transmit. When the deal was percolating earlier last year, response was negative and took CMCSA down. However, as the market has become more comfortable with the details, the share price has rebounded amid a very positive climate for cable companies. Take a look at **Liberty Global**, our other cable investment, and you'll see what we mean. This year the shares have nearly doubled.

With the class of 2010 now profitably booked, we're ready with a quintet for 2011. **S**A

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# Five for 2011

With share prices taking off since the end of August, many once languishing positions that were candidates for this year's basket of ideas made up lost ground and are less attractive. But this quintet retains enough question marks that the market remains wary. Each carries enough of a pessimism discount to make them interesting for contrarian investors.

**Tetra Tech (TTEK—Nasdaq)**, an environmental engineering company with a core competence in water issues, is suffering through a recessionary/post recessionary phase that eventually will resolve itself into better times. Because government and construction, two engines for TTEK's revenues, either have restricted funds (government) or diminished need (construction), TTEK's revenues and profits have fallen. The shares took a drubbing early this year, have recovered somewhat but remain 20% down year to date. The last quarter (through June) did show improvement, and with 1% long-term debt on its balance sheet and the largest cash position in the company's history, Tetra Tech is in an excellent position to regain lost ground as the climate improves. It is also taking advantage of that weak environment through a series of strategic acquisitions.The time to buy Tetra Tech is now during a lull, not after its backlog and income statement boom once more.

In its Q3 10Q, Tetra Tech's per share earnings year-to-date exceeded analysts' projections. Revenue advanced in all sectors except commercial. Federal, state, local and international business expanded anywhere from 3% (Federal) to 25% (International). Though operating income was flat, earnings were up 3% after accounting for a $39.8 million tax refund in 2009. But only one of TTEK's divisions, Environmental Consulting, demonstrated strong growth (11%). The rest were flat. Fortunately Environmental Consulting is the biggest division, accounting for almost a third of revenues. The book to bill ratio, that is the ratio of new business divided by billed or completed projects remains above one, a sign of good health in a difficult market.

Management expects 2011 to be stronger than 2010 not only because economic conditions should be better but also because TTEK anticipates reaping revenue from international clients. The first step was to make modest acquisitions to provide a toehold. The same strategy was used to access the alternative energy industry when TTEK acquired several companies that do wind-power engineering, a bet on demand for alternative energy. These deals boosted TTEK's visibility on Wall Street during the 2008 energy bubble when oil hit $148 a barrel, but at present are just part of Tetra Tech's range of businesses.

More central to TTEK's growth is expansion outside the United States. Last month it announced the purchase of BPR, a Canadian engineering firm that specializes in water, energy, industrial plants, buildings, and infrastructure projects. This followed two other Canadian acquisitions in January 2009 and in February of this year. BPR with 1600 employees nearly doubled Tetra Tech's Canadian work force. It's expected to be profitable immediately. Tetra Tech is also looking at and beyond Australia and the United Kingdom, where they've made acquisitions to generate business not just in those countries but as entry points for the Mideast and Asia, where infrastructure, especially for water, has badly lagged population and economic expansion. Through Q3 this year, TTEK has gotten 13% of its revenues outside the U.S. Next year, TTEK expects 25% of revenues will come from non-U.S. clients.

Valuations are extremely modest. With the exception of 2005 when Tetra Tech struggled through its massive write-offs that vaporized earnings, current price ratios are as low as they have been over the last decade. We recommend TTEK up to $26.

**Transocean (RIG—NYSE)** owned the Discover Horizon that sat on the BP's Macondo well in the Gulf of Mexico, and when that platform exploded and fell to the bottom of the Gulf, RIG immediately was presumed to be liable for some of the ever increasing damage the spill caused to say nothin of the loss of 11 lives. The Swiss government, which regulates RIG, blocked payment of the previously announced distribution, which remains unpaid.

However, a cursory examination of Transocean's contract with BP or a glance at its 10Q or 10K revealed that RIG appeared to be insulated from almost all of the potential costs involved in the spill: stopping it, eradicating its environmental damage and the tsunami of government fines, public and private civil suits and potential criminal charges that have ensued. When we reviewed that contract, we told our subscribers what we had found. Unfortunately being right is no substitute for whatever the market decides it wants to think.

On the eve of the April 20th blowout, RIG closed at $92.03, near its post-bear market high, but over the following weeks and months, as oil and gas continued to spew from the well, RIG shares plummeted to $42.58 on June 9th, a 53.7% collapse, worse inexplicably than the damage to BP's share price. Since then, with almost no exceptions, evidence suggests Transocean is unlikely to suffer any meaningful damage to its business or its balance sheet, which has taken RIG back to just under $64, a nice recovery that still leaves the shares $28 or 44% below where they traded on April 20th. We think they should trade at least back to that level and perhaps higher.

Consider that in the two quarterly reports filed since April 20th RIG management has indicated modest costs associated with the Macondo well, and though the company can expect to invest significant sums to meet new drilling conditions now that the moratorium has been lifted on deepwater drilling in the Gulf of Mexico, these costs will be passed on to firms that lease Transocean's rigs.

The company this year has put five new rigs into operations and have four more coming on line next year. We expect them to command premium rates. In short, revenues and earnings should be strong over the next few years, even were the price of oil to fall below $80 a barrel, which for the present seems to be the base price. Indeed, if we look at how the share price for the companies Transocean sells its services to have performed, it's possible to imagine RIG not just regaining its pre-April 20th price but going well beyond that level. Consider that Chevron, RIG's biggest client with 11 rigs under lease, has risen 32% since the explosion. Add on the distribution—which we are confident the Swiss government eventually will green light—and you have an extraordinary opportunity. We recommend buying RIG up to $80.

**Leucadia (LUK—NYSE)** continues to justify the high opinion we hold for its principals, Ian Cumming and Joseph Steinberg, who created what is today's Leucadia in 1978 and have achieved a remarkable track record. We owned LUK once before, selling it in December 2004 for a 70% gain, more than double the standard benchmarks' performance. This time round LUK is up 62% since its reintroduction 19 months ago, better than the Dow (+43%), the S&P (+46%) and the Wilshire 5000 (+50%) and the Nasdaq (+59%). Cumming and Steinberg have the ability not only to ferret out cheap assets but also to attract willing buyers at significantly higher prices.

Often compared to Berkshire Hathaway, Leucadia's typical investments are light years away from what Buffett buys. Rather than buying into world-class companies that Buffett says he's content to never sell, Leucadia traffics in companies with significant problems and/or untapped potential. They buy to sell and the sooner the better. When Warren Buffett referred to "cigar butt investors," who for next to nothing buy companies they find in the financial gutter that might have just a puff or two left, he might well have been thinking about Leucadia. For an overview of what Leucadia currently owns and some insight into how Cumming and Steinberg think, look at the most recent (2009) annual letter to shareholders (http://www.leucadia.com/c-p_letters/luk_c-p2009.pdf).

For instance, Leucadia in early 2008 spent $374 million for about 25% of the common shares of Americredit, which specializes in providing credit for vehicle purchases by less-than-creditworthy (=subprime) customers. Needless to say, 2008 was a terrible year for anything involving financial services, particularly those marketed to credit-challenged clients. At the time, Steinberg and Cumming told shareholders: "We have known of this excellent company for many years, having been in the sub-prime auto business ourselves… In this environment, financing for ACF is going to be very difficult and management is taking appropriate steps to downsize the company. We are guardedly optimistic that the financial market will climb out of its bunker next year. People need auto financing to get to work." Flash ahead to this July and Leucadia no longer owns ACF, the company having been sold to General Motors for $3.5 billion, which gives LUK $405 million in profits on its $374 million investment a mere 19 months later. What's next? Would it surprise you that a new partnership, Garcadia (with Garff Enterprises) is acquiring car dealerships now?

If Buffett would not buy what Leucadia traffics in, he recognizes talent and partnered (Berkadia) with them earlier in the decade to unwind the assets of Finova, a bankrupt financial services company. Berkshire provided the AAA credit rating and Leucadia did the grunt work. Last year, Leucadia approached Buffett about reviving Berkadia, this time to acquire bankrupt

Capmark Mortgage, America's third largest servicer of commercial mortgages as well as an originator of commercial mortgages. The 50/50 partnership spent $434.4 million and Berkshire created a $1 billion line of credit to purchase existing loans from Capmark. As was the case with Finova, the crisis that destroyed the company had less to do with the long-term quality of its loans but everything to do with a credit crisis. Berkadia in both cases had the talent and the credit quality to step in and clean up.

But Leucadia isn't limited to plucking half-smoked tobacco products from the gutter. It's also willing to bankroll growing the tobacco. Portions of the portfolio include a start-up biotech company and a couple of projects in the nascent liquid natural gas industry. The best example is the $408 million Leucadia has invested in Fortescue, Australia's third largest iron-ore miner. In exchange, Leucadia received 9.99% of Fortescue's common shares (currently worth $395 million) and a note that gives Leucadia 4% of revenues net of royalties paid to the Australian government for all ore mined at two mines. Fortescue, still in its early stages, is sitting on huge iron ore deposits and with Chinese contracts, is in a strong position. However, earlier this year, Fortescue floated the possibility it might issue new securities that impinged on the revenue-participation notes Leucadia (and others) hold. Though no new notes have been issued, Leucadia as lead plaintiff petitioned Australian courts to block issuance of these new shares. We expect a positive resolution.

Then there is time. Though current prices don't reflect the present to say nothing of the potential worth of what Cumming and Steinberg have accumulated, they won't a decade from now be at the helm. Both are in their late 60s, though contracted through 2015. Unlike Berkshire Hathaway which will live on after Buffett no longer oversees its portfolio, Leucadia without its founders most likely will be liquidated, which should be a fat final payday for shareholders. We recommend LUK up to $30.

**Boston Scientific (BSX—NYSE)** has over the last five years earned a near universal reputation as one of Wall Street's worst stocks, a view that took hold not long after the company overpaid for Guidant, the heart-rhythm device company, back in 2006 after outbidding **Johnson & Johnson** to win the prize. Major problems that neither JNJ nor BSX as suitors recognized soon turned Boston Scientific's absurdly rich acquisition into a deeply flawed asset. At the same time as Guidant's product issues exploded, Boston Scientific's own product problems, though less severe, also emerged.

The rationale for acquiring Guidant was sound and simple: Boston Scientific, which had a long history of making acquisitions, needed significant new products to balance its reliance on stents. Guidant, a major designer and manufacturer of cardiac rhythm devices such as pacemakers and defibrillators, fit the bill. Unfortunately Boston Scientific's then senior executives became so fixated on winning a bidding contest with JNJ that they made several profoundly wrong decisions. First, to finance the deal BSX recruited Abbott Labs to provide $4.5 billion. Also, Abbott agreed to buy $1.4 billion in new BSX shares. In exchange, Abbott got all of Guidant's interventional cardiology business (including its products in development) as well as Guidant's Xience Stent, which would become the next-generation device. Boston Scientific management declared their victory over JNJ as "transformative."

They were right about the magnitude of the deal's impact on their company, but wrong about the direction. The transformation was ugly. In addition to what Boston paid ($24.2 billion) and gave away, it also took on $6.5 billion in new debt (nearly quadrupling long-term debt), diluted its existing share count by 80% and had to foot the $705 million Guidant paid to JNJ for breaking their merger agreement. Since then, new difficulties emerged at Guidant, demand declined for drug-coated stents, the heart of Boston Scientific's revenues and Abbott now owned the best-selling stent. There were also concerns about the superiority of coated stents in general. BSX shares clunked down from the mid-$30s just before the Guidant deal (they'd traded in the mid-$40s in early 2004) to $6.92 today.

When the deal occurred, 13 Wall Street analysts hailed the acquisition. According to Yahoo!'s current online survey of analysts' ratings, 24 put BSX as a hold or underperform and a mere four consider it a Buy or a Strong Buy. We're among the latter, but why?

The problems at Guidant, though they now and again do flare up, are a dwindling legacy issue. Sales from that division have continued to grow. The stent business, though hurt by Abbott's ascendance, remains solid. In fact, Boston Scientific remains the dominant player in this sector, though that dominance till now has depended on sales of the Promus stent, the licensed version of Abbott's Xience model, which BSX gave to Abbott. Boston Scientificis rolling out a new stent, the Element, which will supplant some of its

Xience/Promus sales, which means no royalties to be paid to Abbott.

In addition, Boston owns several other valuable product lines, which either will enjoy revenue growth in the future or, as just happened with its neurovascular business sold to **Stryker** for $1.5 billion, could be monetized if sold. There are new products in the pipeline, including what could be the next cutting-edge drug-coated stent. The team that brokered the catastrophic Guidant deal has been replaced by executives who had turned Zimmer, a maker of replacement knees and other joints, into a winner. In place of the previous management's aggressive ego-driven deal making, the new CEO Ray Elliot is focused on stabilizing Boston Scientific. They have been reducing debt, creating operations less prone to manufacturing problems and have purged questionable sales techniques.

> With share prices taking off since the end of August, many once languishing positions that were candidates for this year's basket of ideas made up lost ground and are less attractive. But this quintet retains enough question marks that the market remains wary. Each carries enough of a pessimism discount to make them interesting for contrarian investors.

Wall Street's soured view of the company exaggerates the problems, thus ignoring its strengths. Valuations are rock-bottom: Price to Sales stands at 1.1 versus an industry average of 2.4. Price to Book is 0.8 versus 2.8 for its peers.

Frankly, we can't be certain that Boston Scientific has the stuff to return to the once lofty levels at which it once traded. To do that, management would have not simply to get the company on track, they would have to produce several industry-dominant products. That's possible. But as a worst-case scenario, if Elliot can start to put together successive quarters that outpace Wall Street expectations, BSX will outperform the averages handily. Indeed, the last two quarters have begun to set a new direction. Characteristically, in Q2 after the company announced better-than-expected results and enjoyed a bounce, almost immediately news broke that there were potential problems with some older Guidant products, which crashed the shares to new lows. Earlier in the year, again as the company was creating less negative news, it had to recall all of its defibrillators after it realized that it had failed to get FDA approval of an innocuous change in how they were manufactured. For 12 weeks Boston Scientific did not sell a single defibrillator, and lost some market share.

In mid-October, BSX again announced better-than-expected results, and miraculously avoided shooting itself in the financial foot. Since then, the shares are up 14%. We think this is just the beginning and recommend BSX up to $8.50.

**Dodge & Cox Stock Fund** has not embarassed its managers this year, but has lagged the S&P 500, its benchmark, primarily because large cap value stocks in general have languished during this phase of the market recovery. As *Morningstar* notes in its annual coverage of loved and unloved funds, large cap companies, both domestic value and growth lagged the overall market. ([http://www.morningstar.com/Cover/videoCenter.aspx?id=357151](http://www.morningstar.com/Cover/videoCenter.aspx?id=357151)).

Dodge & Cox fell hard during the 2008 bear market in no small part because like many value-oriented funds, it had built positions in financials with names like AIG and Wachovia. As management noted in its 2008 annual report: "we clearly underestimated the worsening credit crisis, the likelihood of government interventions, the depth and breadth of the ongoing economic problems, and the combined effect of these on many of the Fund's holdings, particularly within the Financials sector."

Almost two years later, one significant development in the fund's largest holdings is the return of financials. From an underweighted exposure to financials at the end of 2009, the fund has gone to near equivalence versus the S&P 500 today (15%): Capital One and Wells Fargo (which acquired Wachovia at a fire sale price), though each had been in the portfolio at the start of the year, have climbed into the top ten positions. But the greatest overweights versus the S&P are in healthcare (19.8% vs. 11.6%) and consumer discretionary (17.4% vs. 10.4%), while the biggest underweights are in consumer staples (2.4% vs. 11.3%). It's not that DODGX pursues themes. Rather the managers are discipline bottom-up investors, which often means a concentration of similar positions.

We should note that more than any other mutual fund, the *Sound Advice* portfolio shares more positions (11) with DODGX than with any other. Among the Five for 2011, DODGX should be the least volatile, and if you want to put money into equities now, we can't think of a more effective, lower cost way to benefit from what we believe will be a continuing bull market. Costs are very low, particularly for a managed fund, and the performance, though diminished by the 2008 bear market, we can be confident, is returning. **S**A

# Portfolio Updates

The September-October stretch that was supposed to be Wall Street's Armageddon met expectations—but perversely decimated just the bears. The *Sound Advice* portfolio, as it did last month, outperformed the standard benchmarks except for the techcentric Nasdaq (+8.8%), adding 8% since we priced the October portfolio on 10/1 versus the Dow's 5.7%, the S&P's 7% and the pan-market Wilshire 5000's 7.3%. We're in the midst of earnings season, and though company specific quarterly outcomes made big waves for individual stocks, the overall market moved to the beat of quantitative easing and the beating of Democrats on November 2nd. Intuitively you'd expect quantitative easing with its impact on longer-term interest rates to drive yields lower and bond prices higher should mean that the **ProShares UltraShort Treasury ETF** was destined to fall further. Instead it added 11.9%. Were traders taking profits, were they hedging against the eventual upward move in yields or had the rush into Treasuries leading up to the Fed's QE II launch gone too far? TBT remains a hedge against an abrupt rise in interest rates.

**Paychex**, the October recommendation, also confounded expectations by trailing the market, up 3.5% despite last Friday's better-than-expected jobs report (151,000 versus the expected 100,000). If our thesis is correct, investors should have gravitated toward Paychex, whose revenues are tightly tied to job creation. It didn't happen. Given PAYX's 4.2% yield, we can afford to wait for investors to get the message.

With the Nasdaq leading the market, not surprisingly our best sector was technology. **Maxim Integrated**, the chip maker, not only reported solid sales and profits but also increased guidance for the next couple of quarters. Part of the good news involved a change MXIM made in its business model when it put significant emphasis on chips aimed at consumer mass-market devices such as phones. Maxim traditionally had focused on highly engineered chips for industrial applications. These were high margin products that enjoyed long product cycles. Neither is true of the consumer-oriented products, a change that created anxiety among analysts. Apparently a good quarter and better outlook calmed them. On the earnings report, MXIM jumped 10.2% and is 23.9% higher since the last letter. Less techie but part of the general industry, **Xerox** has been among our best positions this year (+38.3%), and added another 11.4%. **Symantec**, which we were about to sell just a few months ago, continues to rebound. Since the last letter, SYMC is up 11.7% on the strength of better quarterly results and rumors. From our gloomiest comments back in the August issue, SYMC is up 32%. The company finds itself at the confluence of investor interest in large scale data storage and management (through its Veritas division) and concerns about security (its core division). With McAfee, its primary competitor for security applications about to become an Intel subsidiary, Symantec is now the dominant independent player. Rumors are swirling that dissident institutional holders want to force Symantec to sell off its Veritas division, whose purchase in 2005 damaged the company operationally and reputationally and led to our recommending it in the first place. The prospect of turning a quick buck by selling Veritas excited traders.

The **Columbia Seligman Tech Fund** is performing as expected. Although its big tech stocks are hot, it's experiencing a drag on performance because the put options it sells as a part of its income generating component are falling in price. Since the last letter, STK is up 3.6%. This closed-end fund provides a steady income return (in a flat market this should run around 10% annually and in an upwardly trending market or in a declining market should perform in line or slightly ahead of the Nasdaq). But we're experiencing a more aggressive move in the biggest tech names and this is what happens.

With QE II in the air, the dollar has been dropping again, which is good news for commodities. As a group they were up 8.9%, led by **Anglo American**, which was propelled by the consequences of lower interest rates in the U.S. that effectively make the dollar less attractive and thus cheaper. AAUKY added 20.7%. **Leucadia**, whch we feature in the Five for 2011 recommendations, added 14.8%, again aided by a cheaper dollar. **Agrium**, which we suggested last month was due to cool down, did not, increasing 13.6% despite reporting less than expected quarterly results. **Plum Creek Timber**, though dependent on a not-even- on-the-horizon recovery in real estate,

# **Sound**Advice — Portfolio Updates for November 2010

| Income With Growth | Symbol | Exchange/ Phone | Price/ N.A.V.* | Yield** | Buy Limit | ACTION |
|---|---|---|---|---|---|---|
| CommonWealth REIT*** | CWH | NYSE | $26.32 | 7.60% | $28.00 | BUY |
| Telecom New Zealand | NZT | NYSE | $8.36 | 8.49% | **$8.70** | BUY |
| **Diversified Growth** | | | | | . | |
| Agrium | AGU | NYSE/TSE | $85.15 | 0.26% | **$90.00** | BUY |
| CarMax | KMX | NYSE | $32.35 | 0.00% | **$35.00** | BUY |
| CGM Realty Fund | CGMRX | 800-343-5678 | $26.34 | 2.35% | N/A | BUY |
| Comcast | CMCSA | NASDAQ | $21.04 | 1.55% | $23.00 | BUY |
| Dodge & Cox Intl.Fund | DODFX | 800-621-3979 | $36.27 | 1.20% | N/A | BUY |
| Dodge & Cox Stock Fund | DODGX | 800-621-3979 | $104.89 | 1.04% | N/A | BUY |
| Fastenal | FAST | NASDAQ | $53.74 | 1.56% | $60.00 | BUY |
| Ford Motor Convertible Pfd | F.PRS | NYSE | $51.35 | 7.28% | **$55.00** | BUY |
| Gabelli Global Telecom Fund | GABTX | 800-422-3554 | $21.18 | 1.70% | N/A | BUY |
| Honeywell | HON | NYSE | $49.28 | 2.46% | **$51.00** | BUY |
| International Speedway Corp. | ISCA | NASDAQ | $23.50 | 0.68% | **$26.00** | BUY |
| Johnson & Johnson | JNJ | NYSE | $64.65 | 3.34% | $68.00 | BUY |
| Leucadia National Corp. | LUK | NYSE | $27.30 | 0.00% | **$30.00** | BUY |
| Mattel | MAT | NASDAQ | $23.94 | 3.13% | $26.50 | BUY |
| Microsoft | MSFT | NASDAQ | $26.95 | 1.93% | **$31.00** | BUY |
| Molson Coors Brewing | TAP | NYSE | $50.25 | 1.91% | **$54.00** | BUY |
| Paychex | PAYX | NASDAQ | $28.20 | 4.40% | $32.00 | BUY |
| Pfizer | PFE | NYSE | $17.18 | 4.19% | $19.00 | BUY |
| Stryker Corp. | SYK | NYSE | $52.43 | 1.14% | $55.00 | BUY |
| Superior Industries | SUP | NYSE | $18.36 | 3.49% | $20.00 | BUY |
| Tetra Tech | TTEK | NASDAQ | $21.68 | 0.00% | $26.00 | BUY |
| Third Avenue Value Fund | TAVFX | 800-443-1021 | $53.27 | 2.14% | N/A | BUY |
| Time Warner | TWX | NYSE | $31.34 | 2.68% | $34.00 | BUY |
| United Parcel | UPS | NYSE | $69.79 | 2.69% | $75.00 | BUY |
| UnitedHealth Group | UNH | NYSE | $36.86 | 1.36% | $38.00 | BUY |
| Wal-Mart Stores | WMT | NYSE | $55.20 | 2.19% | $60.00 | BUY |
| Xerox | XRX | NYSE | $11.90 | 1.45% | **$13.00** | BUY |
| **Energy/Natural Resources** | | | | | | |
| Anglo-American PLC | AAUKY.PK | PINK SHEETS | $24.48 | 0.00% | **$28.00** | BUY |
| Fidelity Select Nat. Gas Fund | FSNGX | 800-544-8888 | $28.05 | 0.17% | N/A | BUY |
| Plum Creek Timber | PCL | NYSE | $38.88 | 4.32% | **$42.00** | BUY |
| PowerShares Water Resources ETF | PHO | NYSE | $18.12 | 0.57% | $19.00 | BUY |
| USAA Precious Metals & Minerals | USAGX | 800-862-6909 | $46.34 | 0.02% | N/A | BUY |
| **Aggressive Growth** | | | | | | |
| AOL Inc. | AOL | NYSE | $24.92 | 0.00% | $28.00 | BUY |
| Boston Scientific | BSX | NYSE | $6.92 | 0.00% | **$8.50** | BUY |
| Davis Financial Fund | DFIBX | 800-279-0279 | $22.46 | 0.00% | N/A | BUY |
| H&Q Life Sciences Fund | HQL | NYSE | $10.25 | 6.24% | **$11.89** | BUY |
| Liberty Global | LBTYA | NASDAQ | $39.43 | 0.00% | **$43.00** | BUY |
| Maxim Integrated | MXIM | NASDAQ | $22.67 | 3.71% | **$25.00** | BUY |
| Seligman Premium Growth Fund | STK | NYSE | $19.43 | 9.53% | **$22.00** | BUY |
| Symantec | SYMC | NASDAQ | $17.21 | 0.00% | $20.00 | BUY |
| Third Avenue Focused Credit Fd**** | TFCVX | 800-443-1021 | $11.47 | 5.26% | N/A | BUY |
| Transocean | RIG | NYSE | $63.92 | 0.00% | **$80.00** | BUY |
| UltraShort 20+ Treasury ProShares | TBT | NYSE | $35.28 | 0.00% | N/A | BUY |

**This table has live prices, charts & buy limits on our website:** http://www.soundadvice-newsletter.com

* Prices as of Friday, November 5, 2010
** Yield represents all distributions during previous 12 months divided by current share price. Note that all fund distributions fluctuate annually.
*** Name and Ticker changed from HRPT (HRP--NYSE)

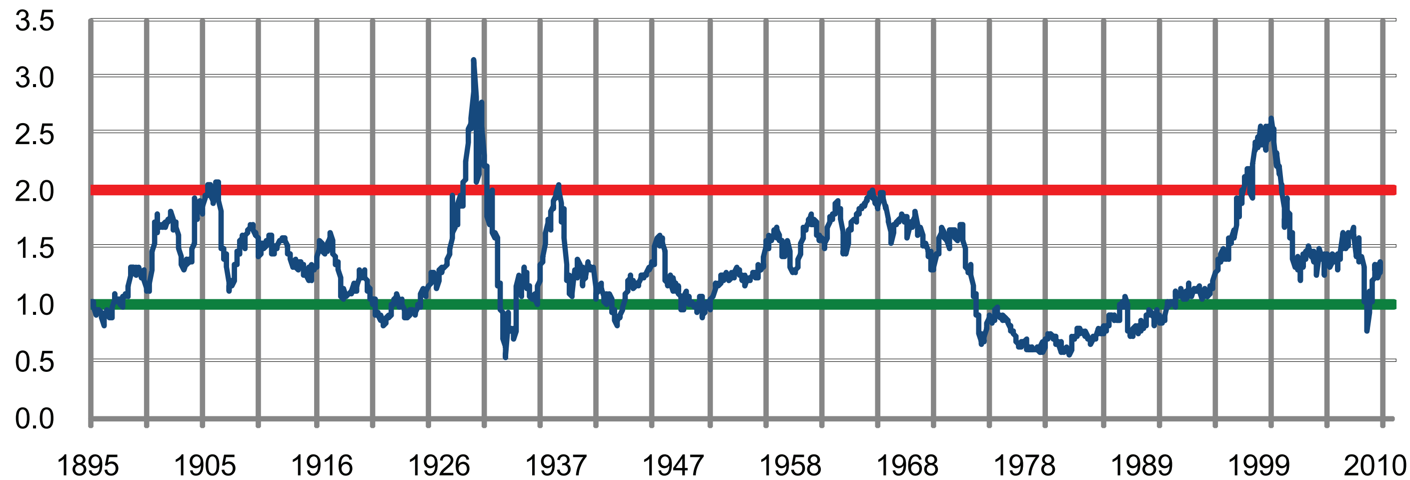
**** Covers distributions from Aug 31, 2009 - October 1, 2010
BUY, HOLD, SELL OR LIMIT IN **BOLD** INDICATES A CHANGE IN ACTION OR LIMIT

also boomed, adding 9.5%, and the **PowerShares Water Resources ETF** gushed 9.1%. **Tetra Tech**, which constitutes a large position in PHO and about which we have more to say on page three, moved up just 2.1%. Gold continued to run higher, a natural beneficiary of a cheapening dollar. **USAA Precious Metals & Minerals Fund** is up another 6.2%. Though it's been an excellent investment this year, over the last month, the mining stocks USAGX owns (it holds no bullion) have slowed relative to gold and silver themselves. **Transocean** has marked time after a strong couple of months as the market reconsidered its earlier anxieties over RIG's liabilities for the Macondo well disaster. See page three for more. **Fidelity Select Natural Gas** is up 7.4%, though natural gas continues to underperform oil. The fact is that despite FSNGX being more exposed to natural gas producers than to oil companies, separating one from the other to form a pure natural gas fund is not possible, and as oil rises, so too does FSNGX. But the disparity between oil and natural gas prices is intriguing. Some say that there is an historical ratio between the prices for oil and natural gas. We know that the energy content of a barrel of oil is roughly six times that of an MMBtu of natural gas, so a perfect balance in terms of energy value of oil:natural gas would be a 6:1 price ratio. That is helpful provided the supplies of each are sufficient, but currently that is not the case. Natural gas is in oversupply, so the ratio of market prices is distorted and currently runs around 22:1. Though we've read that the historical norm should be anywhere from 6:1 to 10:1, it is clear that the market, at least when it comes to the ratio between oil and natural gas prices, embraces Henry Ford's dictum that "history is more or less bunk." Indeed, futures prices indicate that investors expect the current ratio will extend far into the future. We're willing to bet against that certainty. We're looking at another way to play natural gas, and might have something to say in the December issue.

Healthcare was mixed. The more defensive positions such as pharmaceuticals were quiet. **Pfizer** is unchanged for the month, while **Johnson & Johnson** and **Stryker**, the orthopedic company that continued to expand its scope with two acquisitions, the biggest at $1.5 billion for **Boston Scientific**'s neurovascular business, respectively added 4.7% and 4.8%. **Hambrecht & Quist Life Sciences Fund** increased 6.9%. **UnitedHealth**, the HMO that along with its peers had been singled out as the sector most to suffer from healthcare reform, continued its rise, adding another 4%, which brings it to 21% year to date. Perhaps it's the notion that Republican control of the House means death for insurance reform, but more likely it's an unexpected but reasonable effect of a deep recession: people are not using their insurance because copayments are too much to cover, and thus HMO margins are healthier. At least that is what quarterly reports from the industry suggests. **Boston Scientific**, which could use the Stryker cash to pay down its debt and fund acquisitions, had a big month, up 14%, much of it on October 1st when, on no news but heavy volume, the shares increased more than 6%. No, we don't think the upswing validates rumors that someone is stalking BSX. Instead, it suggests that value investors are reconsidering the shares. We have more to say on page five.

REITs did OK with **Commonwealth REIT** still recovering from its recent common stock offering. CWH added 3.7%. Ken Heebner's **CGM Realty Fund** did much better, up 9.4%. Heebner had purged mining shares from his portfolio in the first half and, if we can use the most recent report to shareholders (6/30) as a guide, has concentrated on lodging and resorts, residential and office and industrial REITs. However, given Heebner's mercurial investing style, we probably can't rely on what his portfolio was four months ago. Still, for investors who can survive the ride's twists, CGM remains, in our opinion, the best long-term way to play real estate through a fund.

Media and telecom stocks also continued to rally. We discuss **Comcast** (+18.1%) on page two, but its performance, both this month and for the year, is modest compared to that of **Liberty Global**, which builds national cable systems outside the U.S. This month LBTYA leaped another 28.8%, bringing it to 80.1% for 2010. **AOL** has been extremely volatile (in the last 27 trading days, 21 saw moves of 1% or more) amid talk that it could be involved in the dismemberment of Yahoo!. We are beginning to ask ourselves whether continuing to hold AOL, the part of TimeWarner-AOL that we least respect, makes sense. As for **TimeWarner**, it's up 2.4%. **GAMCO Global Telecommunications**, which holds shares in all of these companies, was up 4.2%. Another GABTX holding, **Telecom New Zealand**, reported an OK quarter, which means it continues to absorb a declining landline business while investing in a very competitive mobile and broadband sector. Nonetheless, NZT has benefitted from a declining U.S. dollar and a hefty dividend. But expect that distribution to shrink this year, since it varies from year to year depending on earnings. Since the last letter, NZT is up 12.2%.**S**A




The Risk Indicator measures the overall risk in the stock market by plotting the ratio of stock prices to home prices. 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 1.40. This reading reveals that stocks are still below their average relative to house prices, and present a better value. The February 2009 reading of 0.77 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 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.

## 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 21.8 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 | | |

As far back as February and March 2009 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 current reading is 25 percent, which does not change our market perspective. That will change only with a signal from the Lagging Indicators.

**The Diffusion Index of Lagging Indicators** gives "Caution" signals when all three of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. Our next signal will come from this Index. This Diffusion Index currently stands at 33 percent.