

SOUND ADVICE

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“Give me a place to stand and a lever long enough and I will move the world” said Archimedes 2400 years ago. In the world of investing, leverage lately has become toxic. Wall Street created the longest financial lever imaginable to magnify profits until that golden lever snapped. The financial world is still trying to put itself back together. All investors need a “place to stand,” a point of view from which to work. Unless you are confident in your choices and consistent in your discipline, there is no hope that you can profit, since inevitably the market makes you question what you do, Also, value investors require a version of Archimedes’ long lever as well. We need time enough for ideas to work out. Companies in difficulty, which is what we buy, rarely turn themselves around on a dime. It takes time. During a good market, when prices are on the rise, it’s easy to pontificate on how profitable it is to buy what others were selling. When the market stinks, holding such views is absurd to anyone looking in from the outside, and frankly, looking from the inside out, it doesn’t feel too good right now either. If misery loves company, there is plenty available among the most vaunted value investors. Berkshire Hathaway, Warren Buffett’s holding company, is off 17% year-to-date, Dodge & Cox Stock Fund 20% and, if you want to see how fast you can fall from the penthouse to the doghouse, Bill Miller’s Legg Mason Value Trust this year is down 33%. These long-term winners are not licking their wounds. They are buying.

--Gray Emerson Cardiff

Superior Results But...

The first half of 2008 was nothing to write home about, unless it's for a loan. The Dow ended down 14.4%, the S&P 500 12.8%, and the Nasdaq 13.6%. Large cap value funds lost on average 12.9% and large growth 10.1%. With the exception of natural resources, sector investing was no better. On December 31, 2007, had you bought equally weighted positions in the *Sound Advice* portfolio, you would be down 6.2%.

In fact, that -6.2% understates how our historical portfolio performed. In the historical portfolio, as do indexes, positions have different weightings depending on whether they rose or fell since being included and, as with mutual funds, how frequently we have reinforced them by re-recommendations. If you bought more when we re-recommended a position, your performance like ours differs significantly from the unweighted number we report above. Thus, **American Century Global Gold Fund** was initially recommended in October 2005, and re-recommended three more times before we replaced it this March with **USAA Precious Metals & Minerals Fund**.

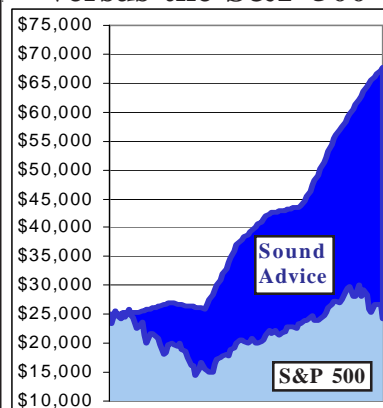
In our unweighted year-to-date performance (-6.2%), **American Century** contributed a 17% profit. If you were following all of our recommendations in real time, your portfolio would be weighted accordingly. For example, you would overweight **American Century** due to its appreciation and repeated recommendations, which would increase results. Conversely, your position in **American International Group**, which is down this year and is also overweighted in the historical portfolio, would impose a larger loss. Were we comparing apples-to-apples by using the historical portfolio, *Sound Advice* actually is in the black this year, up 10.2% since the January issue was closed

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Annual Returns

- 10.2% Since 1-1-08
- 19.1% Since 1-1-06
- 19.0% Since 1-1-03
- 12.4% Since 1-1-00

Versus the S&P 500



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

\$24,356 with the S&P 500
for a loss of \$644

\$67,865 with *Sound Advice*
for a gain of \$42,865

SA First Half 2008 Performance vs. S&P 500 by Sector

S&P 500 Sector	S&P Weighting	S&P Performance	SA Weighting	SA Performance
	As of 12/31/07	Through June 30	As of 12/31/07	Through June 30
Financials	17.64%	-30.89%	4.08%	-23.70%
Information Technology	16.73%	-13.43%	12.24%	-3.20%
Energy	12.86%	8.12%	8.16%	12.70%
Health Care	11.97%	-13.47%	8.16%	-10.50%
Industrials	11.51%	-14.59%	12.24%	-2.40%
Consumer Staples	10.23%	-8.54%	10.20%	-10.50%
Consumer Discretionary	8.48%	-13.86%	18.37%	-14.30%
Utilities	3.62%	-4.34%	0.00%	0.00%
Telecommunications Services	3.62%	-18.90%	6.12%	-13.20%
Materials	3.33%	0.19%	8.16%	15.20%

(our internal tracking runs from issue to issue). The chart on Page 1 reflects the weighted portfolio.

But for this review we're using the equally-weighted portfolio, and even that makes our value-oriented performance successful. Were we into self-promotion, we'd trumpet "Another Six Months of Market Beating Performance! More Than Double the S&P!" As it is, we'll just say we wish the unweighted recommendations had done better.

Wall Street's mood is is surly and anxious. Levitating prices for energy, food and other commodities, credit markets, employment, housing, the dollar, geopolitical instability, consumer confidence, shrinking profits (have I left anything out?) and the common assumption that it's only going to get worse all make the likelihood of a rip-roaring recovery unlikely. In good times when our portfolio has been firing on all cylinders, we've lamented how hard it is to find good ideas at cheap prices. We even got nostalgic for bear markets. Well, we now have our wish, and as unpleasant as it feels, we think there are plenty of excellent investments to be made. Are we nuts? We endorse investing's great paradox that Shelby Cullom Davis summarized: "A down market lets you buy more shares in great companies at favorable prices. If you know what you are doing, you'll make most of your money from these periods. You just won't realize it until much later."

Better relative performance results not just from what we owned but what we did not own. At the end of 2007, our portfolio had 49 positions. Since then, we sold five and added seven: two in finance/ real estate, one each in healthcare and consumer discretionary, a general value fund, a precious metals fund, and a tracking stock derived from an existing position.

The chart above compares sector weightings for the S&P 500 and *Sound Advice* for the last six months. The S&P gained in only two: Energy (8.1%) and Materials (0.2%). The worst performing S&P sector—and the heaviest weighted (17.9%)—were the Financials, which dropped 30.9%. *Sound Advice* also showed a profit in the same two sectors, except they were 12.7% and 15.2% respectively. In fact, we outperformed the S&P in eight of 10 sectors, lagging modestly only in Consumer Staples and Consumer Discretionary. As for Financials, our portfolio began 2008 deeply underweighted at 4.08%.

As for our non-sector mutual funds, as a group they are down 8.5%. Needless to say, we hope to do better. So where are we looking amid the rubble? This month we are adding an industrial service stock, and expect we will be sorting through sectors that are most under siege. Of course, these days everything seems to be under siege. Not a cheery time to be an investor but, we expect, looking backward it will turn out to be a profitable passage. [SA](#)

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The Route From Rags to Riches

History might not repeat itself but it at least rhymes. Ditto for the patterns stock prices follow. Consider how recessions or economic slowdowns impact cyclical stocks. *Value Line*, in our opinion the single best source of uniform data for researching investment ideas, provides for each stock discussed a very helpful chart extending over the previous 12 years. In addition to price and volume, these charts track price to cash flow, relative P/E and overlays a dark gray bar that designates periods of recession. We are now either in recession, on the verge of one, or, if we avoid technically falling into recession, investors are treating the economy as if it were in recession. As politicians like to pussyfoot around the situation: “We’re in a rough patch.” The investment media is filled with suggestions about how to invest during a recession and/or a bear market. Though the ideas have some range, they advise avoiding growth-oriented companies. We’re here to take the other side of that argument.

In the most recent *VL* charts, there is only a relatively skinny bar covering the 2001 recession's eight months. If you consult earlier issues (my library of old *VL*s goes back to 1996), others appear. Not surprisingly during each recession, most shares decline in price. In fact, prices tend to be in decline by the time a recession officially occurs. (*VL*— as do we—relies on the National Bureau of Economic Research’s numbers to mark expansions and contractions. For how the NBER calculates a recession, see www.nber.org/cycles/recessions.pdf, or the May issue of *Sound Advice*).

Consistent with how stocks act leading up to economic slowdowns, they tend to rise before a contraction concludes. Experience with past recessions and mere slowdowns suggests that an excellent time to be a buyer is in the midst of a slowdown, though we admit that more often than not, buying during distressed periods often opens with continuing declines, which brings us to **Cintas (CTAS—Nasdaq)**, the biggest provider of uniforms to U.S. companies.

CTAS is yoked to the American business cycle, expanding sales and profits when companies are expanding and hiring, and slowing that dynamic when U.S. companies are contracting and laying off workers.

A publicly traded company since 1984, Cintas has experienced two recessions: July 1990-March 1991, and March -November 2001. Not surprisingly during each recession, CTAS like most other companies saw its shares crest before the recession (June 1990 and December 2000) and bottom before the recovery began (November 1990 and March 2001).

CTAS shares started their current decline in December 2003 after management failed to meet ambitious sales and earnings targets the company had set. Since then, it has been a jagged downhill tumble from \$50 to today’s \$25.73.

Hitting ambitious targets was part of Cintas' cachet. It had been a growth story for most of its life. Not only was Cintas innovating in the uniform business, it was also snapping up local and regional companies by making them more profitable in what was a very fragmented industry. CTAS' success created very pricey valuations.

Before this year, CTAS had never traded at a relative P/E lower than 1.2 (2006), and between 1984 and 2005 its Relative P/E averaged 1.8. Investors valued its earnings at almost double the market average. No longer. Lately, Cintas is trading at a Relative P/E of 0.6. Cintas does not need to regain that lofty relative P/E to be a very profitable investment at current levels, but if it should, a double in price would result in short order.

CINTAS

Eighty years ago Cintas began humbly in Cincinnati recycling work rags from local factories and other businesses, cleaning them and delivering them back to customers. Though anyone with a truck and a washing machine could compete, service businesses such as the family-run company that became Cintas relied on developing relationships with clients that grew out of the recurring visits it made to factories and businesses.

Today, Cintas is a \$3.7 billion in sales service company that finds new ways to create revenues from those pick up and delivery routes. Cintas 40 years ago expanded into providing business uniforms in every imaginable sector ranging from the snappy clothes your airline captain wears and coveralls

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mechanics servicing the plane wear to the aprons worn at your favorite fast food shop. Over the years, the Cintas trucks' frequent pickups and deliveries invited the addition of other products that require regular replenishment or service.

Until this year, reflecting the dominance of its uniform rental business, Cintas had lumped revenues into just two categories: rentals and other services. "Rentals" included uniforms, other garments, mats, mops, towels and similar items, while "Other Services" included direct sales of what Cintas rents as well as the sale of first aid, safety and fire protection products and services, document management services, and the sale of branded promotional items. As an extension of its cleaning materials, Cintas also cleans commercial bathrooms. Now that the company breaks out numbers for these other segments, we can appreciate how much they do now and can in the future contribute to both the top and the bottom lines.

Rentals account for the lion's share of revenues and profits. In the most recent (Q3) report, Cintas Rental Uniforms & Ancillary Products accounted for 72.5% of sales and 87.1% of operating profits. Direct Sales of uniforms brought in 12.9% of sales, which translated into 11.1% of operating profits. First Aid and Fire Protection collected 10.2% of sales but only 6.5% of profits. Document Management, the newest business, generated 4.4% of sales and 4.3% of operating profits. Corporate expenses reduced operating profits by 9%, which explains why the sum of the operating segments is greater than 100%.

Cintas, with more than 800,000 customers, is not just the dominant provider of rented uniforms in North America, it is also the most profitable. The next largest competitor, G&K Services, last year had less than \$1 billion in sales (Cintas' uniform rental revenue alone in 2007 was \$2.7 billion). More important, Cintas' operating margin ran at 19.2% and net profit margin at 9%. G&K eked out 13.4% and 4.7%.

But lately even as Cintas has been able to keep expanding sales, it has not been able to take that growth down to the bottom line. Sales increased during the first three quarters by \$186.1 million (+6.8%) compared to the same period in FY2007, but income has been flat, which can be traced to profit declines in the

dominant uniform rental business (-2.2%) despite 4.2% higher sales, a 4.9% drop in income from uniform sales, and a 4.7% drop in the First Aid, Safety and Fire Protection segments, though sales jumped by 13.7%.

Management says that increased costs, primarily from training its sales force to cross sell the expanding line of products, account for decreased margins and income. However, in a slowed economy cost-consciousness among existing and new customers also has to be a factor. In the case of the Safety and Fire Protection business, a slowdown in commercial construction has hurt sales, but was balanced by income from servicing its existing customers' fire protection systems.

The lone exception to this year's pattern of higher revenues and lower income was Document Management Services, which grew revenues, admittedly from a modest base, by 76.3%, while income more than quintupled. The lion's share of this growth came

from acquisitions as the company repeats the pattern it used to grow its uniform business.

Though still modest, the document business along with the Safety and Fire Protection offer extraordinary opportunities for growth. Consider that Safety and Fire Protection products is a \$7 billion market, of which Cintas represents perhaps \$400 million or less than 6%. Cintas' share of the document management business is similar, and offers even greater potential for growth.

Both of these sectors, as was the case with the uniform rental business, remain highly fragmented, which means Cintas can apply the same consolidation tactic it employed with the uniform rental business. But with a twist, since Cintas already has a high profile in almost all regions of the country. With its employees serving customers along their routes in Cintas' primary businesses, the potential for adding on additional services looks like a cinch. Not only can Cintas trade on existing relationships, it can also cheaply piggyback new services and products on what it already does for clients, which should give them an advantage over single-service competitors.

Cintas always has been adept at cutting costs at its own facilities and at those it acquires. With startup

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costs high for its new ventures, we can expect Cintas to quickly bring them down as it gains experience and size. For example, in the Documents segment the selling and administrative costs as a portion of sales dropped a stunning 5.7% over the first nine months of the fiscal year, and gross margins leaped 3.5%. This occurred against rising energy costs.

Without growth from the Document division Cintas would be looking at the likelihood of the first year in its history that did not show growth in sales and profits. Investors, who had banked on Cintas continuing to churn out quarter after quarter, and year after year of growth, run away from excellent companies such as this whenever they fail to meet unrealistic growth expectations, and in the process bring the share price and valuations to levels associated with value stocks. Our working assumption is that CTAS might have to limp through several weak quarters.

Finally, Cintas is very much a family affair. The current CEO, Scott Farmer, succeeded his father, who succeeded his father, who founded the company. Family-run publicly traded corporations too often are run for the founding family's benefit. Not so here. Cintas treats all shareholders, family and the rest of us, fairly. When the company last year failed to meet its sales and profit goals, bonuses were cancelled for senior executives. As for options, CTAS doesn't churn them out, and when they do issue them to employees, they tend to go, unlike at most companies, to people working outside the executive suite.

GROWTH: INTERNAL, EXTERNAL, INTERNATIONAL

Over its history, Cintas has traced a sizzling revenues and earnings growth story. Between the mid-1980s and 2000, sales grew at an average rate of 19.2%, while net profits increased at a 24.4% clip.

As we noted, acquisitions have been an integral part of how Cintas grows, especially when it enters a new region, where it prefers not to start from scratch. Thus, in 2005 Cintas acquired nine small uniform rental companies, ten in 2006, but nearly nothing in 2007. Meanwhile, in non-uniform businesses, Cintas made over the same period 24 and 27 acquisitions, all of them smallish, and has been active this year.

Despite a relatively dry spell over the last nine months, we expect to see Cintas acquiring other uniform providers, since when the economy slows

demand for uniform sales and rentals smaller competitors become receptive to selling out, but we do not expect anything major, if only because there are fewer large population centers left for CTAS to colonize. The last big addition was Omni Services, which covers the mid-Atlantic region, for \$600 million in 2002. If any meaningful acquisitions occur, we suspect they will be in the new lines Cintas is cultivating.

In the most recent 10Q, the Safety and Fire Protection business derived almost half of its growth from assets acquired during the first nine months of the 2008FY. For Records Management, 58% came from acquisitions made over the previous 12 months.

During FY2007 Cintas began to reorganize how it markets its diverse products and services. The so-called "Project One" initiative aims to turn each sales rep into a promoter of everything Cintas offers. This makes sense, but the process is taking longer than expected. In the third-quarter's 10Q management attributed lower-than-anticipated profits to the continuing cost of implementing the program.

As the economy resumes its growth (you don't doubt that, do you?), business will increase, but were Cintas to remain anchored in the uniform business, it cannot be expected here in the U.S. to put together the same furious growth exhibited over the last 40 years.

But comparable growth is possible in uniform rentals and sales in foreign markets, which today are as undeveloped as they were in the U.S. 40 years ago. Last month, management said it was exploring foreign markets for future expansion, and last year CTAS acquired Certo, a Dutch document management company. In Europe, document management is a small scale business that an ambitious company like Cintas could consolidate and expand.

However, Cintas opened its first foreign offices not in Europe but in Hong Kong and Macau, suggesting that Asia is the initial focus, and that Cintas first will rely on its core uniform services model. It would make sense for Cintas to gain a foothold by supplying existing North American customers with large international exposure such as McDonalds and Starbucks before attempting to market to local companies.

LABOR ISSUES

Cintas is almost completely non-unionized, which

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These Valuations Are Uniformly Too Low

	1984-2007 Average High	1984-2007 Average Low	Current
Price to Sales	4.3	2.3	1.1
Price to Cash Flow	23.7	15.4	8.3
Price to Earnings	35.8	23.4	12.2
Price to Book Value	6.6	4.3	1.9

as with other more high-profile companies like **Wal-Mart** has created legal and public relations problems. Unlike Wal-Mart, however, Cintas, because it does not depend on the general public for its sales, is not as vulnerable to PR assaults. Nonetheless, we expect that over time Cintas will become more unionized regardless of how intent management is to avoid that outcome. Earlier this year, a Canadian facility was unionized. In addition, there are two major lawsuits initiated by disgruntled employees in federal courts. Each is seeking class action status, which, should the litigants be successful and prevail, could have "material" impact on Cintas' revenues and profits. We're not lawyers, but despite Cintas' concerns, we suspect that Cintas would not be harmed seriously were unions to become more influential in its U.S. operations.

BUYBACKS AND VALUATIONS

The company pays an annual 46 cent dividend (1.8% yield), which it has increased annually. Cintas' balance sheet is solidly conservative. The ratio of all debt to market cap is 29%, somewhat higher than in the past but still comfortable. Abundant free cash flow gives management the ability to buy in shares, something it did not do much of in the past.

Cintas for many years was in the enviable position of using highly valued shares as a currency to make acquisitions. Accordingly, share buybacks made little sense. However, as its share price and valuations have shrunk, Cintas has begun share buy backs. In 2005, the company authorized a \$500 million program. In 2006, another \$500 million was added. Through the end of the 2007 fiscal year, Cintas had bought in 14.2 million shares at an average cost of \$40.89 for a total of \$580.6 million. With shares trading at a 37% discount to that average cost, we expect to see management exhaust the remaining \$418.4 million, and replenish its buyback war chest.

CTAS discounted price ratios are extraordinarily compelling, especially because for years the shares traded at that fat premium. We concede that cheap price ratios are no guarantee that the shares are primed to explode higher immediately, especially in a market that has crossed over into bear territory.

Bearish arguments as to why Cintas is fairly priced in the mid-\$20s emphasize the shrinking U.S. manufacturing base that even in a recovering economy means Cintas will face permanently diminished demand. Frankly, demand for work clothes and uniforms in the services sectors, where employment growth is today, should more than make up for job erosion in manufacturing.

Perhaps investors, even if they think there is growth in uniforms and Cintas' other lines, don't care currently to buy anything tied to the economy. From our perspective, when buyers retreat waiting till they can see firm evidence for recovery, it is a good time to buy. We've made our living from such investor anxiety.

Focus instead on the business model, how the crucial underlying numbers such as sales, cash flow, earnings and book are doing in a weak business environment, look at metrics of efficiency, and at how strong the balance sheet is. You come away convinced Cintas is an excellent long-term investment. Whether the current quarter continues to reflect what is going on in the economy (CTAS reports on July 15th, after we go to press), you need to look ahead.

We began with comments on how Cintas has moved from a significant premium relative to the market to its currently humble discount. But better than how Cintas is trading relative to the rest of the market, is how the shares are priced in terms of their own history. The chart at the top of this page demonstrates how far from the norm current valuations are. Cintas now is in the rag bin, which as its own history demonstrates, is a great place to look for profits. We recommend starting to build a position in Cintas up to \$29. **SA**

Portfolio Updates

Since the last letter was priced (June 6th), the market has been down 18 of the 24 trading days. Over that period, the Dow lost 9.1%, the S&P 8.9% and the Nasdaq 9.5%. *Sound Advice* did not escape the carnage. Our unweighted portfolio (see page one for what we mean by "unweighted") was down 11.4%. Not only did our counter-trend positions get hurt but neither defensive positions in healthcare nor natural resource and energy stocks support the portfolio. It was an ugly month. Not surprisingly, the **Prudent Bear Fund** led the portfolio, up 10.8% as its short positions on broad indexes, selected stocks and longs primarily in junior mining stocks all combined to push it up. Though the performance is welcome, what it meant for the overall portfolio was bleak.

The June recommendation, **UnitedHealth** fell 32%. Earlier in the month, UNH reduced by about 20% its earnings target for the quarter from 81 cents to 65 cents and for the year from \$3.65 to \$2.95. Even relatively good news had its downside. UNH settled suits resulting from its flagrant backdating of options. Yes, the matter is now resolved but it cost \$895 million. Along with the earnings projection, UNH said it would reduce its workforce by 4000 or about 5%. Finally on the day we priced the end-of-month portfolio, Congress voted to limit payments to Medicare Advantage, an add-on to Medicare that has been profitable for HMOs. Though no surprise (we had believed this outcome was factored into the share price), the decision confirmed Wall Street's worst fears about HMOs: Congress would cut Medicare/Medicaid payments while demanding greater services. During the previous quarter, UNH also cut its projections, which pushed shares toward valuations that have occurred only at its lowest share price in the past. Not this time. They were just a waystation to lower levels. The overall story remains the same: though Wall Street presumes changes in healthcare insurance, budget constraints both in Washington and in private corporate headquarters will reduce profits at HMOs.

Short-term, these are problems. UNH swears it will not cut its prices in order to win contracts, a tactic weaker competitors hide behind, which ultimately is destructive. Longer term, we believe HMOs have a vital—and profitable—role to play in the healthcare system regardless of how it is structured. At the risk

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of sounding foolish, those valuations we touted last month as "too good to pass up" are even more tempting now—even after factoring in UNH's lower expectations.

The automobile sector is shambles. General Motors' woes were key to the Dow's tumble. Though GM provided the worst news, Ford was not far behind: an inventory still overweighted toward big SUVs and trucks, slower sales, bigger losses, higher gasoline prices, demoralized, stingy consumers. We're again hearing the B-word whispered about GM, which is enough to unnerve any shareholder. Fortunately we do not own GM. As for Ford, we believe it's in better financial shape than its larger rival, and is even less of a candidate, which makes holding prudent, and if you are bold, acquiring more of the **Ford Cumulative Preferred** worthwhile. We are now looking at a 13% yield, and a cheap option on a Ford recovery. Since the last letter, the Ford Cumulative Preferred is down 21%, about half as poorly as GM shares have done. **CarMax**, the used-car dealer, is unloading the SUVs and big trucks on its lots, which is cutting into revenues and profits. Along with the shares of manufacturers, those of dealers, both new and used, are being shunned. CarMax is not slashing prices except on its

Sound Advice Portfolio for July 2008

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
DWS RREEF Real Estate Fund II	SRO	AMEX	\$10.39	16.98%	\$13.00	BUY
HRPT Properties	HRP	NYSE	\$6.88	12.21%	\$8.00	BUY
Diversified Growth						
Agrium	AGU	NYSE/TSE	\$101.47	0.11%	\$110.00	BUY
American International	AIG	NYSE	\$23.08	3.47%	\$30.00	BUY
Boston Scientific	BSX	NYSE	\$12.09	0.00%	\$16.00	BUY
Cintas	CTAS	NASDAQ	\$25.73	1.79%	\$29.00	BUY
Disney	DIS	NYSE	\$29.20	1.06%	\$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	\$38.73	7.13%	N/A	BUY
Dodge & Cox Stock Fund	DODGX	800-621-3979	\$105.98	16.90%	N/A	BUY
Fastenal	FAST	NASDAQ	\$43.97	1.05%	\$52.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	\$12.72	0.31%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	\$21.41	1.08%	N/A	BUY
Honeywell	HON	NYSE	\$49.31	2.03%	\$59.00	BUY
Insituform Technologies	INSU	NASDAQ	\$14.86	0.00%	\$21.00	BUY
Johnson & Johnson	JNJ	NYSE	\$66.26	2.51%	\$73.00	BUY
CarMax	KMX	NYSE	\$11.98	0.00%	\$18.00	BUY
Liberty Capital****	LCAPA	NASDAQ	\$15.25	0.00%	\$20.00	BUY
Mattel	MAT	NYSE	\$17.25	4.35%	\$22.00	BUY
Microsoft	MSFT	NASDAQ	\$25.25	1.74%	\$33.00	BUY
Molson Coors Brewing	TAP	NYSE	\$54.25	1.51%	\$62.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	\$9.02	0.00%	\$11.50	BUY
Sara Lee	SLE	NYSE	\$12.44	3.38%	\$17.00	BUY
Schering-Plough	SGP	NYSE	\$21.28	1.03%	\$28.00	BUY
Sony	SNE	NYSE	\$40.46	0.54%	\$50.00	BUY
Sprint Nextel	S	NYSE	\$8.43	1.19%	\$12.00	BUY
Superior Industries	SUP	NYSE	\$16.36	3.91%	\$24.00	BUY
Tetra Tech	TTEK	NASDAQ	\$21.69	0.00%	\$29.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	\$48.47	4.32%	N/A	BUY
United Parcel	UPS	NYSE	\$57.99	2.90%	\$68.00	BUY
UnitedHealth Group	UNH	NYSE	\$22.16	0.14%	\$30.00	BUY
Wal-Mart Stores	WMT	NYSE	\$56.29	1.19%	\$62.00	BUY
Whole Foods Markets	WFMI	NASDAQ	\$21.04	3.42%	\$33.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	\$43.47	4.70%	N/A	BUY
Xerox	XRX	NYSE	\$13.06	1.23%	\$19.00	BUY
Energy/Natural Resources						
Anglo-American PLC	AAUK	NASDAQ	\$29.06	3.89%	\$36.00	BUY
EnCana	ECA	NYSE/TSE	\$82.95	1.93%	\$98.00	BUY
Icon Energy Fund	ICENX	800-764-0442	\$34.51	28.35%	N/A	BUY
Plum Creek Timber	PCL	NYSE	\$42.12	3.99%	\$50.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	\$77.56	3.71%	\$87.00	BUY
Transocean	RIG	NYSE	\$145.02	24.45%***	\$162.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$36.92	7.18%	N/A	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	\$18.49	1.34%	\$24.00	BUY
Discovery Holdings	DISCA	Nasdaq	\$20.64	0.00%	\$29.00	BUY
Ford Motor Convertible Pfrd.	F.PRS	NYSE	\$24.78	13.12%	\$35.00	BUY
Icon Financial Fund	ICFSX	800-764-0442	\$8.21	20.33%	N/A	BUY
Liberty Entertainment****	LMDIA	NASDAQ	\$23.41	0.00%	\$29.00	BUY
Liberty Global	LBTYA	NASDAQ	\$29.45	0.00%	\$35.00	BUY
Maxim Integrated	MXIM.PK	NASDAQ	\$18.49	1.89%	\$26.00	BUY
The Prudent Bear Fund	BEARX	800-711-1848	\$6.97	2.87%	N/A	BUY
Symantec	SYMC	NASDAQ	\$18.82	0.00%	\$25.00	BUY
Time Warner	TWX	NYSE	\$13.78	1.60%	\$20.00	BUY
Western Digital	WDC	NYSE	\$33.06	0.00%	\$41.00	BUY

*Prices as of the market close on Friday, July 11, 2008

**Yield represents all distributions during previous 12 months divided by current share price.

Note that all fund distributions fluctuate annually.

***Yield represents a one-time special distribution.

****Recently spun off

BUY, HOLD, SELL OR LIMIT IN BOLD SIGNALS CHANGE IN ACTION OR LIMIT

Sound Advice: Portfolio Updates for July 2008

slowest sellers, but continues to gain market share. As with UNH, an unwillingness to compete purely on price is possible given the strong balance sheet. KMX is doing better than the new car dealers but still lost 35% last month.

In a frightened market, even with energy prices still pressing against their all-time highs, energy stocks were getting sold. Our only energy position to end higher this month is **Transocean**, up 1.1% after reporting a blockbuster new five-year contract for one of its ultradeepwater drilling rigs, the Deepwater Pathfinder capable of working up to a depth of 10,000 feet. The projected revenues, about \$1.2 billion, represent nearly a 30% jump over a contract signed just three months before. At the time, that contract was mindboggling. With this new deal, the numbers declare that energy companies are desperate to pursue fields at just about any price, and they don't seem too concerned about whether oil and natural gas prices will decline. The flipside for how much Transocean can get from energy producers for its rigs is that energy companies' operating costs are rising fast, which cuts into their profits.

However, it's not the exploration and development part of the business, the so-called upstream portion for the Chevrans and the BPs that is the real concern. The problems are primarily downstream in the refining and sales segments, where high oil prices have narrowed the spread between the price paid for oil and the prices charged for what is distilled from that oil: gasoline, heating oil and other distillates. Chevron, for example, on the day we closed this issue and oil spiked up by 3%, fell by 4.2% after warning it would lose \$250 million for the quarter from its downstream operations.

If you want to look at an energy sector that is drowning in red ink while elsewhere the ink is all black, consider the standalone refiners/marketers like Valero and Sunoco, which are down by almost 60% over the last 12 months. For the last month, these two dropped 22%. So, the big integrated energy companies like **Royal Dutch**, despite the public outcry about their bloated profits, are worrying investors because they are significantly exposed to downstream issues. Royal Dutch fell since the last letter by 6.3%. **The Icon Energy Fund** dropped 4.1%, and **EnCana**, the Canadian natural gas and oil company, fell 10.4%.

Agrium, the Canadian fertilizer maker and retailer, added 9.9% as investors argue over whether there is a bubble in fertilizer and other agriculture input shares or demand for agricultural products justify those share prices. Certainly the rise in ag prices has outshone energy price increases, though in both cases there are plausible reasons and fundamentals to support those prices. It's glib to compare what is happening here with what occurred in the dotcom mania years, but at least here we have real earnings and real demand. Nonetheless, we think that agricultural commodities are overpriced, and are setting a tight buy limit on AGU. Presuming we hit that limit, we are ready to close out this position for the present.

If everyone is jittery, then gold usually shines. The **USAA Precious Metals & Minerals Fund** added 3.9%. More specifically, the rise in gold prices might anticipate further dollar weakness should the Fed need to bail out the two giant mortgage companies, Fannie Mae and Freddie Mac, whose shares have become unhinged as the media amplifies anxieties over liquidity concerns. We would not be buyers of either company's common shares in hopes of another bonus similar to what those who bought Bear Stearns shares at the worst of the panic in March received, though we expect both Fannie and Freddie will survive.

Financial stocks and everything tied to housing stumbled badly, especially after the Freddie-Fannie follies picked up. **American International Group** lost 32% on concerns it would suffer another round of write-offs, while **HRPT Properties Trust** lost 7.3%. Though we think that AIG will roar back, HRP at the moment represents the better investment, especially because HRP is back at a 12.2% yield.

Schering-Plough, which as recently as last April dropped 30% over three days after negative news related to its anti-cholesterol drugs, Vytarin/Zetia hit, has recovered that loss and more, adding 7% since the last letter as Wall Street expects it would release data to support the benefits of Vytarin/Zetia and the prospect of new drugs coming to market. We think it is proper to look at the low prices the market is currently putting on our portfolio, and remember Schering-Plough. We're working on the belief that stocks left for dead by Wall Street can and do recover. Is that a guarantee? Hardly, but that is how we have made our money. **SA**

Sound Advice Market Indicators for July 2008

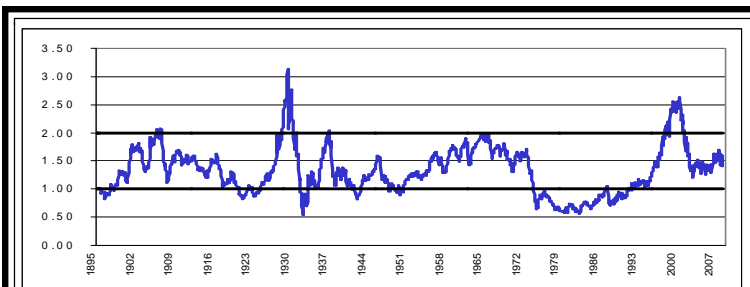
The Diffusion Index of Lagging Indicators gives "Caution" signals when all of its individual lagging economic indicators rise above their respective levels of six months earlier, providing a 100 percent reading. This reveals a strengthening economy and inflationary pressures ahead. Currently 63 percent of the indicators is above its level of six months earlier.

The Diffusion Index of Leading Indicators gives "Aggressive" signals when its individual leading economic indicators drop below their respective levels of six months earlier, providing a zero percent reading. This reveals a softening economy and a ripe atmosphere for a lasting decline in interest rates. The latest reading came in December 2005 as an "Aggressive". Currently 67 percent of the indicators are above their level of six months earlier.

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 rose substantially without exception. The average gain was 30 percent, not counting dividends. On an annualized bases the gain was 16.2 percent per year. Confining stock investing to these times would have produced substantially more profits than a single buy-and-hold strategy.

During "Caution" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased a paltry 0.82 percent per year, a return that could have easily been beaten many times over with safe investments such as Treasuries, short-term bonds or other low-risk investments.

To assess whether a market crash is likely after a "Caution" signal, we turn to the Risk Indicator. If the Risk Indicator is close to or above 2.0, we know the market is relatively high and contains a high degree of risk. This was indeed the case in September 1999 when the Diffusion Index of Lagging Indicators flashed a "Caution" signal and the Risk Indicator was (substantially) above 2.0. The peak came in six months, marking the end of the bull market as well as the peak of Supercycle Five. The market subsequently crashed. The S&P 500 dropped 39 percent until the next "Aggressive" Signal was given by the Diffusion Index of Leading Indicators in February 2003 (which was the exact month that bear market low point was reached). During that decline, most stocks suffered greater losses. The NASDAQ dropped nearly 80%.



The Risk Indicator tracks supercycles in stocks by comparing prices of stocks to real estate (house prices). A reading above 2.0 indicates times when stocks are extremely high relative to real estate. These are times when the risk is high and a supercycle is approaching a zenith. Conversely, a reading below 1.0 indicates stock prices are extremely low relative to real estate. At these times, the upward phase of a new supercycle is beginning. The current reading stands at 1.41.

Conversely, the market does not suffer lasting declines after "Aggressive" signals when the risk level is low. For example, the signal in November 1974 was one month from the bottom of that bear market, and came at a time when the Risk Indicator was below 1.0. Consequently, this "Aggressive" signal also marked the beginning of Supercycle Five. As the upward phase of Supercycle Five ensued and the Risk Indicator remained relatively low, the market did not experience lasting downturns after "Caution" signals. Instead, the bull run was merely interrupted with short declines, sideways movements, and sometimes even advances. Even the three-day decline in October of 1987, which became known as the "Crash of 87", was followed by a stampede of buyers snapping up bargains. I remember seeing individual investors lined up to invest outside discount brokerage offices because the phones were log-jammed with buyers.

However, as previously noted, when Supercycle Five reached its peak and the Risk Indicator climbed above 2.0, the decline was severe after the September 1999 "Sell" signal due to the excessive heights to which prices had previously been propelled.

We use the *Sound Advice* Market Indicators to influence our approach and nature of our recommendations. When "Caution" signals are in force, our recommendations are more defensive in nature. We will be looking for special situations and are likely to recommend taking profits more readily. Conversely, during "Aggressive" signals, our recommendations will be more aggressive. We believe that these proprietary indicators have been important factors in our ability to consistently outperform the market averages (See page one for the stats.). **SA**

Buy Signals		Sell Signals	
Date	S&P 500	Date	S&P 500
Sep-69	94.51	Feb-69	101.50
Nov-74	71.74	May-73	107.20
Jan-81	132.97	Aug-77	97.75
Sep-85	184.06	Dec-83	164.36
Mar-89	280.00	Oct-87	280.16
Oct-92	415.10	Sep-89	347.33
Feb-97	798.38	Jan-95	464.72
Feb-03	841.15	Sep-99	1,383.60
Dec-05	1,248.29	Jul-05	1,234.18

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