Gray Cardiff's

SOUND ADVICE

Volume XXII, Number 3 | Subscription Rate: $195 per year | March 13, 2009

Schering-Plough, after this issue closed, announced it will sell the company for $32.2 billion ($23.61 a share) to Merck, with which it partnered in developing Zetia, a non-statin drug to reduce cholesterol, and Vytorin, a combination of Zetia and Merck's statin, Zocor. The deal is $10.50 in cash and 0.5767 of a share of MRK common, which based on Friday's close represents a 34% premium for SGP.

Among the reasons we first recommended SGP back in 2003 at $16 was the track record of Fred Hassan, who after salvaging Pharmacia Upjohn and selling it to Pfizer took over at Schering. We speculated that he might do the same with SGP. Needless to say, in this harsh market the acquisition is welcome, if bittersweet, news.

Why "bittersweet?" Considering that the S&P 500 is 29% below where it was when we initially recommended SGP, we should be pleased to see a 45% profit (not counting dividends). However, we think that SGP is worth more than this. First, revenues from Vytorin and Zetia remain depressed due to studies that the media mis-hyped shamelessly. Second, Schering itself made a major acquisition two years ago when it bought Organon Biosciences that is just beginning to impact SGP. Finally, we think that investor pessimism about healthcare lowered the price Merck was willing to pay and Schering accept. As we explain in the updates section, we believe the market is overreacting to headlines about healthcare. We'll have more to say about this deal in the coming issue.

--Gray Emerson Cardiff

Approaching A Buy Signal

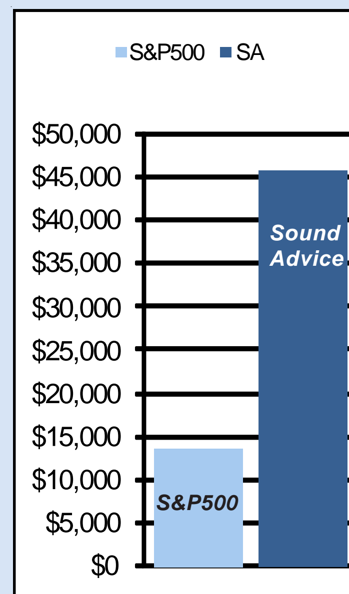
Stock buyers—the few that remain—are being advised to act like traders. Buying and holding is for saps. With the S&P today at where it stood in April 1997, this snap-judgment opportunism might appeal to others, but we think patience remains a virtue. We continue to buy when we think assets are cheap and the market and economy in the dumps and hold till we think assets have become dear and the market and economy couldn't be better. It's not foolproof, but our track record says it works.

Currently our indicators remain cautious, though that does not mean there are not buys. But it is difficult, even painful, to be a buyer, since after being knocked around 22 months, we sometimes feel that the only encouraging evidence for a market recovery—and I know that only the most battle-hardened contrarian would agree—is the very lack of apparent evidence.

Certainly the market has not gained confidence from Washington. Every time Washington announces some new way either to salvage the financial sector and/or yank the economy out of the ditch, share prices fall. Whether investors think someone has better plans, or just are so unhinged that no plan will be cheered unless and until it has proved effective, we have rarely seen investors in so self-flagellating a mood. At this point, it is worth considering what evidence we should be alert for regardless of how wispy it might be?

Stabilization for some commodity prices is one wisp. Both oil and copper are higher today than at the end of last year. But the only commodities to show real strength have been the

Sound Advice Versus the S&P 500



Since 1-1-2000, an Investment of $25,000 becomes:

$13,365 with the S&P 500, for a loss of $11,315, or

$45,874 with *Sound Advice*, for a gain of $20,874, a difference of $32,189 (129 percent of the investment)

Sound Advice, 939 Hartz Way, Suite 210, Danville, CA 94526. 800-825-7007.

precious metals, which hardly points toward a more positive market environment.

Sound Advice's economic and market weathervane, the diffusion index of leading indicators, which tracks four data points (unemployment, building permits for housing, timeliness of supplier deliveries and the spread between short and long term Treasury yields), has three of those metrics pointing toward a buy signal, a reflection of a depressed economy. Provided the current narrowing trend for Treasuries persists, we will soon have a zero reading, our buy signal. As that noted macroeconomist Bob Dylan observed: “You don’t need a weather man to know which way the wind blows.”

Some investors will wait for improving corporate earnings before considering stocks. By the time that happens, we think the lion's share of price recovery will be over. Goldman is predicting 2009 earnings for the S&P 500 will fall to $40, almost half of what was expected 12 months ago. Better employment figures too won’t materialize until corporate earnings revive. Ditto for Consumer Confidence, which last month hit 25, the lowest point in its history (the previous low had been in 1974 at 43.2)

Americans are feeling distinctly depressed by the precarious job market, by losses in the stock market, especially in their retirement accounts, and most of all by the fall in market prices for their homes, which for some had been their ATMs and for all had been the assurance of personal prosperity. The first widely recognized sign that the economy has bottomed will be improvement in housing prices, and before that occurs we must see a slowing in foreclosures. In fact, until that happens we can't expect the credit crisis to begin to resolve itself. This is what Ben Bernanke was thinking about when he talked recently of "the adverse feedback loop."

The most recent figures show abysmal new home sales, down 10.2% in January compared to December and 48.2% compared to January 2008. Foreclosures that are abandoned because owners can neither pay nor refinance their mortgages not only blight neighborhoods and provide another reason for other houses in the neighborhood to lose value, they also force repricing of securities built on mortgages, which is how the collapse of the housing bubble metastasized into the banking and credit crises. Stop that continued bleeding and it will be easier to solve the financial crises.

Washington has targeted assistance to homeowners unable to meet their mortgage payments. We expect to see even more aggressive initiatives aimed at the entire home market. Hence, we want to monitor the foreclosure rate across the U.S. Until owners are able and willing to stay in their homes, and others have reason to buy homes, we won’t see an end to the economic, banking and market sickness.

There are several sources for foreclosure data. Most prominent are the Mortgage Bankers Association (quarterly) and RealtyTrac (monthly). MBA for the most recent quarter (ended 12/31/08) reports all foreclosures represented 11.18% of outstanding mortgages, the highest percentage ever. Realtytrac, relying on numbers through January 30, 2009 reports a decline over December. The two sources use somewhat different methods in gathering and calculating foreclosures. So, should we conclude that the more recent data from RealtyTrac represents a positive change?

Unfortunately not. RealtyTrac itself suggests its improved numbers are a mirage, the result not of better economic conditions but of government attempts to freeze or postpone foreclosures. Fannie Mae, Freddie Mac and Florida, for example, have imposed either mandatory or voluntary moratoriums on foreclosures. We need definitive solutions not delays to start healing housing.

Meanwhile, this issue focuses on energy and metals, among the hardest hit sectors. However, since the start of 2009 these have steadied. Once the economy does regain stability, demand will surge. ***SA***

Gray Cardiff's Sound Advice is published monthly by S.A. Newsletters, LLC. Editor-in-Chief: Gray Emerson Cardiff. Managing Editor: Steve Horwitz. Executive Editor: Linda Cardiff. Subscription rate: $195 per year. Send subscription requests to: Sound Advice, 939 Hartz Way, Suite 210, Danville, CA 94526. Phone: (925) 838-6710. Fax: (925) 838-0522. Information presented in Sound Advice may be used provided the newsletter—its name and address—is mentioned as the source. The information contained herein has been carefully compiled from sources believed to be reliable, but accuracy cannot be guaranteed. ©2009 S.A. Newsletters, LLC.

When securities are initially recommended herein, the editors, affiliates, and associates of the editors do not have positions in such securities and are required to wait at least seven days from the date Sound Advice is mailed before placing orders for them. Editors and staff members may own stock of companies discussed herein.

So Where Will a Recovery Show Up?

As suggested in the cover essay, detecting any positive trends in the current economy or market might be an exercise in self delusion. Even the small positive changes we can see are not trusted. For instance, some commodity prices, especially oil and copper, have stopped falling and are even increasing, consumer spending in January rose and so did prices, the Conference Board's Leading Indicators have been up the last two months, building permits are down. However, it's too easy, after being clubbed month after month and warned by the media that there is no end in sight, to dismiss these are one-offs, statistical aberrations or perilous come-ons.

The cues value investors always have employed are, it seems, no help. Low price valuations, for instance, have gotten even lower and severely depressed investor sentiment, rather than signaling a market ripe to rebound, has been prophetic. But the pervasive bear market has not discouraged some. Warren Buffett, who has taken serious lumps in this market, observes in his 2008 annual report to shareholders, we feel like "hungry mosquitoes in a nudist camp. Juicy targets are everywhere." *Sound Advice* concurs, though sometimes we wonder whether we'll go broke snapping up bargains. So far, it's us mosquitoes that have gotten stung.

Those who have been bold enough to make major investments despite (or because of) deteriorating fundamentals and panic have had their heads handed to them. Berkshire Hathaway's book value has had its worst year since 1965 (the only other year it declined), his share price now half of where it stood at the end of 2007. Ken Lewis, Bank of America's CEO, who seemingly never met an acquisition he could resist, acquired first Countrywide and then Merrill Lynch, and has seen his share price fall from $39.11 immediately after the Countrywide deal was announced in January 2008 to today's $3.14.

Which brings us to natural resource stocks. They have suffered mightily both because a deep global recession has vaporized demand and because prices at the zenith in mid-2008 had reached unsustainable levels. Just as during the bull market, energy, copper and the rest were playthings for bullish speculators, so too now on the downside they are being pushed around by the bears. But we are firmly convinced even before the current deep recession yields to the massive stimulation that is being applied, current prices will move higher as investors anticipate revived earnings and prices. We are adding to our positions in these securities, and suggest subscribers consider them as timely now.

TRANSOCEAN

When we introduced Transocean back in June 2003 the adjusted share price was $23.73. Day rates were running not much above the cost of operating their marine and land rigs. Despite the 2001 recession having ended that November, energy companies, certain that prices would recede, remained reluctant to expand development and production even though oil and natural gas prices had risen from their recession lows. At the time, three of RIG's four biggest clients, accounting for nearly half of revenues, had throttled down capital expenditures in 2000, 2001 and 2002. Until they saw economic expansion, few were willing to sink cash into expanding reserves or production. Energy companies turned out to be far too pessimistic about demand and supply imbalances.

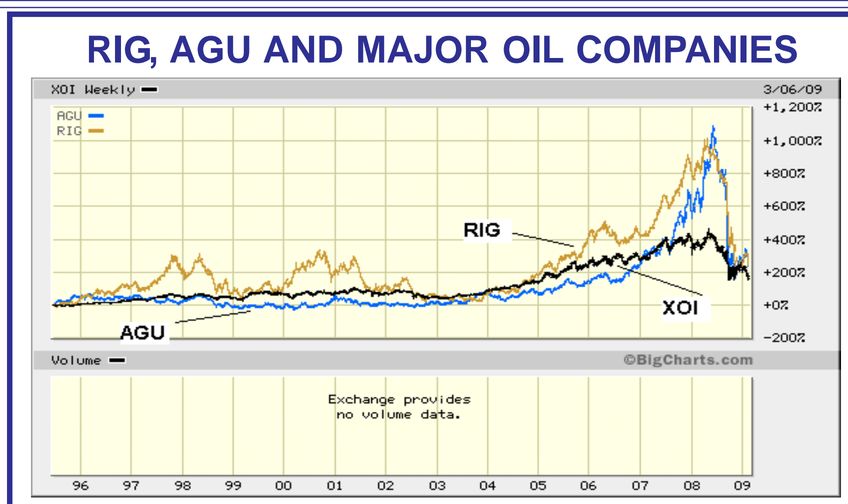
Look at the chart on the following page to see how Transocean's share price tracks compared to the prices of the big integrated energy companies represented by the XOI index. Service companies' shares amplify whatever the integrateds do on the both up and the downside. From the trough hit in 2003, RIG shares rose strongly and then peaked during the frenzied energy market that saw oil hit $147 a barrel and RIG $163, an all-time high. Now oil is back to the low $40s, and RIG is trading at about a third of its peak price. Though we are not predicting that Transocean is set to vault back to its old high, we do think it will perform strongly when energy prices rise off of what appears to be a bottom around $40.

The environment for exploration and development has slipped back to what we saw six years ago as the global economy again continues to weaken, energy companies are cutting back their capital expenditures and waiting. Speculators play their role at the margin. Few seem willing to accumulate shares. How quickly investors' convictions can change.

To get a sense of how tempting RIG was last year as energy companies sought to lease everything available, especially the ultra deepwater rigs, which Transocean dominates, consider that a semi-submersible deepwater

rig Transocean operated last year off the coast of Mozambique had a day rate of $362,000. In December, with oil prices hitting new lows, a new contract was signed with Burgundy Global Exploration to relocate the rig to the Philippines at a day rate of $550,000, a 50% jump in revenue. That's how tight the market is. However, in January, Burgundy failed to fund the escrow account, thus cancelling the deal. That's how tough financing is. It's a tug of war between limited supply that Transocean to some extent can control and suppressed demand.

RIG, AGU AND MAJOR OIL COMPANIES



Last week, Transocean provided information on new and significantly revised contracts involving a half dozen operating rigs, all of which are working in Asia and Africa. On the whole, the news is good: three enjoy day rates higher than their previous contracts. However, three other rigs are not in service, either cold stacked (not being actively marketed) or warm stacked (available for immediate service) and one, the contract for which was terminated, is in legal limbo. Transocean most likely will get partial compensation. Note that Transocean, because it dominates the ultra-deepwater end of the energy business, which remains the segment most likely to produce the next giant fields, can afford to keep rigs off the market in order to support day rates. Needless to say, this is a balancing act: mothball too many rigs to make sure rates for those rigs that do get leased are maximized and total revenues suffer.

What we need to watch is not so much Transocean's ultra-deepwater equipment, which will remain in high demand but the mid-depth and shallow rigs where competition is greater. We're factoring in slower revenues from these sectors but still expect to see earnings increase this year despite depressed oil prices.

Transocean has changed considerably over the period we've recommended it. The most significant change occurred in 2007 when it acquired its biggest competitor, GlobalSantaFe. The company also, for additional tax benefits, last year switched its headquarters from the Cayman Island to Switzerland. However, the biggest changes have been in revenues. In 2002, the year before we recommended RIG, earnings were $1.18 a share. In 2006, the year before the GlobalSantaFe deal, earnings were $2.94 a share. Last year, the first full year for the combined companies, earnings were over $14 a share.

Not surprisingly, price valuations are extraordinarily low. Compared to previous share price lows (1994,1997,1999, 2001), valuations today are as low or lower. RIG represents the most potent way to position yourself for a recovery in energy prices.

ICON ENERGY FUND

For those who prefer hunting for profits with a shotgun rather than a rifle, funds provide that diversification. The Icon family of funds uses a quantitative method to construct a value-oriented portfolio. If you'd like to explore that method, visit http://www.iconadvisers.com/WebContent/Public/System_Team/2_1.aspx?t=undefined. Icon, when we introduced it in January 2005, had favored energy service companies, an overweighting it maintained until the second half of last year when the portfolio shifted decisively toward the largest integrated energy companies. As of January 31st, Exxon Mobil represented 18.21% of the portfolio, followed by Chevron at 14.14%, ConocoPhillips 8.61% and Occidental Petroleum at 5.09%. Altogether, the integrateds account for 56% of the portfolio. Exploration and Development companies comprise 9.34%, Refining and Marketing 6.56% and Storage and Transportation 6.08%. Perhaps the most counter-intuitive holdings are airlines, which account for 7.05% and represent a hedge against the possibility oil prices might fall further. Railroad holdings also play the same role. The two airlines are Skywest and Delta. Burlington Northern and Union Pacific are the rails.

Given what we know about the Icon funds' methods, which are quantitative and favor subsectors that have been outperforming on a relative basis, we expect to

see going forward an emphasis on exploration and development companies and on energy service names, both of which—provided we are right about improving energy prices—will move more quickly than the majors that now dominate the portfolio. Look at the chart we printed to show how Transocean reacts to changes in the underlying market to appreciate why Icon will gravitate back toward service names. In fact, Transocean remains in ICENX's portfolio at 1.6%, which is smaller than two other energy service names: Schlumberger (6.06%) and Dresser-Rand (2%).

AGRIUM

Agrium (AGU—NYSE), a manufacturer and seller of fertilizers, belongs to the Natural Resources sector not only because its products are key to food production but also because the primary feedstock for its nitrogen-based fertilizers is natural gas. Domiciled in western Canada, Agrium when we introduced it in 1998 caught our attention due to depressed valuations and its access to cheap natural gas. At the time, Agrium manufactured and sold its products in Canada and the United States. The company has evolved into the second largest fertilizer company in the world, and the largest retailer of agricultural inputs in North America.

Presuming credit markets stabilize and recession subsides, we are expecting significant inflation, a not-unexpected consequence of extraordinary fiscal and monetary stimulus around the globe but especially here in the United States.

Over the past 11 years, the fertilizer industry expanded and then enjoyed explosive growth both in sales and investor interest since 2003 as global demand for food expanded rapidly along with the standard of living in the emerging markets. When ethanol, thanks to subsidies from the federal government and out of control gasoline prices, started to be mixed with gasoline, fertilizer demand spiked, since growing corn, a primary source for ethanol, requires more fertilizers than do many other crops. Look at the chart below that tracks AGU and the XOI to see how food and fuel converged in Wall Street's imagination on the way up and fears on the way down. Shares peaked at $112 in June 2008.

After bottoming in late November along with the other investments we discuss in this issue, AGU has added about 35%. But the big jump is still ahead, as the reflationary policies being strenuously applied by central bankers and governments will both rekindle demand and push prices for hard assets higher. Combine these two forces and the recovery in commodities should be robust.

We're not the only ones noticing this. In recent weeks, CF Industries has bid to acquire Terra Industries. Then Agrium made an unsolicited bid for CF, asserting that CF would reinforce and broaden its existing businesses. Private investors are also returning to fertilizers. For instance, George Soros has been picking up shares in Potash Corporation, against which Agrium competes.

Agrium expanded its original business as a producer/distributor of fertilizers to become the largest retailer of seeds, fertilizer and other agricultural inputs in North America. It also expanded geographically, developing manufacturing and distribution systems in South America, and is expanding operations in both the Mideast and China. The retailing segment now accounts for 25% of revenues with the fertilizer business dominated by nitrogen-based products (61% of sales).

Valuations not surprisingly are extraordinarily attractive. Price to Sales and Price to Earnings are at levels seen only when shares were in the process of bottoming. Back in 1998, when we originally thought AGU's valuations were compelling, the P/S was 0.5, where it now trades, the lowest level in the last decade. P/E in 1998 was 8.4, today it is 3.7, again a decade-long low. P/BK in 1998 was 1.7, today it is 1.2. Only P/CF today is higher than it was in 1998 (7.1 vs. 4.3).

ANGLO AMERICAN

Anglo American (AAUK—Nasdaq) is a holding company, domiciled in the United Kingdom and traded in the form of American Depository Receipts (= 0.5 shares as traded in London), that manages a broad range of natural resource companies assembled from acquisitions begun during the years South Africa was a political and economic pariah in the world. The abrupt termination of the bull market in natural resource stocks has been particularly hard on miners as share prices fell far deeper than have revenues and profits.

Today, Anglo American oversees the world's largest platinum production (40% of mine production), which in 2008 contributed 19% of sales and 23% of operating profits and diamond mines (40% of value of global diamond production), 9% of sales and 2% of operating profits. AAUK also has broad exposure to base metals

such as copper, nickel and zinc, representing 18% of 2008 revenues and 26% of operating profits. Iron-ore related mining and related businesses accounted for 21% of sales and 6% of operating profits. Finally, industrial materials such as rock aggregate, asphalt and cement represented 9% of revenues and 2% of operating profits. Exposure to gold mining, which AAUK historically has been involved in through ownership of AngloGold Ashanti, continues to diminish. Early this year, Anglo American dropped its ownership to 11.8%, down from over 40% as recently as 2006.

This combination of a tumbling share price and still solid sales and profits presents opportunity across the entire industry. Every non-precious metals miner now trades at low historical valuations. However, Anglo American, if we compare its valuations to those of other major diversified miners such as BHP Billiton, the biggest mining company, which with a market cap over $100 billion dwarfs AAUK at $18 billion, appears to be the most compelling. Using 2008 numbers, AAUK trades at a Price/Earnings less than half of Billiton's, ditto for Price/Sales, a third of BHP's Price/Book and less than two-third's BHP's Price/Cash Flow. Compared to the next largest miner, Freeport McMoRan, only when it comes to P/S does AAUK appear less undervalued but it's a relatively slim margin. Compared to the next two larger mining conglomerates, Companhia Vale do Rio Doce and Rio Tinto, Anglo American also trades at markedly lower price ratios.

We would be remiss not to point out some blemishes. Anglo American derives more than half of its revenues from South Africa and 29% from South America, which means that 80% of its business is done in geopolitically less stable regions. Even without political risk, there are social and economic issues. For example, for several months last year, South Africa was unable to provide enough electricity to operate many of Anglo American's mines, which hurt production.

The significant reduction in its AngloGold Ashanti gold position reflects a decision to focus the company on coal, ferrous, base and industrial metals, which is part of a much larger restructuring that saw divestiture of its paper business. Next on the block is its cement business.

In response to the global recession, Anglo American is pulling back. In addition to suspending its dividend, which will retain $1 billion for operations, the company also is laying off 11% of its workforce and has cut its capital expenditures for 2009 by half to $4.5 billion. A share buyback program has been suspended as well. In addition to making operations more efficient, capex is focused on boosting copper, coal and iron. Expansion projects that are ongoing will start contributing in 2011, by which time most presume global demand will start to be felt.

During the last couple of years, consolidation was rampant in the mining industry, and we expect that as demand picks up for commodities, so too will an appetite for acquisitions. Indeed, some believe that the new management's efforts to streamline AAUK is intended to make it more marketable to another miner. In any case, it's priced now for excellent appreciation once currently miserable market conditions relent.

USAA PRECIOUS METALS & MINERALS FUND

Whereas our view of prices for energy and metals primarily depend on an economic recovery that will bring increased demand, our endorsement of precious metals results from investor anxiety and perceptions. Lately, gold has drawn investors as a safe harbor during unprecedented financial instability. Presuming credit markets stabilize and recession subsides, we are expecting significant inflation, a not-unexpected consequence of extraordinary fiscal and monetary stimulus around the globe but especially here in the United States.

We're using the **USAA Precious Metals & Mineral Fund (USAGX)**, which combines relatively low expenses (1.1% expense ratio) to support a portfolio focused on low cost, primarily North American miners. It's enjoyed the same manager, Mark Johnson, for 15 years, and according to *Morningstar* has the best performance over the past 3, 5 and 10-year periods.

Though the portfolio bias is toward senior producers such as Goldcorp, Newmont and Kinross, each of which accounts for 6% of assets, the fund also finds space for smaller ventures such as Canada's Red Back Mining Inc. Johnson applies traditional value criteria for the miners he does include regardless of size. The portfolio average price valuations run about 75% of what its peers are prepared to pay for sales, cash flow, earnings and book.

As the fund name suggests, the manager can temper his holdings with non-precious metals, something he has done from time to time, though not much at present.

We do not propose that you bet the farm on gold, but it can provide an excellent anchor in troubled times, something at present we have in abundance. ***SA***

Portfolio Upates

If you are human, you have fantasized about how much you could have made had you gotten into the market in 1982 when the S&P bottomed at 109, or in 1987 during the crash that climaxed with the S&P at 259, or in 1990 when the market swooned to 330, or in 2002 when it hit bottom around 880 before starting a five year run that took it to a new all-time high around 1565. If you are human, you at this moment have to wonder who in their right mind would be buying in this terrible market?

Of course, that is why most investors only fantasize about such gains. Last week, the markets hit prices last seen in fall and winter of 1996.

Since we closed the February issue teh S&P is down 21.3%. The *Sound Advice* portfolio dropped 21.7%, hurt particularly by healthcare and real estate.

The **Prudent Bear Fund** performed as designed, adding 15.4%. Performance was tempered by its junior precious metal miners. Bullion and mining shares dropped as investors took profits in one of the only sectors to remain strong in recent months. **USAA Precious Metals & Minerals Fund** dropped 4.6%. See pages 3-6 for more about USAGX as well as metals and energy positions.

Sprint Nextel also remained strong, up 23.1%. For that matter, Sprint is up 66% for the year, the best performer in the S&P. The story with Sprint Nextel flows from the merger of these two companies that turned two successful wireless operators with very different business models and client bases into a fiasco. When we stepped in, Sprint Nextel was losing subscribers hand over fist, a process that has continued though is now slowing. Renewed interest in Sprint rests on two factors: first, an end to subscriber erosion and, most importantly, success for WiMax, a technology that extends wireless signals up to miles. A consortium of partners including Intel, Google, Comcast and Time Warner are backing Sprint and its operational partner, Clearwire, in the effort. WiMax is operational now in Portland, Oregon and Baltimore, and is expected to start up in eight other major cities this year and hit New York, Boston, Washington, Houston and San Francisco next year.

Last month's recommendation, **Stryker Corp.**, was caught up in the freefall in healthcare stocks after President Obama's address to Congress that included the broad outlines of his healthcare plan. SYK fell 25%.

ADD 6 MONTHS TO YOUR SUBSCRIPTION, FREE AND RECEIVE EACH MONTH'S ISSUE ASAP

Switch to an E-Subscription, and get your issue by E-mail on the same day we mail hard copies to other subscribers. Of course, you will continue to receive mid-month and other portfolio updates as well.

We will pass on printing and mailing savings by adding SIX MONTHS to your current subscription or renewal. No more postal delays, no more copies mangled in the mail, no more changing your address when you move or are traveling.

Go to www.soundadvice-newsletter.com, click on "Switch to E Subscription", and follow the prompts.

Wall Street interpreted Obama's insistence on cutting costs as part of expanding coverage to all Americans as a death knell.We've been overweighted in healthcare, because not only are such companies able to maintain respectable earnings during a recession but also because we believe that Wall Street concerns over how healthcare reform in this country will play out are too drastic.

This month we paid for that optimism, but that does not change our opinion that whatever plan comes out of Congress will not destroy the healthcare industry. Rather, we expect that expanded medical insurance rather than crippling them will boost HMO's revenues and profits, that wider insurance will create more demand for surgeries, meaning more stents, pacemakers, artificial joints, and that greater access to drug plans will have the same effect on pharmaceuticals. However, our expectations must first survive the surge of pessimism that took **UnitedHealth** down 38%, **Boston Scientific** 32%, **Odyssey** 19%, **Johnson & Johnson** 17% and **Schering Plough** 10%. See the page one sidebar for major news on SGP.

We got collateral damage from the freefall in financials, since anxiety over bank solvency and concern that the deepening recession has no end in sight convinced investors that all borrowers would find it impossible to finance their businesses. Real estate, which almost always requires debt, is at ground zero, since many had leveraged their balance sheets during the boom that

Sound Advice Portfolio for March 2009

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
Duke Realty Convertible Pfd	DRE.PRO	NYSE	$7.25	28.88%	**$13.00**	BUY
HRPT Properties	HRP	NYSE	$2.72	17.65%	**$3.50**	BUY
Public Storage Pfd	PSA.PRM	NYSE	$15.65	10.58%	**$19.00**	BUY
Diversified Growth					.	
Agrium	AGU	NYSE/TSE	$31.43	0.35%	$45.00	BUY
Boston Scientific	BSX	NYSE	$6.33	0.00%	$11.00	BUY
CGM Realty Fund	CGMRX	800-343-5678	$10.30	5.92%	N/A	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	$16.14	5.82%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	$53.88	3.41%	N/A	BUY
Fastenal	FAST	NASDAQ	$26.38	1.74%	$40.00	BUY
Gabelli Global Telecom	GABTX	800-422-3554	$12.10	2.73%	N/A	BUY
Honeywell	HON	NYSE	$23.60	4.24%	$38.00	BUY
Johnson & Johnson	JNJ	NYSE	$47.97	3.84%	$68.00	BUY
CarMax	KMX	NYSE	$8.68	0.00%	$12.00	BUY
Mattel	MAT	NYSE	$10.82	6.93%	$18.00	BUY
Microsoft	MSFT	NASDAQ	$15.28	2.88%	$26.00	BUY
Molson Coors Brewing	TAP	NYSE	$34.10	2.40%	**$45.00**	BUY
Odyssey Healthcare	ODSY	NASDAQ	$8.91	0.00%	$12.75	BUY
Schering-Plough	SGP	NYSE	$17.63	1.25%	$21.00	BUY
Sprint Nextel	S	NYSE	$3.04	0.00%	$4.00	BUY
Stryker Corp.	SYK	NYSE	$32.01	1.25%	**$42.00**	BUY
Superior Industries	SUP	NYSE	$9.48	2.53%	**$13.00**	BUY
Tetra Tech	TTEK	NASDAQ	$21.17	0.00%	$28.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	$25.45	0.72%	N/A	BUY
United Parcel	UPS	NYSE	$39.38	4.57%	**$45.00**	BUY
UnitedHealth Group	UNH	NYSE	$17.90	0.17%	**$25.00**	BUY
Wal-Mart Stores	WMT	NYSE	$48.91	1.37%	$60.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	$22.29	9.57%	N/A	BUY
Xerox	XRX	NYSE	$4.28	3.74%	**$6.00**	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	$7.12	15.87%	**$11.00**	BUY
Icon Energy Fund	ICENX	800-764-0442	$11.18	1.04%	N/A	BUY
Plum Creek Timber	PCL	NYSE	$24.02	6.99%	**$32.00**	BUY
PowerShares Water Resources ETF	PHO	NYSE	$10.41	0.77%	**$13.00**	BUY
Transocean	RIG	NYSE	$51.11	0.00%	$75.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	$21.11	0.05%	N/A	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	$11.63	2.13%	**$16.00**	BUY
DWS RREEF Real Estate Fund II	SRO	AMEX	$0.64	N/A****	N/A	**SELL**
Ford Motor Convertible Pfd	F.PRS	NYSE	$4.85	67.01%	**$10.00**	BUY
Icon Financial Fund	ICFSX	800-764-0442	$3.02	0.00%	N/A	BUY
Liberty Global	LBTYA	NASDAQ	$10.39	0.00%	**$15.00**	BUY
Maxim Integrated	MXIM.PK	NASDAQ	$11.49	5.43%	**$16.00**	BUY
Federated Prudent Bear Fund***	BEARX	800-711-1848	$7.89	0.00%	N/A	BUY
Symantec	SYMC	NASDAQ	$12.93	0.00%	$19.00	BUY
Time Warner	TWX	NYSE	$7.47	2.95%	$13.00	BUY
Western Digital	WDC	NYSE	$14.55	0.00%	$20.00	BUY

**Prices as of the market close on Friday, March 6, 2009*
***Yield represents all income during previous 12 months divided by current share price.*
Note that all fund distributions fluctuate annually.
****Note change in name for this fund*
*****Distribution Suspended.*
*BUY, HOLD, SELL OR LIMIT IN **BOLD** SIGNALS CHANGE IN ACTION OR LIMIT*

crested in early 2007, and face not just vacancies in a cooling economy but also lenders reluctant to step up. Regardless of how careful we've been in relying on REITs whose balance sheets are healthy, have good cash flow and face no imminent need to refinance, all were mercilessly pounded, even the two preferred recommended two months ago. Let's start with them, since one issuer, **Public Storage**, is the dominant player in the most recession resistant REIT sector, mini-storage, and has a balance sheet that essentially is without debt, because it has used preferred shares to finance expansion. Its preferreds' total face value is $3.5 billion and requires only $22 million a year in interest payments, while its traditional debt toals $646 million. Market cap is $8.3 billion with a debt/equity ratio of 0.07.

Yet Public Storage, which is insulated from the credit crunch, saw its common shares over the past month fall 25%. The M series preferred dropped 21%. Our second preferred, **Duke Realty Series O** was cut in half while Duke's common fell 56%. Duke also faces no imminent debt refinancing, and though it is in a more stressed sector, offices and light industrial properties, is well managed. Contrary to the view that it is impossible to borrow, Duke recently set up lines of credit and also has $5.5 billion in unsecured property that it believes could be borrowed against even in this market at a 50% loan to value ratio. We have no reason to think that Duke Realty is in peril, but we have every reason to think that the REIT market has become unhinged, and has put valuations back to where they were 16 years ago when REITs were a relatively new asset class. The PSA story is one example, and we think the same is true for Duke.

As for **HRPT Properties Trust**, which fell 32.7% since the last issue, there was significant news but nothing to explain the shares' fall. HRP, as we said last month, has reduced its dividend to 12 from 21 cents a quarter in order to retain capital. It also authorized a $100 million share buyback program that as of February 25th had gathered 3.3 million shares. Also, HRP intends to spin-off 29 of its government properties, its most credit-worthy tenants, into a new REIT, Government Properties Income Trust. HRP will retain 49.9% of the shares. HRPT's reasons are several: first, the sale will bring in cash that can be used to retire debt, second, HRP believes that such an IPO would be at higher valuations than HRP itself currently enjoys, and would demonstrate how cheaply HRP currently is priced. Finally, though HRPT does not plan to sell its remaining stake in this IPO, the shares could be used to raise cash for other acquisitions or to pay down debt. As with Duke, HRP is not pressed by any imminent debt refinancing, and like Duke is responding proactively to what is a nasty real estate environment. We consider the shares grossly undervalued.

CGM Realty Fund fell 27%, which still put it ahead of both RWR, the REIT ETF and the Dow Jones Composite All REIT Total Return Index. Heebner, the fund manager, as of the end of 2008 has boiled the portfolio down to four sectors: retail (34%), office and light industrial (23%), 15% each in apartment and mortgage REITs and 9% in healthcare REITs. For the long term, Heebner remains the best performing fund manager, and we expect that his ability to take advantage of dysfunctional markets will let him take full advantage of the eventual recovery in REIT prices.

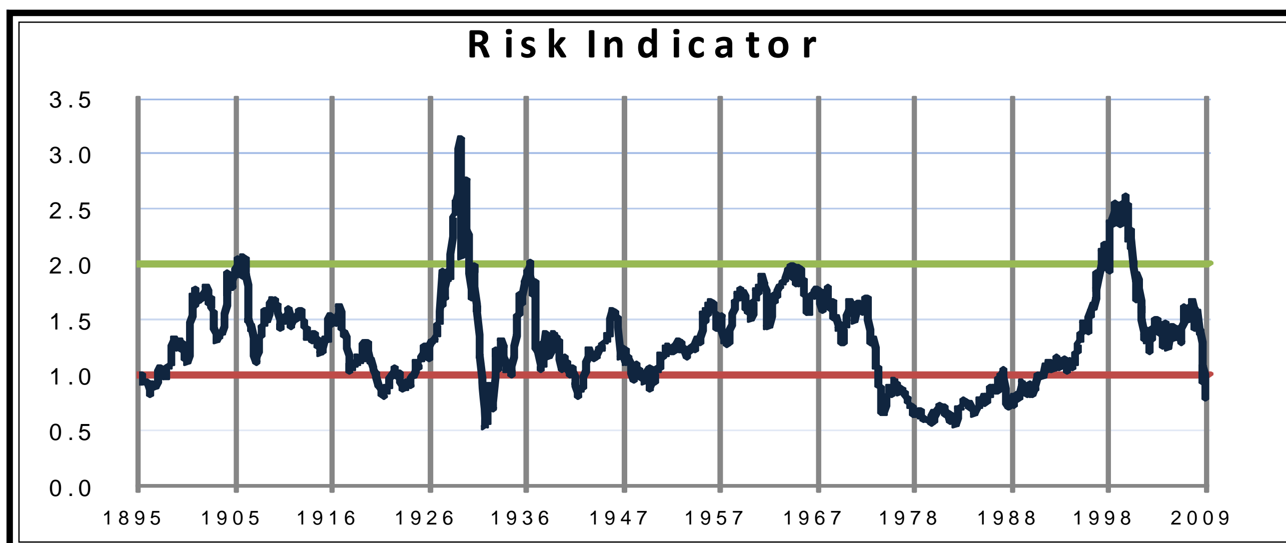
We've concluded that the managers at **DWS RREEF Real Estate Fund II** won't do that. Despite carrying a persistent steep discount to NAV, the closed-end fund continues to woefully underperform its benchmark. We are purging the fund from our portfolio.

At present, REITs in terms of their properties are trading at a 45% discount to privately held real estate. We firmly believe they should be bought either through funds such as CGMRX or as individual equities, though we cannot stress enough the need to avoid REITs with extraordinary leverage, particularly leverage that must be refinanced this year or next. Yields, even if they are being trimmed, or in some cases being paid in shares rather than in cash, are stunning, and though we traditionally have considered outsized yields to be a red flag, for REITs today we are making case-by-case judgments.

Finally, REITs, particularly thinly traded REIT preferreds, are being pushed lower by forced selling by funds, particularly closed-end funds like the DWS position we are selling off. Over the past month, as was the case in autumn when REIT funds were forced to liquidate to raise cash in order to get their debt structure back within loan covenants, shares were dumped without consideration to value or market impact. Don't confuse panic with shrewdness.

For investors able to tolerate the extraordinary volatility and pain, REITs now represent extraordinary opportunities. As we noted at the outset, circumstances are now forming that at some point in the future will cause you to fantasize about the profits that could have been made in the broad market. REITs are the most obvious case in point. ***SA***

Sound Advice Market Indicators for March 2009



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.

The Risk Indicator is in historically low territory. At the S&P 500 low on Friday, March 6, 2009, the Risk Indicator dropped to 0.79. A reading this low reveals that stocks are historically low relative to house prices. This is coming at a time when both stock and house prices fell to new lows: The S&P to 683.38, and median price of a new home to a low of $201,100. It is just that stock prices fell faster than house prices.

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. This Diffusion Index currently stands at 17 percent.

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.

The next signal we are looking for is an "Aggressive" signal from the Diffusion Index of Leading Indicators. This Diffusion Index currently stands at 25 percent. The only indicator that is still above its level of 6 months earlier is the indicator that measures the gap between the Federal Funds rate and the yield on 10-year Treasury bonds. The unusually large gap is indicative of an abnormal credit market. However, this reading is based on the data for January, which is the most current data available. However, if we assume that the indicators did not improve since January, a likely prospect in view of the economic conditions since then, then the Diffusion Index of Leading Indicators will hit zero for March. However, to be safe, until we actually see a zero reading, we should remain cautious in our investing.

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 17.5. 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 1.1 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

YOUR CHOICE: A GREAT DEAL OR THE BEST DEAL

BEST DEAL! 24 Month Renewal. This is a 68% Savings!
24 Months of *Sound Adivce* for only $125.

FREE Research Reports with Your 24 Month Renewal!

The Credit Crunch of 2008-09 A $29.95 Value...**YOURS FREE**. This report explains exactly what is going on in the worst credit crunch of modern times, as well as the key indicator that will reveal when the credit crunch will be over.

The Sound Advice Special Situations A $29.95 Value…**YOURS FREE**. Here is a complete update of each stock and mutual fund in the *Sound Advice* model portfolio. We review the fundamentals of each recommendation, why they are special situations, and what we expect for the future. This will give you a chance to review your investments along side our recommendations, and make sure your money is working the hardest it can for your future.

The latest edition of ***The Science of Making Money in Turbulent Stock Markets***. A $59.95 Value...**YOURS FREE**. This is the book that explains all of the *Sound Advice* indicators, including the Diffusion Indexes and the famous Risk Indicator, and exactly how they work so that you can update them yourself.

Our #1 Investment of the Year. A $29.95 Value ... YOURS FREE. If you could make only one investment, this is it. Time is of the essence. You should invest right now.

If you take the **BEST DEAL**, you will receive *Sound Advice* for only 17 cents a day. You can't buy anything for that. But whether you take the Great Deal or the Best Deal, you will receive wealth-building advice that you can take advantage of on your own through no-load funds or discount brokers. The commission savings alone will pay for your subscription many times over, not to mention the astonishing and reliable profits I am confident you will reap, along with inflation-proofed high income. Join me in helping you dramatically increase your wealth safely in the new bull markets starting right now.

GREAT DEAL: 12 Month Renewal for only $85!
This is a 56% Savings!

FREE Research Reports with Your 12 Month Renewal!

The Credit Crunch of 2008-09 A $29.95 Value...**YOURS FREE**. This report explains exactly what is going on in the worst credit crunch of modern times, as well as the key indicator that will reveal when the credit crunch will be over.

The Sound Advice Special Situations A $29.95 Value…**YOURS FREE**. Here is a complete update of each stock and mutual fund in the *Sound Advice* model portfolio. We review the fundamentals of each recommendation, why they are special situations, and what we expect for the future. This will give you a chance to review your investments along side our recommendations, and make sure your money is working the hardest it can for your future.

E-Subscribers Get 6 Months FREE!

Regardless of your choice, you can add 6 months to your renewal, absolutely FREE.
Go to WWW.Soundadvice-newsletter.com and click on "Renew".
To fax or mail in your renewal, see the coupon on the reverse side.

To fax or mail in your renewal, please fill out the coupon below.

(or go to www.Soundadvice-newsletter.com and click on "Renew".)

Sound Advice / 939 Hartz Way/ Suite 210 / Danville, CA 94526 ***Fax 925-838-0522,*** *or call 800-866-0026*

☐ **BEST DEAL! 24 Month Renewal for only $125 - A 68% savinfgs! Plus, you will receive ALL of the Special Research Reports:**

1. The Credit Crunch of 2008-09
2. The Sound Advice Special Situations
3. Our #1 Investment of the Year.
4. The Science of Making Money in Turbulent Stock Markets.

☐ **GREAT DEAL: 12 Month Renewal for only $85 - a 56% savings! Plus, you will receive two of the Special Research Reports.**

1. The Credit Crunch of 2008-09
2. The Sound Advice Special Situations

E-Subscribers Get 6 Months FREE!

Regardless of your choice, you can add 6 months to your renewal, absolutely FREE!

☐ Enclosed please find my check payable to: ***Sound Advice***

☐ Please charge my **Visa** or **MasterCard**: Card #: ____

Expiration Date:___________ Security Code _______________ (the 3-4 Digit Number on the back of your credit card)

E-mail Address: ____

(For important news and updates between issues)

Daytime Phone (_______)_________-_______________________

(In case we have a question about the order)

☐ **Yes!** Add 6 months to my choice above and E-mail me my issues. My E-mail address is above.

Enclosed: the March Issue of *Sound Advice* for...

NEXT ISSUE APRIL 10TH

Address Service Requested

First Class Presort
US Postage
PAID
Permit #185
Sacramento CA

Sound Advice
939 Hartz Way
Suite 210
Danville, CA 94526

(tear along perforated dotted line)