Gray Cardiff's

SOUND ADVICE

Volume XXII, Number 2 | Subscription Rate: $195 per year | February 13, 2009

Fidelity has been firing mangers who performed poorly last year, which is what shareholders in Fidelity funds have been doing by selling off their shares after a particularly brutal year.

Before you pull the trigger and shoot the manager, you should ask whether instead you are just shooting the messenger. For example, consider the now-fired manager of Fidelity Latin America Fund, which lost 46% over the last 12 months, a big enough loss in most markets to justify dismissal, had the second best performance over last year among the 26 Latin funds *Morningstar* tracks. In fact, none of these funds lost more than 51%, while the "best" lost 45%, not much different than what the hapless Fidelity manager got fired for achieving.

If you check performance for 2009, the same Fidelity Fund is up 9.2%, again the second best performer among non-leveraged Latin funds. But senior managers felt the need to "do something," and like a baseball team that fires its manager when it's the players that should be sent packing, pink-slipped its employee.

We're sceptical about firing a manager, even a fund manager who significantly underperformed should not be shot summarily when he has a long history of outperformance. Take Dodge & Cox Stock Fund, which last year lost more than the average Large Cap Value Fund (-35%). But we have no argument with the discipline that shaped its choices. Over time luck loses its effect. The message Fidelity's Latin American manager and DODGX conveyed was that 2008 was lousy. Dodge & Cox will continue, humbled but not different. Fidelity, which worries too much about its image, thinks firing someone is the answer.

--Gray Emerson Cardiff

Smug Mr. Market

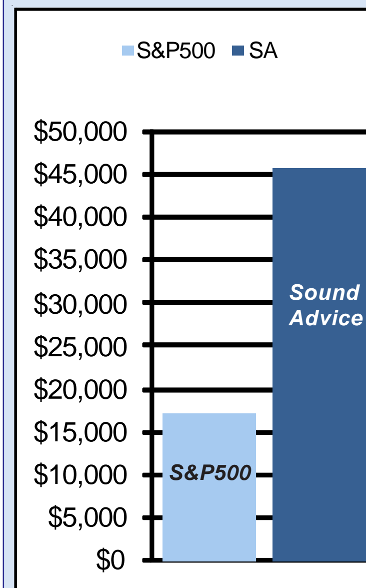
As we struggle through the worst bear market since the 1930s, investors act as if the market will never get back its groove. It's painful to remember a time when enthusiasm, not gloom, was rampant on Wall Street. Robert Shiller, a Yale economist, who for years has played Cassandra for investors, captured that bubbly mood in coining "irrational exuberance," which Alan Greenspan appropriated in a 1996 speech. Immediately after Greenspan spoke, terrified, if not chastened, investors retreated for a couple of weeks, dropping share prices by about 3%, but soon enough they were back.

Though it was fun while it lasted, you have to ask why Greenspan did nothing—absolutely nothing—to take some of the fizz out of the market either in 1996 or later as it hurtled higher to truly unsustainable levels. Instead, he either denied during that run (as he did with the next bubble in housing) that a bubble even existed or he asserted it was impossible to detect a bubble until after it had collapsed. As a free market apostle, Greenspan felt it was not the job of the Fed (or any government entity) to interfere in markets, which made it all the stranger whenever the market teetered that Greenspan abandoned that pose, freely, dropped interest rates and did everything he could to talk them back to stability.

Shiller warned early this decade that the nine-year explosion in housing prices that started in 1997 but really took off in 2002 and ended in 2006 was aberrant, and will not soon be revisited. Between February 1997 and the peak in June 2006, housing prices nationally almost tripled. Between February 2002 and June 2006, they jumped 82%. Miami shot up 123% as did Los Angeles.

Shiller, if you don't know his work,

Sound Advice Versus the S&P 500



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is a behavioral economist, a relatively new approach among academics that developed in reaction to the idea that investors and accordingly markets were rational. Classical economists believed that economic man (*homo economicus*) always acted to achieve the maximum economic benefit with the least effort. Emotion and human instincts played no part. Out of this came the concept of the Efficient Market, in which stock prices embodied all information available to investors, who because they were rational made appropriate decisions. In short, the price was always right. Out of this in turn came the index fund strategy. Since no one except by luck could outperform an efficient market, index funds promised to match the performance of the overall market, or as new indexes have proliferated, some subsection of the market. The idea that markets were efficient also encouraged the notion that they should be self-regulating, controlled by some mysterious gyroscope that would always correct back to balance. Hence, regulation of markets was not needed, and, as Alan Greenspan naively pronounced, would only distort their natural course.

The flaw in classical economics is that it confuses what people should do with what they do do. We are human, and fear and greed always work against rational decisions. The most glaring challenge to efficient market theory is the growth and collapse of bubbles. How rational was it to pay $22 for a share of Pets.com on the day it debuted at an IPO price of $11, especially because it had lost $42 million in the previous quarter on sales of $5 million? How rational was it three years ago to pay $82 for a share of Beazer Homes, a homebuilder, whose new home buyers patently could not afford their mortgages?

But, if academic economists are just discovering how irrational investors and markets can be, it's hardly news to professional investors. In fact, the father of value investing, Benjamin Graham, characterized how crazy investors and the market are when he conjured up Mr. Market, your partner and a financial manic-depressive, who one day is demanding to buy you out at any price, and the next day, when the market dives, is begging to sell you his share at whatever price you suggest. In Graham's description, Mr. Market is the ideal patsy. Unfortunately most investors prefer to party when Mr. Market parties and mourn when he mourns.

Right now, Mr. Market is depressed and insists on dumping what he owns. As tempting as it is to say that Mr. Market is always wrong, we cannot deny that he has been brilliant since October 2007, and remained resolutely bearish even after the market entered traditional bear territory last September when the S&P 500 fell 20% below its previous high. In fact, Mr. Market, ignoring Shiller, was also right back in 1996 when he just kept on buying straight through to 2000.

On the other hand, Mr. M. back in 1999 and 2000 ignored other assets, the old economy companies, real estate and commodities that became the engines for the next surge. Today, Mr. Market sees no value anywhere—with one perilous exception we'll get to below—and is creating the same sorts of bargains we captured the last time he went to extremes. The question for us, as Mr. Market's partner, is whether it is Mr. Market who is unbalanced or is it us? Are we crazy to be buying when he insists on selling? We've been stocking up again on REITs and companies with strong balance sheets, excellent business models and the misfortune to be in the middle of a deep recession.

The only thing Mr. Market can't buy fast enough is U.S. Treasury debt, driving yields to levels that make little sense unless you believe inflation for the next decade will be zero, or that there are no consequences to the Federal Reserve's helter-skelter expansion of the money supply and the Treasury's equally frenetic issues of new debt. *Sound Advice* is banking on Mr. Market being wrong about both.

Mr. Market repeats what the media tells him: the Fed really worries about: demon deflation, which explains totally why it's rational for Treasuries' yields to shrivel and prices to soar. We think Mr. Market, even if he was perceptive enough to start selling stocks at the market peak in 2007, has long since slipped back into his depressive state. His infatuation with Treasuries is one piece of evidence, and, we expect to see at some point this year, his fixed pessimism about equities is another. ***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.**

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Replacement Parts

When this bear market is history, you will look back and wonder how you could have not bought shares in blue chip companies with great cash flow, excellent sales, bulletproof balance sheets, excellent management and great prospects. The implication is that waiting for some unequivocal evidence that a bull market was underway is foolish. However, as we suggest in our cover essay, "Smug Mr. Market," you could have begun snapping up shares last year—and you might lashing yourself, wondering how you could have bought such shares in blue chip companies regardless of their virtues.

Though our indicators have helped us outperform the market and currently have us in caution mode, our task is to identify situations that will generate above-average profits even if that result takes time. We suggest in these times a gradual approach to implementing our recommendations by buying a portion of your target investment now and the balance over the next few months, You probably will sleep better. After 15 months of decline, the market has humbled many excellent companies, whose shares in their heyday we never would have thought to recommend because they were priced too richly. Not any longer.

Stryker Corporation (SYK—NYSE) is a $17 billion market cap medical device company best known for its artificial knee and hip implants with sales last year of $6.7 billion. During 2008, Stryker shareholders saw their share price tumble from $74 to under $40, which in the worst year for stocks in memory would make sense were Stryker itself to have had a terrible year. Instead, Stryker had a fine year by any standard except its own. Indeed, one factor contributing to the sharp drop in SYK's share price was that investors had come to expect 20%+ annual growth in per-share profits, a demanding standard Stryker had established over the previous 29 years. At moments when investors fretted that this streak might end (as they feared wrongly in 2004), the shares would sell off.

It wasn't that management overpromised but underdelivered. It's just that Stryker had spoiled Wall Street. In fact, Stryker finished 2008 with net sales up 12%, gross profit as a percentage of sales up 10.9%, operating income as a percentage of sales up 16.2%, net earnings from continuing operations up 16.3% and net earnings up 12.8%. It even increased its modest dividend by 21%. And it accomplished this not just in a recession but against the adverse effects of a strengthening dollar. However, Wall Street, despite all its talk about long-term investing and the absurdity of trying to trade in and out of stocks based on news from yesterday, this week, this month or even this year, rarely walks its talk. So much the better for us.

STRYKER

Stryker has been supplying the hospital and orthopedic segment since 1941, though its entry into artificial knees, hips and other replacement parts began about 30 years ago through an acquisition, which today accounts for 59% of sales and extends to materials and techniques for the repair of hard and soft tissues, a natural extension of its implant business. Stryker in addition to its knee and hip implants is an industry leader in trauma implants, in spinal implants, in craniomaxillofacial implants, in powered surgical equipment, in surgical navigation and in tools for minimally invasive surgery. Finally, it produces and markets decidedly low-tech hospital supplies such as beds and stretchers. The company gathers these non-implant products under the banner of its MedSurg division, which accounted for 41% of 2008 sales.

Stryker competes against several other implant and hospital equipment companies. For implants, the most prominent are Zimmer Holdings, which derives the bulk of its sales from orthopedic devices and the healthcare leviathan **Johnson & Johnson**, whose DePuy implant subsidiary is just one part of its business. As opposed to its two major competitors Stryker is more committed to orthopedics than JNJ but more balanced between orthopedics and surgical equipment than Zimmer. Hospital equipment is an even more diffused industry. Stryker is the biggest provider of operating room equipment (33%), but plays a smaller role in minimally invasive surgical tools (5%)

ORTHOPEDICS AND BABY BOOMERS

A recent issue of Consumer Reports *On Health* notes that demand for joint replacements is increasing not just because the tide of baby boomers is starting to surge but also because obesity is taking its toll on the knees and hips of younger patients. Another demand stream comes from middle-aged recreational athletes, whose devotion to running and other high-impact activities increases wear and tear on joints. This segment of the market presents new challenges, since implants have a 10 to 20 year lifespan, which in a geriatric population in the past was not an urgent issue. As implants go into much younger bodies and as life spans continue to expand, manufacturers are working toward more durable products. Nonetheless, the replacement joint business remains firmly involved with older patients. The average age for a recipient of an artificial hip or knee is 68.

With $2.2 billion in cash and cash-equivalents on hand and an untapped billion dollar line of credit, Stryker can be considered bulletproof. All it needs to do to prosper is get through the hideous current economy, since its products are in demand, and stand to become only more so as baby boomers start to fall apart.

The United States is by far the largest market for medical devices and accounts for more than 40% of global demand. The European Union accounts for more than half of the rest, with Japan the next largest market at about 10%. Driving demand is the aging of the generation born after World War II, the baby boomers, those of us born between 1946 and 1964, who in the U.S. number about 77 million. There are comparable population bulges around the world. A study, *World Population Aging 1950-2050,* estimates that those aged 60 or more will increase from 20% of the world's population in 2006 to 32% at midcentury.

The most common reason for replacement is arthritic degeneration, which occurs in more than 50% of those 65 years or older. Stryker last year reported flat sales of hip replacements but 15% increases in knee replacement, 22% growth in trauma-related items and 20% growth in spinal implants. In total, domestic sales in this division rose 10%. International sales overall grew 10% with a similar distribution.

Some consider orthopedic implants to be recession proof. However, in difficult economic times there are counter currents. As workers lose their jobs, they also lose medical insurance coverage, which makes joint replacements, in most cases elective surgeries, less likely. On the other hand, others concerned that they might lose medical coverage, decide to have the procedure as soon as possible. Even when insurance would cover most of the cost, in a tough economy workers might decide they can't afford either the co-payment or the time away from work. However, these are transient influences on demand. We need to focus on the more persistent influences that an aging population presents.

Given the average age of candidates for replacement joints, the role of Medicare and Medicaid is obvious. When combined with government payments for their own employees, for military personnel and their families, about half of all medical care is billed to government. One concern has been that both Washington and state governments, strapped for funds, would reduce reimbursements and/or make the criteria for using implants more stringent, which would have an impact on Stryker and its competitors.

Both government and private insurance sources continue to express concern about fast rising hospital billings, which have been growing at close to 8%, significantly higher than overall health costs, which themselves are rising faster than growth in the general economy. Payers have established lower reimbursement levels, imposed schedules for reductions in expenditures, but have suggested a willingness to share any savings with care providers if less expensive health solutions are developed, which favors companies like Stryker that underwrite hefty research and development programs and partner with other firms whose technologies supplement their own such as hip resurfacing instead of total hip replacements and the use of minimally invasive techniques, which either are cheaper to perform and/or require less hospital time.

Countering attempts at limiting expenditures is the political clout from an ever-growing tide of baby boomers. In the short term, we expect that whatever stimulus program gets passed by Congress will benefit

medical care and inject more funds both through Medicare and, by giving money to states, through Medicaid.

MEDSURG

Profit margins are lower for the non-implant divisions but are still robust. MedSurg saw a 14.6% increase in sales compared to the Orthopedics 10.6% growth. MedSurg sales are dependent on hospital capital expenditures, and last year contended with overall corporate cost cutting. Not only were hospital expansion plans throttled back, but hospitals postponed new equipment purchases to conserve funds. In addition, several of Stryker's product lines will be updated in 2009, which also encouraged hospitals to wait for the newest generation of equipment. Nonetheless, sales increased 11% domestically and double that outside the United States.

EXCHANGE RATES

A weak dollar between 2002 and 2007 had provided a tailwind for all exporters, but that reversed last year and weakened overall results. Medical device companies were especially helped and then hurt by these swings. Stryker in 2008 maintained 2007's 64%/ 36% ratio of domestic to foreign sales.

Last year, Stryker estimates that a more robust dollar reduced revenues by about 4.1%. Simply put, when the dollar is strong and foreign sales are translated back into dollars, numbers shrink. As you know, *Sound Advice* expects the dollar to run into its own serious headwinds as the monetary implications of the various bailouts and the overarching stimulus plan emerge. Hence, we suspect Stryker, which states it expects continuing dollar strength, could find more hospitable exchange rates sooner rather than later.

LEGAL AND REGULATORY ISSUES

Stryker and its competitors cultivate close relationships with orthopedic surgeons, whose preferences obviously is crucial for sales. It's a tricky relationship. Surgeons need not only to be sold on the virtues of each product but also trained on how to implant and maintain them. Unfortunately, the relationships between healthcare professionals and the companies that supply them can create conflicts of interest. In 2005, the Justice Department began to investigate payments made by orthopedic device companies to surgeons. Of the six medical device firms, Stryker was the first to step forward to cooperate with the DOJ. Though it accepted the same monitoring the DOJ imposed on its competitors, Stryker was the only firm not indicted, which, we feel, reflects responsible management

If Stryker was on good terms with the Justice Department, it and other medical device makers were not so fortunate when it came to the FDA. In Stryker's case, in little more than a year it received three warning letters. The initial letter, dated March 2007, concerned hip replacement parts manufactured at its Irish facility. The second concerned a plant in New Jersey that also produced hip replacement parts. The third letter addressed other problems at the New Jersey plant. The most serious accusation involved falsified documents, which were traced to field sales reps, who were fired. The FDA warnings worried investors, and though the shares continued to move higher, the last FDA letter coincided with a peak for many healthcare companies' shares, and marked the all-time high for SYK.

Stryker responded vigorously to the FDA warnings, and reported that it increased compliance-related costs by $55 million in 2008, and expects to exceed that in 2009. Management is cautiously optimistic about the FDA rescinding the three warning letters.

FUTURE GROWTH

Demographics insure that Stryker will see increasing demand for its implants. The same increasing demand for medical care from an aging society, and the prospect that some form of national health insurance suggests a boost for the MedSurg division. But that is true for all healthcare companies. Stryker has several advantages, aside from its impressive line of innovative products, that favor its prospects.

Historically Stryker has grown not just organically but through crucial acquisitions and strategic partnerships. Recall that the orthopedics division came

from an acquisition. More recently, management has bought smaller companies with innovative products in both the implant and minimally invasive surgical tool segments. Stryker also has partnered with smaller companies (some of which it later acquired). For example, Stryker's technology for hip resurfacing, a less invasive alternative to total hip replacement, is licensed from a British firm and was approved last year by the FDA. Though hip implants were up only 2%, this partial procedure cushioned that weaker demand.

At the end of 2008, Stryker was sitting on $2.2 billion in cash, cash equivalents and marketable securities even after spending $1 billion on share buybacks last year. Given how strong cash flow is for Stryker, that unleveraged balance sheet could be used, as it was in the late '90s, to make a significant acquisition. The bear market for medical device and equipment stocks has brought not just Stryker's share price down but the market caps of companies whose businesses could complement Stryker's current mix. We expect to see management deploy some of this trove to expand existing product lines and, perhaps, to add complementary businesses.

BALANCE SHEET AND VALUATIONS

At the end of 2008, the balance sheet carried no long-term debt, which means trivial debt servicing costs. The last time SYK carried significant debt was in 1998 after buying Pfizer's orthodpedic division. Within six years long-term debt again was zero. With $2.2 billion in cash and cash-equivalents on hand and an untapped billion dollar line of credit, Stryker can be considered bulletproof. All it needs to do to prosper is get through the hideous current economy, since its products are in demand, and stand to become only more so as baby boomers start to fall apart.

That billion-dollar share buyback was done at an average price of $57, about midway between the 2007 high and where shares currently stand. Management is not opposed to further buybacks, especially at these levels, but the priority is on making strategic acquisitions while valuations across the industry are so attractive.

There are few medical device companies with fallen valuations as attractive as Stryker's. In its best years this decade, Stryker benefited from increased unit sales, an ability to raise prices (e.g. in 2003 implant prices in the U.S. rose 6%) and beneficial currency exchange rates, which provided a 4% tailwind to sales. With a new bull market that brought investors for all stocks back SYK became one hot stock.

Stryker announced fourth quarter and full-year 2008 results on January 28th, exceeding expectations and igniting a brief rally in the shares that subsided as holders took advantage of the price rise to unload shares. With the share price currently at just under $43, SYK is back where it traded a couple of years ago. Looking backward, we see that SYK changed hands at these prices in October 2005 and before that in autumn 2003. But that reflects the least important metric, market price, and obscures the real value here.

If we look at the valuation ratios, it's clear that Stryker today is trading at a bargain price. We need not compare today's valuations to the lofty numbers hit in 2004 when Price to Earnings broke 40, Price to Sales was over 5, Price to Cash Flow broke 27 and Price to Book rose above 7. A better indication of relative value is to compare current numbers to the low valuations Stryker has averaged over the past 17 years: until now, the average low P/E had been 22.7, P/S 2.8, P/CF 16.4 and P/BK 12.2. As we price our portfolio on February 6th, Stryker carries a P/E of 15.3, a P/S of 2.6, a P/CF of 15.6 and a P/BK of 3.

We recognize that price ratios are backward looking and there is no guarantee that they represent an absolute limit to how low the shares can go. For that matter, should sales, cash flow, earnings or book value plummet and take the share price with them, low price ratios would be a worthless indicator. But Stryker has maintained a remarkable history of increasing sales, cash flow, earnings and book value. We see no reason to believe that their recent drop represents anything more than tough times, and expect rising sales and earnings, which will create rising valuations and a significantly higher share price. We recommend buying SYK up to $48. ***SA***

Portfolio Upates

Since the January issue was closed on January 9th—and since the start of 2009—stock prices have eroded. The standard market benchmarks remain weak. The Dow for the year is down 8%, the S&P 7.2% and the Nasdaq 3.9%. Since the January letter, the Dow is down 3.7%, the S&P 2.4%, though the Nasdaq is up 1.3%. *Sound Advice* for the year is up 2.4% and since the last letter held its own with a 0.71% gain.

It's safe to say that the market remains unreliable, especially if you try to correlate price changes in related assets. In the January issue, for instance, we recommended two REIT preferred shares: **Public Storage 6.625%** and **Duke Realty 8.375%**. The former is 1.6% lower and the latter 9.6%. However, over the same period their common shares are off about half that. In part, Duke's drop simply reflects how volatile office/industrial REITs are in the current economy, while Public Storage's stolid month reflects the stability characteristic of storage properties' cash flow. Additionally, as is the case for all thinly traded shares—and even these more widely held REIT preferreds are thinly traded—sharp price changes in either direction can occur when the market has to digest either a handful of small trades or just one relatively large trade. Consider that the bid-ask for Duke's common shares at this moment is one cent but for the preferred is 21 cents, which suggests how volatile lightly traded preferreds can be. We remind you that limit orders are essential when buying or selling thinly traded shares. If you want to try to make this volatility work for you, putting in a buy order well below the current price or a sell order well above it and then just waiting for days or weeks to see if it gets hit is one way to reach for better prices. Of course, should prices drop or rise for substantive reasons, you'll probably find yourself buying in a falling market that has further to fall, or selling in a rising market that has further to rise.

Surveying the entire portfolio provides a snapshot of what was hot and what was not since the last letter. As the Nasdaq's divergence from the S&P and Dow suggests, tech is showing strength, but **Western Digital** ran circles around other old tech companies with a 28% jump that began a week before it announced better-than-expected results for the quarter amid reports of extraordinarily low inventories. WDC, as we always note, is not for the faint of heart, since huge price swings are characteristic. We tolerate the volatility because Western remains the best managed company in a sector that straddles two still crucially lucrative sectors: computer and entertainment storage.

Symantec, the data and computer security and management company, added 18.1% and **Maxim Integrated**, the analog chip maker, picked up 14.2%. SYMC also surprised analysts with higher results and convinced some it was recession resistant. We'd rather focus on its potential once IT spending increases. The Veritas division, the purchase of which started SYMC's tumble into value territory, is now contributing, and other more complementary acquisitions are increasing what the company offers corporate customers. Maxim, on the other hand, reported less than expected results and reduced expectations for the next quarter. As has been the case with other semiconductor stocks this year, disappointing results and expectations did not discourage buying.

Healthcare also rose across the board. **Boston Scientific**, despite losing a long-contested patent case against **Johnson & Johnson**, added 23%. Though earnings were lower, it's likely that investors paid attention to numbers and remarks from management

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Sound Advice Portfolio for February 2009

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
Duke Realty Convertible Pfd	DRE.PRO	NYSE	$15.10	13.87%	$20.00	BUY
HRPT Properties	HRP	NYSE	$4.04	11.88%	**$4.25**	BUY
Public Storage Pfd	PSA.PRM	NYSE	$19.74	8.39%	$23.00	BUY
Diversified Growth					.	
Agrium	AGU	NYSE/TSE	$38.61	0.28%	**$45.00**	BUY
Boston Scientific	BSX	NYSE	$9.41	0.00%	**$11.00**	BUY
CGM Realty Fund	CGMRX	800-343-5678	$14.25	4.28%	N/A	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	$20.26	4.64%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	$69.62	2.64%	N/A	BUY
Fastenal	FAST	NASDAQ	$37.13	1.24%	$40.00	BUY
Gabelli Global Telecom	GABTX	800-422-3554	$14.44	2.29%	N/A	BUY
Honeywell	HON	NYSE	$33.44	2.99%	$38.00	BUY
Johnson & Johnson	JNJ	NYSE	$58.51	3.14%	$68.00	BUY
CarMax	KMX	NYSE	$9.28	0.00%	$12.00	BUY
Mattel	MAT	NYSE	$12.91	5.81%	$18.00	BUY
Microsoft	MSFT	NASDAQ	$19.66	2.24%	$26.00	BUY
Molson Coors Brewing	TAP	NYSE	$41.17	1.99%	$50.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	$11.05	0.00%	**$12.75**	BUY
Schering-Plough	SGP	NYSE	$19.75	1.11%	$21.00	BUY
Sprint Nextel	S	NYSE	$2.47	0.00%	$4.00	BUY
Stryker Corp.	**SYK**	**NYSE**	**$42.98**	**0.93%**	**$48.00**	**BUY**
Superior Industries	SUP	NYSE	$10.89	2.20%	$15.00	BUY
Tetra Tech	TTEK	NASDAQ	$25.00	0.00%	**$28.00**	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	$31.93	0.58%	N/A	BUY
United Parcel	UPS	NYSE	$47.07	3.82%	$60.00	BUY
UnitedHealth Group	UNH	NYSE	$28.94	0.10%	**$32.00**	BUY
Wal-Mart Stores	WMT	NYSE	$49.63	1.35%	$60.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	$30.29	7.04%	N/A	BUY
Xerox	XRX	NYSE	$7.06	2.27%	$9.50	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	$11.18	10.11%	$15.00	BUY
Icon Energy Fund	ICENX	800-764-0442	$14.32	0.81%	N/A	BUY
Plum Creek Timber	PCL	NYSE	$33.30	5.05%	$41.00	BUY
PowerShares Water Resources ETF	PHO	NYSE	$13.18	0.61%	$16.00	BUY
Transocean	RIG	NYSE	$59.73	0.00%	$75.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	$22.13	0.05%	N/A	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	$14.17	1.75%	$18.00	BUY
DWS RREEF Real Estate Fund II	SRO	AMEX	$0.64	N/A****	**$0.83**	BUY
Ford Motor Convertible Pfd	F.PRS	NYSE	$9.72	33.42%	$12.00	BUY
Icon Financial Fund	ICFSX	800-764-0442	$4.40	0.00%	N/A	BUY
Liberty Global	LBTYA	NASDAQ	$14.95	0.00%	$22.00	BUY
Maxim Integrated	MXIM.PK	NASDAQ	$13.87	4.50%	$18.00	BUY
Federated Prudent Bear Fund***	BEARX	800-711-1848	$6.84	0.00%	N/A	BUY
Symantec	SYMC	NASDAQ	$16.06	0.00%	**$19.00**	BUY
Time Warner	TWX	NYSE	$9.63	2.28%	$13.00	BUY
Western Digital	WDC	NYSE	$17.91	0.00%	**$20.00**	BUY

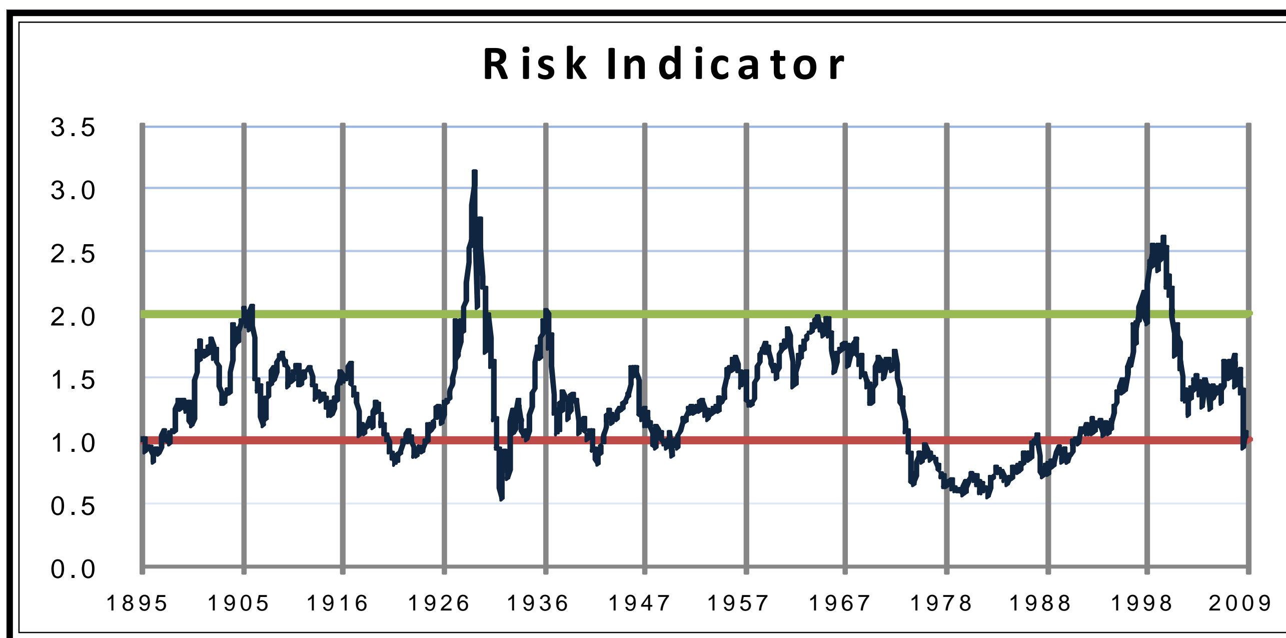
**Prices as of the market close on Friday, February 6, 2009*
***Yield represents all income during previous 12 months divided by current share price.*
Note that all fund distributions fluctuate annually.
****Note change in name for this fund*
*****Distribution Suspended.*
*BUY, HOLD, SELL OR LIMIT IN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

that the Guidant division (defibrillators and other heart rhythm devices), which as occurred at Symantec with its Veritas acquisition that soured Wall Street on the acquirer, finally is beginning to fulfill expectations. **Odyssey Healthcare** tacked on 22.8%, though it won't report earnings until later this month. As with the fast moving tech stocks, value investors again are taking positions, believing these shares were too cheap. **UnitedHealth Group**, the HMO, was up 9.4% after reporting solid results, and again there is no hard news. Instead, we believe others are beginning to accept one rationale proposed when we recommended the shares: rather than being a bogeyman for the Obama healthcare reforms, HMOs—and UNH is the biggest of them—can benefit as a tool for bringing costs down and extending care to citizens currently not insured. **Schering-Plough** added 7.9% on superior earnings. After Pfizer bid for Wyeth, some expect more consolidation, and SGP with a healthy pipeline of new drugs might be attractive. That Fred Hassan, the CEO, has made a career of fixing broken drug companies and then marrying them off to competitors does nothing to muffle the buzz. The one healthcare laggard in the portfolio was **Johnson & Johnson** (-0.91), which like **Microsoft** (+0.71), which also lagged our tech positions, is dominant in its industry. Yet they did not get the buying smaller, less high profile companies received since the last letter. We suspect that during the worst of the bear market, these two giants were punished less, and now they are lagging those shares that suffered the most during the downturn.

Natural resource stocks had a split performance. **Transocean**, the ultra-deepwater driller, rose 9.6% despite continuing weakness in oil and natural gas prices. Contracts with lucrative day rates were signed with an Indian company, which might mean that exploration and development companies are starting to put money back into capital expenditures. We're waiting to see when the big multinational oil companies start to expand their budgets, something that won't happen till energy prices bottom. **Icon Energy Fund** has deemphasized earlier exposure to energy services companies and switched to the biggest multinationals with Exxon Mobil, Chevron and Conoco Phillips accounting for more than 40% of the portfolio. It was flat since the last letter. **Plum Creek Timber**, the lumber REIT, added 5% after reporting lower earnings that still exceeded analysts' expectations. Furthermore, management expects to beat earlier projections despite lower timber prices and a moribund homebuilding and commercial construction . PCL has closed a sawmill, slowed logging activities, and pulled some real estate parcels off the market. As for metals and mining, **Anglo American** went nowhere. We are watching China now, as it ramps up demand for everything it needs for an infrastructure building binge. Given AAUK's earlier partnerships in coal development with Chinese companies, we expect to see benefits from this revival for Anglo. **USAA Precious Metals & Minerals Fund** did have a good month that extends the rally in gold mining stocks after the market bottomed on November 20th. USAGX added another 9.9%.

What hurt the overall performance was financials, which lurched lower led by the big banks, especially Citigroup and Bank of America. The **Icon Financial Fund** has significant exposure to both, and dropped 12.7%. Icon funds meld both value and relative momentum to select stocks, and both banks by these metrics had shown resiliency last year, which led to their being emphasized in the portfolio. Suddenly that relative strength turned into absolute weakness. Even with this hit, ICFSX is still outperforming the SPDR Financial ETF, though that is slight solace. Our REITs, with one hearty exception, also had a weak month. **CGM Realty Fund** was off 8.6% and **DWS RREEF Real Estate Fund II** continued to move jaggedly, dropping 21%. However, the discount from NAV fattened again, and now stands at 22%. SRO, trading under $1, has become a high-wire act, though that discount from NAV is inviting. We expect SRO will survive, and if it does, offers a high reward to risk ratio. **HRPT Properties Trust**, the office and light industrial REIT, which suffered as much as any REIT during the bloody and irrational dumping of shares in October and November, became so compelling that we included it in our Five for 2009 portfolio last year. Since then it is up more than 50% and since the last letter is up 20.2% even after reducing its dividend from 21 to 12 cents a quarter. HRP also announced a $100 million buyback that amounted at the time to more than 10% of shares outstanding, to be implemented during 2009. We're upping the buy limit from $4 to $4.25. ***SA***

Sound Advice Market Indicators for February 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 the Stock Market*** 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 November 20, 2008, the Risk Indicator dropped below to 1.0 to 0.97. A reading this low reveals that stocks are historically low relative to house prices. This came at a time when both stock and house prices fell to new lows: The S&P to an intraday low of 747.78, and median price of a new home to a low of $214,600. It is just that stock prices fell faster than house prices. For January 2009, the Risk Indicator reads 1.01.

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 33 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. Until we 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

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