



There is a perverse logic on Wall Street. Despite the lip service the Street pays to free markets, it cringes at talk that the Fed might stop handing out free money. Wall Street, after 28 years of a bull market for bonds, is addicted to cheap credit. As interest rates remained relatively stable over the last few months, it was fashionable to argue that they would stay benign. Some argued they would even fall further.

The companion view was that the U.S. economy would remain stagnant or even fall back into recession. We were warned that stock prices could not stand rising interest rates. Is it certain this view was dead wrong? No, but we can say that their certainty is now being severely challenged.

Last Friday, with equity markets in the U.S. silent to mark Good Friday the bond market made the noise. Yields rose in response to good news about job creation, which is the essential marker for economic recovery. Treasury yields jumped, especially on the long end, as the market asked itself, even if unemployment remained at 9.7%, were we "there" yet? Have we gone deep enough into the recessionary forest that we are finally beginning to move out of it?

On this Monday, after Wall Street had a weekend to consider the question, the answer at least for the day was yes. Share prices had a solid day, and the bond market was even more emphatic about where rates were heading. The 10-year Treasury Note finished the day at 4%, something of a watershed, though still below the 4.5% most market mavens believe is appropriate if the economy really is on the mend. We think that higher yields and rising share prices can coexist provided rates rise because investors are factoring in a resurgent economy. That is where we believe we are now. After that, yield increases might not be so benign.

**-Gray Emerson Cardiff**

## How Can This Be?

We are now more than a year into a market rally and there is sufficient evidence that the U.S. and global economies are on the mend, but fortunately many, many investors still refuse to participate, adamant they won't get in until they have unequivocal evidence that a recovery is under way. Others, some of whom still own funds and shares, deny the market has rallied. How can this be in a world awash in data and opinions? *Forbes*, *Fortune*, *SmartMoney*, *Kiplingers* and *CNBC*, to say nothing of the general media, record what is happening and strive to tell us what will happen in the markets. Everyone should have a general sense of how the economy is recovering and how the markets are faring. Not so. According to a national poll conducted by Bloomberg in late March, by a nearly 2-1 ratio those polled believed the U.S. economy over the previous 12 months was continuing to worsen, and among those who owned stocks, bonds or funds only one in three said the value of their portfolios had risen over the past year. For the record, GDP in the last quarter was up 5.6%. The broadest measures for equities show that the Dow since March 9th is up 67%, the S&P 74%, the Nasdaq 89% and the pan-market Wilshire 5000 79%. As for bonds, the average junk bond fund last year gained 57%, the average corporate investment grade bond fund was up 18% and the average long-duration Treasury fund is down 9%. How is it possible for investors to not know this?

Apparently the average investor wears blinders that prevent him or her from glimpsing reality, which might explain why the general public continues to shun equities. As psychologists have demonstrated in other contexts, we humans tend to believe what validates our biases and to reject what does not. And we are risk adverse. We profile reality, which might explain why so many investors never make money.

Those who do make money see opportunities where others see disaster. Look at the most recent letter to shareholders from Berkshire Hathaway's

The **SoundAdvice** portfolio is up **40.35%** since 1/1/2009

**SoundAdvice vs the S&P 500**

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

**\$76,205**  
with **SoundAdvice**

**\$24,132**  
with the S&P 500



CEO, Warren Buffett (<http://www.berkshirehathaway.com/letters/2009ltr.pdf>). Over its 45 year history this holding company has racked up a 20.3% annualized growth in book value, and its shares have increased 54 fold. In the 2009 letter, Buffett, explains how he thinks. Buy what you know and understand and whose future you have a realistic chance to evaluate. Buy companies with strong balance sheets that need not rely on others for financing. Always keep a strong surplus cash position on the balance sheet. Let managers at subsidiaries operate independently. Don't court Wall Street opinion or march to its short-term beat. Don't pay attention to the financial media.

Buffett recalls that after the 2008 letter to shareholders, a spurt of stories appeared in the media to suggest he was predicting a market collapse based on this excerpt from the letter: "We are certain, for example, that the economy will be in shambles throughout 2009 – and probably well beyond..." However, few media sources provided the complete quotation that finished "but that conclusion does not tell us whether the market will rise or fall." In fact, Buffett lives for economic disruptions. Anyone who stood aside last year missed a rare opportunity. Buffett didn't.

From his office in Omaha, Buffett views poor market conditions and Wall Street analysts' handwringing as evidence of a fertile market. What did he do with an economy "in shambles?" Berkshire went shopping—big time. Buffett was an active buyer of corporate and municipal bonds, "but I should have done far more. Big opportunities come infrequently. When it's raining gold, reach for a bucket, not a thimble." As for equities; "We've put a lot of money to work during the chaos of the last two years. It's been an ideal period for investors: A climate of fear is their best friend. Those who invest only when commentators are upbeat end up paying a heavy price for meaningless reassurance. In the end, what counts in investing is what you pay for a business – through the purchase of a small piece of it in the stock market – and what that business earns in the succeeding decade or two."

"At the very peak of the [2008] crisis, we poured

\$15.5 billion into a business world that could otherwise look only to the federal government for help. Of that, \$9 billion went to bolster capital at three highly-regarded and previously-secure American businesses that needed – without delay – our tangible vote of confidence. The remaining \$6.5 billion satisfied our commitment to help fund the purchase of Wrigley, a deal that was completed without pause while, elsewhere, panic reigned." In each case, Berkshire bought preferred shares with a 10% yield that carried rights to buy common shares. The \$5.5 billion Goldman Sachs deal included warrants to buy GS common at \$115 a share. Today, Goldman trades at \$170, a 48% gain, and Berkshire continues to reap that 10% yield. General Electric also issued Berkshire \$3.3 billion in preferred shares with 10% yields and a conversion right for the common at \$22.25 a share. As with the Goldman conversion right, this represented a discount from where the shares were trading. Unlike the Goldman deal, GE shares remain 18% below the conversion price. When Mars Candy acquired Wrigley, Berkshire invested \$6.5 billion: \$2.1 to purchase 5% preferred shares of Wrigleys and \$4.4 billion for 11.45% subordinated debt. In March 2009, Berkshire put \$2.7 billion into convertible preferred shares of Swiss Re that yield 12%. Then there was a \$3 billion purchase of 8.5% convertible preferred shares in Dow Chemical. It was a busy six months. He topped all this with the purchase of Burlington Northern for \$26 billion.

One other Berkshire venture Buffett discusses merits mention, because it relates to our portfolio. Buffett has revived Berkadia, a 50-50 partnership with **Leucadia National**. Last time they collaborated was to unwind the assets of a busted financing company. This time they're unwinding the third largest mortgage servicing company in the U.S. Berkshire supplies the credit and Leucadia does the heavy lifting.

This month's recommendation, beleaguered **Telecom New Zealand**, has some serious problems, but also offers considerable upside. As with Buffett's 2008 and 2009 purchases, NZT also offers considerable income, though, as we will explain, there are some question marks. **SA**

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# Lord of the Ringtones

To say that the telecom industry is in flux would be understatement. The transition from landlines to wireless is the most obvious dynamic. What once had been an industry dominated by stable quasi-public utilities devoted to voice communication today is the essential interface between us and the infinite Internet, television, movies, games, music and whatever techno-entertainment and cloud computing produce next. Beyond the industry specific forces roiling telecom, these companies have had to contend with business cycle specific pressures. As we've seen over the recent recession, telecom revenues took a hit as business demand and consumer use declined. Telecom stocks have lagged the rest of the market in this recovery, which we think sets the stage for a nice recovery in revenues and share prices.

But there's a silver lining within the dark cloud hovering over telecom. Even in tight times, legacy telecom companies continue to enjoy healthy cash flow, which means that they can throw off generous dividends. Verizon and AT&T, for example, currently yield 6.1% and 6.4%, while the S&P 500 yields 1.87%. Some regional carriers offer even higher yields. Fat dividends tell us two things: first, with most traditional types of income investing providing meager yields, telecoms are worth considering, and second, if you think high yields can be a valuation tool, current numbers suggest telecom shares are cheap right now for American telecoms.

## Double Digit Yield

But we're not staying at home. **Telecom New Zealand (NZN—NYSE)**, whose shares trade in the United States as American Depository Securities (ADS), each of which represents five shares of NZN as traded on the Wellington, NZ Stock Exchange, currently yields 10.7%, which at the high end of what the shares have ever yielded in NZN's 19-year history as a publicly traded company. As we'll discuss below, other price ratios are also at tantalizing historical lows. Needless to say, you don't see such extremes unless the company is under stress.

Price competition, regulation, large capital expenditures to beef up both infrastructure and the range of products offered have combined to make investors wary of NZN. And just as Telecom NZ rolled out the first 3G wireless network in New Zealand, the company sabotaged itself. As we got further into our research, the hits kept on coming, which explains why Telecom New Zealand has performed worse than its regional competitors. Consider Telstra, the largest Australian telecom company. It competes against Telecom both in New Zealand and in Australia. Its shares over the last 24 months have lost 33%, while NZN has dropped 46%.

## New Zealand

Most Americans know New Zealand as the setting for the *Lord of the Rings*' Middle Earth. It is a thinly populated country with more sheep (47.2 million) than people (4 million). About 86% of the inhabitants are urban, but government policy is determined to provide the remaining 14% with the same level of telecom connectivity as city dwellers enjoy.

Telecom New Zealand began life as a government monopoly, and separated from the National Postal Service in the late 1980s. Its history traces an arc from state-owned utility to a free-market competitor. Even when competitors began to operate in the country, Telecom New Zealand enjoyed several advantages. Not only did it own the national transmission system and connections into homes and businesses, but citizens by default deemed it "the phone company," an incalculable marketing advantage.

In 1990 Ameritech and Bell Atlantic, two American Baby Bells, partnered to buy Telecom New Zealand, though a paternalistic state influence persisted: local calling would remain free to residents. In the following year, shares of NZN began trading locally. Soon government regulators sought to inject competition, which started in the same year the two American telecoms took control of NZN. First came TelstraClear, a division of Australia's dominant telecom, and then Vodafone in 1993, which set up

the first cell phone network to compete against NZT.

However, the big blow to Telecom New Zealand's dominance came in 2006 when the national government announced Telecom NZ would have to unbundle its services, that is, give consumers the right to buy whatever telecom services they wanted from whomever they wanted rather than the entire package from a single provider, which till then generally had meant NZT. Since Telecom NZ owned both the national transmission network and the last mile into homes and businesses, they now found that though they might still bring telecom to customers, they might be merely carrying another company's products. High margin services, particularly broadband for internet and TV, now became a highly competitive battlefield.

It was this direct assault on NZT's de facto monopoly for telecom services (and the anxiety this generated among investors looking forward) that crippled the shares in 2006 and caught our eye. We recommended NZT that August after the shares had tumbled 48% from where they had started the year. Also, the U.S. dollar had been enjoying a resurgence, which cut the New Zealand dollar denominated share price and dividends when translated into Greenbacks. Finally, it didn't help that the company had just announced a poor quarter: revenues and profits were down, write-offs were taken for NZT's Australian investment and the company would soon trim its dividend by 30%. We sold the shares just seven months later after concluding that the NZ dollar was beginning to weaken, which would threaten our gains. We booked 46% return. About six weeks later, NZT peaked and has trended lower ever since.

### **Current Developments**

Now, three years later, we're returning to a humbled share price and a familiar constellation of problems: poor quarterly results, constant competition and new government regulations. The biggest difference is that this time New Zealand is just crawling out of recession. The national economy began to contract in March 2008, about four months after ours, triggered by tight monetary policies and high prices for energy and food, the

latter influenced by a severe drought. Recession continued for five successive quarters that ended last fall with minuscule 0.2% expansions in the third quarter and again in the fourth quarter. Recovery has been uneven with mining and agriculture doing well while construction, retail and manufacturing remain in the doldrums. Unemployment increased throughout the recession and into the fitful recovery. It now stands at 6.5%, which for New Zealand is high. Mitigating the slowdown's severity in New Zealand and Australia were the absence of severe speculation in housing and the presence of China as a significant trading partner. Business and consumer spending are beginning to pick up.

Telecom New Zealand offers the most complete range of communication services in the country ranging from copper-wired landlines into homes and businesses to wireless voice and data systems. The company continues to own the lion's share of connectivity. For the previous few years, constant growth in demand for broadband had buoyed NZT's sales and profits, but recently that had plateaued. Consumers now wanted the newest wireless third generation (3G) technology that would give them access to what heretofore had been available only through wire lines. NZT was first to market with 3G and still maintains an advantage.

However, New Zealand, though it loves this new technology, is a mature market. Just as broadband, after several years of enthusiastic adoption by new subscribers, leveled out, even the 3G system at some point will saturate this small island. Wall Street adamantly dislikes companies like NZT that don't promise accelerating growth. Unless NZT can figure out how to market its services to the country's 40 million sheep, its growth prospects are limited. That does not mean it should not continue to enjoy a dominant and lucrative position. If we can capture a double-digit dividend, we're already ahead of the average total annual return for the S&P 500, which over the last 20 years works out to 10%. Price appreciation in NZT shares would just be the cherry on top.

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## The Company

Let's look at the company, which is structured into five primary divisions: Chorus, which maintains and runs local access hardwire lines into homes and businesses for about 1.8 million subscribers, contributed 19% of the NZT's \$2.7 billion in revenues in the first two quarters of this fiscal year. Chorus is built around that part of Telecom's eroding older technology, but was the only operational division to show any increase (1.4%) in revenues.

Management lumps into one division the wholesale and international businesses. The former sells competitors access to NZT's transmission system. The latter primarily represents NZT's partial ownership of the Southern Cross, the undersea cable that ties New Zealand and Australia into the global communications grid. Combined Wholesale and International accounts for a quarter of NZT's revenues, which for the last six months saw a 6.5% decline in revenues.

The third sector is the Retail division, which sells to consumers and businesses wired and wireless services and equipment, and is the company's revenue core at 39.4% of total sales. It's declined by 2.9%. Gen-I is the company's domestic IT division for government and large corporate clients that seeks to leverage NZT's national footprint into a lucrative consulting business. Over the first six months of this fiscal year, its 26.8% of total sales represented a 7.1% reduction from the same period last fiscal year. AAPT offers similar services in Australia. Its \$570 million in sales represents about 21.3% of income and declined by 12.8%.

Telecom New Zealand's major competitors are Telstra, the Australian telecom company and Vodafone, the much larger international telecom company. Then there are multinationals like IBM and HP that compete against Gen-I and AAPT for consulting contracts. There are also several smaller

telecoms that compete in the residential and commercial markets, and rely on NZT's infrastructure for connectivity. But lately it has seemed that Telecom New Zealand's most menacing opponent is Telecom New Zealand itself, which brings us to how the company this year has turned what was expected to be a long-term advantage into what we believe is a short-term disaster.

## XT Mobile

Over the last couple of years NZT has sunk \$310 million into upgrading its wireless network to 3G, dubbing the new service XT Mobile, to allow data and video capabilities its competitors did not offer. Anticipation of 3G technology's arrival had restrained new subscribers, but once XT arrived in late spring 2009, NZT enjoyed a demand wave—until January and February of this year when the system had four major failures, which deeply embarrassed the company, got its IT director fired, led to significant refunds to subscribers, knocked the share price down and, worst of all, gave customers a reason to look elsewhere for wireless contracts.

Around the same time Telecom New Zealand began 3G service, a new company, 2degrees that uses Vodafone's wireless network, started offering service that is superior to 2G but inferior to what XT Mobile offers. 2degrees used the default weapon new players always do: cheaper rates, which forced NZT to shrink its own prices. Also, Telecom New Zealand had planned to not give competitors access to XT until 2011, but late last year management decided to speed that up to this year. The change suggests that competition from 2degrees was crimping new XT subscribers, and NZT decided it would collect fees from higher volume as competitors crowded into XT rather than wait for higher margins from its own subscribers.

Telecom New Zealand intends to keep pouring cash into beefing up its existing networks. For the current fiscal year management expects to spend \$1.1 to \$1.2 billion on capital projects. At the same time, government regulations continue to be challenging. For example, in mid-March, telecom regulators announced its plan to bring high speed broadband to underserved rural areas, which

could have been a boost to NZT, since it already shouldered this responsibility and was ready to improve its existing lines in the countryside. Funds would come from a tax on the country's telecom companies. Instead, regulators want to develop an independent network. At the same time, Telecom New Zealand will remain responsible for making sure there is basic phone service for rural areas, though the subsidy it had received for this task will now go toward the independent rural infrastructure. NZT estimates the new plan will reduce revenue by \$56 million in 2011, 2012 and 2013.

So why would anyone want to own shares in Telecom New Zealand? Let's start with the balance sheet that shows both a modest debt to equity ratio. Despite the problems outlined above, NZT remains a cash generating machine, throwing off \$214.7 million in free cash flow that the company can use to maintain the dividend. Though in the past Telecom New Zealand has used some of this cash to buyback shares, we don't expect the Board of Directors will authorize anytime soon a new program.

NZT is seeing its dominant position eroded but it still is tightly woven into the national economy not just because it is the country's largest corporation but also because it remains, in the minds of New Zealanders, the national telecommunication company.

Nonetheless, the company is deep into investors' dog house, and the disparity between how NZT is valued versus other telecom companies not surprisingly exaggerates the company's situation. Compared to other telecom companies, NZT trades at a 40% discount from the average telecom's P/E, at an 11% and a 27% discount respectively from their price to book and price to sales even though it is much less leveraged. Vodafone, for instance, which is more than 20 times NZT's market cap, has a debt to equity ratio of 0.3. NZT stands at 0.8. More pertinent is how Telecom New Zealand's valuations compare to its own historical numbers. Current Price to Earnings, Price to Book, Price to

Sales and Price to Cash Flow for the trailing 12 months are respectively 68%, 34%, 51% and 48% of their values over the last decade.

And then there is that 10.7% yield. Skeptics might dismiss not only the ultra-low price ratios and the sky-high yield as evidence that the underlying numbers for earnings, book value, sales, cash flow and the dividend paid will decline in the future. We have no crystal ball, but at current levels, the likelihood is just the opposite. Telecom New Zealand can maintain the current quarterly distribution, though the wildcard is whether the New Zealand dollar or the Kiwi strengthens or weakens against the U.S. dollar.

The U.S. dollar starting last year has been gaining strength against most currencies, the Euro in particular. However, the Kiwi relative to the dollar has not succumbed. It was 51 cents US as recently as January 2009, but now is close to 70 cents. As you know, we believe the U.S. dollar, even after it has rallied recently, remains overvalued, and if the Greenback moves lower, we can expect the same boost to NZT's performance we got in 2006 when the U.S. dollar weakened noticeably against the Kiwi. There is also the possibility that NZT could increase its dividend, since the company does not distribute a fixed amount each quarter. Instead, the amount fluctuates depending on net earnings. Historically the current distribution in absolute terms is on the low end at the same time the yield is high.

Finally, in looking for themes that might enhance NZT's value there is the consolidation trend that has been rampant in telecom over the last few years. It is not inconceivable that either of NZT's two biggest rivals in the domestic market would consider acquiring the company. Vodafone is the elephant at 20 times NZT's market cap, but even Australian Telestra dwarfs Telecom New Zealand. *Sound Advice* prefers to see its recommendations realize their value on their own, though we're not averse to speeding up the process through acquisition. But don't buy the shares thinking NZT is going to be bought out. Buy up to \$8.60. SA

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## Portfolio Updates

Since we priced the March issue, equities continued February's progress. The Dow is up 3.4%, the S&P 3.5%, the Nasdaq 3.3% and the pan-market Wilshire 5000 Index 3.4%. *Sound Advice* added 3.7%.

The March issue featured the **ProShares UltraShort 20+ Treasury ETF (TBT—NYSE)**, which advanced 1.6%. Currently interest rates remain, from our perspective, depressed both because our economy is just emerging from a brutal recession and the Fed in response both to recession and the credit crisis has drowned the economy in ultra-cheap credit. As evidence accumulates that the U.S. economy is moving toward expansion, the market itself will move yields higher and Treasury prices lower, especially at the longer end of the yield curve.

You'll recall fondly that the March issue reflected the remarkable rally off of the early February lows. Our portfolio surged 8.5%. A laggard in that run was **Tetra Tech**, which that month only increased 1.2%, which prompted us to advise that these shares had "significant recovery potential after getting beaten up for the past few months." Without remarkable news, TTEK since then is up 11%. We strongly believe that any solid company associated with water remediation has a bright future. TTEK is that. And there is a wind-power kicker. TTEK hit \$32 last August, and after a couple of quarters of less than blow-the-doors-off results slipped as low as \$20.28 early last month.

We also got first rate results from REITs. **CGM Realty Fund** is up another 8.2% and **HRPT Property Trust** 9.4%. HRP's course is the more interesting, because since the last issue the company issued 44.5 million new shares, which should have pushed the share price lower, or at least to the \$7.25 issue price. So much for expectations. HRP after the shares were marketed closed as high as \$8.14 and settled back to \$7.79.

It's been an interesting year for REITs and for

commercial real estate in general. The consensus last year was that REITs would be decimated by bankruptcies and that any balance sheet debt was poison. Since then, some of the biggest gains have been among REITs that had excruciatingly bad balance sheets. The last subsector among REITs



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to take off has been lodging, since hotels, when a business traveler or tourist does not rent a room, loses that revenue. Lodging literally is built around one night stands. At least for a mall or an office building owner, leases provide continuity of income. Though we did not get to lodging quickly enough, Ken Heebner's CGMRX did it for us. At the end of 2009 the fund's largest exposure was to lodging (18.3%).

If lodging's improvement suggests investors are getting more comfortable with the idea the U.S. economy is in recovery mode, there are plenty of other telltale signs from the NYSE. Companies like **Honeywell** (+7.4%) and **UPS** (+7.8%), which are at the very core of the U.S. economy, outperformed. Ditto for **Fastenal** (+6.3%), **Superior Industries**, a parts supplier to the auto industry (+4.8%) and **CarMax**, which operates a national network of used car dealerships (+11.9%), leaped on quarterly numbers that doubled expectations. Only the **Ford Preferred** did not join the party, losing 2.5%. Given its white-hot performance both last year and even now this year (+16.9%), a giveback is hardly surprising. We continue to believe that F-PS has more miles left in the tank, though we have no sense as to when



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	\$7.79	6.16%	<b>\$8.25</b>	BUY
Telecom New Zealand	NZT	NYSE	<b>\$7.87</b>	<b>10.70%</b>	<b>\$8.60</b>	BUY
<b>Diversified Growth</b>						
Agrium	AGU	NYSE/TSE	\$70.55	0.16%	<b>\$76.00</b>	BUY
Boston Scientific	BSX	NYSE	\$7.23	0.00%	\$12.00	BUY
CarMax	KMX	NYSE	\$26.08	0.00%	<b>\$30.00</b>	BUY
CGM Realty Fund	CGMRX	800-343-5678	\$23.72	2.43%	N/A	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$33.47	6.73%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$102.97	1.67%	N/A	BUY
Fastenal	FAST	NASDAQ	\$48.58	1.44%	<b>\$52.00</b>	BUY
Gabelli Global Telecom Fund	GABTX	800-422-3554	\$18.97	1.74%	N/A	BUY
Honeywell	HON	NYSE	\$45.03	2.69%	<b>\$49.00</b>	BUY
International Speedway Corp.	ISTA	NASDAQ	\$25.90	0.54%	\$31.00	BUY
Johnson & Johnson	JNJ	NYSE	\$65.77	2.98%	\$68.00	BUY
Leucadia National Corp.	LUK	NYSE	\$25.36	0.00%	\$30.00	BUY
Mattel	MAT	NASDAQ	\$22.61	3.32%	<b>\$26.50</b>	BUY
Microsoft	MSFT	NASDAQ	\$29.16	1.78%	\$33.00	BUY
Molson Coors Brewing	TAP	NYSE	\$43.10	2.23%	\$52.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$18.31	0.00%	<b>\$20.00</b>	BUY
Stryker Corp.	SYK	NYSE	\$57.65	1.04%	\$60.00	BUY
Superior Industries	SUP	NYSE	\$16.02	4.00%	\$18.00	BUY
Tetra Tech	TTEK	NASDAQ	\$23.43	0.00%	\$30.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$47.80	2.38%	N/A	BUY
United Parcel	UPS	NYSE	\$64.15	2.81%	\$70.00	BUY
UnitedHealth Group	UNH	NYSE	\$32.99	0.09%	\$38.00	BUY
Wal-Mart Stores	WMT	NYSE	\$55.49	2.18%	\$60.00	BUY
Xerox	XRX	NYSE	\$9.99	1.72%	\$11.00	BUY
<b>Energy/Natural Resources</b>						
Anglo-American PLC	AAUKY.PK	PINK SHEETS	\$22.55	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	\$39.42	4.26%	\$43.00	BUY
PowerShares Water Resources ETF	PHO	NYSE	\$17.56	0.45%	\$19.00	BUY
Transocean	RIG	NYSE	\$88.77	0.00%	\$100.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$35.04	0.03%	N/A	BUY
<b>Aggressive Growth</b>						
AOL Inc.	AOL	NYSE	\$25.36	0.00%	\$28.00	BUY
Comcast	CMCSA	NASDAQ	\$18.86	2.01%	\$21.00	BUY
Davis Financial Fund	DFIBX	800-279-0279	\$22.46	7.57%	N/A	BUY
Ford Motor Convertible Pfd	F.PRS	NYSE	\$46.66	7.27%***	\$50.00	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$9.99	0.00%	<b>\$11.25</b>	BUY
Liberty Global	LBTYA	NASDAQ	\$29.30	0.00%	\$32.00	BUY
Maxim Integrated	MXIM	NASDAQ	\$19.44	4.12%	\$22.00	BUY
Symantec	SYMC	NASDAQ	\$16.77	0.00%	\$20.00	BUY
Third Avenue Focused Credit Fd***	TFCVX	800-443-1021	\$10.83	2.20%	N/A	BUY
Time Warner	TWX	NYSE	\$31.41	2.42%	\$34.00	BUY
<b>UltraShort 20+ Treasury ProShares</b>	<b>TBT</b>	<b>NYSE</b>	<b>\$48.91</b>	<b>0.00%</b>	<b>N/A</b>	<b>BUY</b>

\* Prices as of Thursday, April 2nd, 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, 2009 - March 31, 2010

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

management will restore the dividend and pay the arrears. However, we're confident it will happen, something we were not willing to say 12 months ago.

Healthcare shares are having a mixed month now that the president has signed into law reforms to how healthcare is provided to Americans. Wall Street's first take on this has been to bid up most healthcare-related stocks. **Odyssey Healthcare** is up 3.5% and **Stryker**, the orthopedic device and hospital supply company, gained another 4.7%. **Hambrecht & Quist Life Sciences**, our closed-end fund way of playing biotech, is up 3.9%, though **Johnson & Johnson** has risen only 2.7%. Note that HQL is bringing back its distribution program that pays out a 5% annualized rate of its NAV. **UnitedHealth**, the huge HMO, dropped 2.1%, reflecting worry that the new legislation will harm revenues. We've argued ever since 2008 when Wall Street began to fret about what Obama might mean for healthcare should he be elected that reform would be a positive for all segments of the healthcare industry, even the HMOs. We see no reason to change that perspective. UNH should be accumulated while investors wait to see how adding tens of millions of new insureds to HMOs' rolls will impact their profits. If you can get beyond the political fear factor and the insurers' self-generated PR campaign to weaken insurance reform, you'll see that the benefits outweigh the burdens the new law imposes.

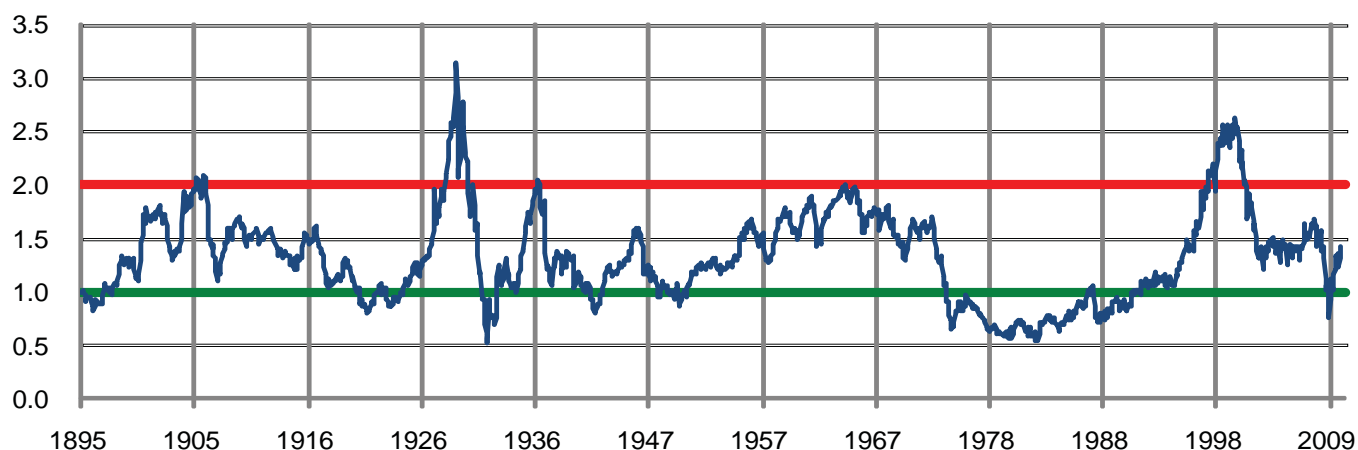
Then there is the melodrama occurring at **Boston Scientific**, which capped off a difficult few months with a breathtakingly brainless oversight: it neglected getting FDA approval for what sounds like an innocuous change in manufacturing procedures for its defibrillators. When BSX realized its mistake, management on its own initiative froze sales and called in its defibrillator inventory, which on Monday, March 15th, took the shares down 19% at their low, as Wall Street scrambled to understand what was happening. The dumbness that caused this recall (and remember, we're a big fan of Boston Scientific's prospects) ignited an anxiety firestorm among investors who, put simply, are fed up with Boston's persistent inability to get it right. By "it" we mean regaining investor confidence by putting to rest the doubts that began with the misguided acquisition of Guidant back in 2006 and have grown with each subsequent stumble. The most recent stagger was, well, staggering, a \$1.7 billion settlement with

Johnson & Johnson over patents for BSX's stent technology.

Frankly, we thought Boston Scientific's management—a new team brought in to fix the company—overreacted to the defibrillator problem, and would have been better advised to confer with the FDA before taking such drastic action. The selling panic that greeted the news on Monday did have a major silver lining: it gave those of us who considered Boston Scientific a grossly undervalued asset even before this event a chance to snap up shares depressed for no substantive reason. At this point, we are waiting for the FDA to green light the production changes BSX failed to file. The FDA, to its credit, says it won't expedite the process just because Boston Scientific innocently screwed up. At best, we expect approval to materialize in a few weeks. Since that Monday low, BSX shares have regained more than half their loss, but still are down 8.4% from where they stood when we priced the March issue. At the risk of looking like masochists, today we are more interested in Boston Scientific than we were before the latest fiasco.

**International Speedways**, which hosts NASCAR events and has suffered as its primarily blue-collar fans have shouldered the brunt of the recession, slipped 5.7%. Aside from a weather cancellation for a major event, there was no major news this month from ISCA. But there was from Speedway Motorsports, a smaller and less well run competitor, which announced disquieting quarterly numbers that showed both top and bottom line declines. Investors made a natural assumption: if times are tough at Speedway, they must be at ISCA. We'll see.

Natural resource shares did well, led by **Anglo-American**, which jumped 11.6%. We recognize that double-digit moves, either up or particularly down, can be unnerving, but some of our positions are volatile, especially as investors try to figure out which part of the business cycle we are in and are heading toward. **Plum Creek**, the timber REIT, which also depends during good times on land sales, added 7.3%. **Transocean** took flight with oil prices earlier in the week as oil pushed toward \$85 a barrel. RIG is up 5.3%. **Fidelity Select Natural Gas Fund**, which jumped 15.3% last month, slipped 1% this time as natural gas prices lagged behind oil. Precious metals did less well as the dollar has been stronger again, but **USAGX** did add 1.7%. SA



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 1.43. This reading reveals that stocks are still below their average relative to house prices, and present a better 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

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 21.1 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 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. This Diffusion Index currently stands at 0 percent, which means that all of the individual lagging indicators are below their levels of six months earlier.

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