

## The Inauguration of Tariffs

On February 1, executive orders were signed imposing 25 percent tariffs on Mexico and Canada, except with a carve-out for Canadian energy products which now have a reduced tariff of 10 percent. An additional 10 percent tariff was also levied on China. These tariffs will have to be absorbed by producers or passed on to customers through higher prices. To the extent that higher prices can be passed on, the overall effect will certainly be inflationary because a wide range of products will be impacted, nearly half of all US imports. It is not possible now to predict how much will be passed on to consumers or absorbed by producers, but will certainly be an unhappy mixture of both.

The tariffs on Canada and Mexico, at least in part, appear to be a negotiation weapon to force Canada, and more importantly Mexico, to tighten up border controls on their respective sides. If that happens, these tariffs may be reduced. However, the Trump administration believes that the US trade deficits with Mexico, Canada, and China are not fair, and that these tariffs will go a long way to rebalance them. For this reason, these tariffs, at least in part, may become permanent. That is bound to increase inflationary pressures in 2025. The Trump Administration believes that inflationary pressures can be combated by lowering energy prices. However, that is unlikely anytime soon based on the reasons discussed in the “Special Selections in Energy” section.

### Long-Term Interest Rates

History and common sense tell us that long-term interest rates are governed by inflationary expectations. Looking back over the last 45 years, we see that, except during Quantitative Easing (QE) programs when the Federal Reserve was purchasing massive amounts of Treasury bonds to rescue the economy, 10-year Treasury bonds historically average a yield of 2.3 percentage points above the inflation rate. That reconciles with the current yield on 10-year Treasury bonds now. If inflationary pressures grow because of tariffs, long term interest rates are bound to increase.

Most companies locked in lower long-term interest rates on their debt during the QE years when 10-year interest rates averaged 2.2 percent. With such low long-term interest rates, corporate debt expanded substantially. However, as corporate debt matures in the months and years ahead, it will need to be refinanced at higher interest rates, which will impede earnings growth.

Accordingly, we should avoid companies with high debt loads, especially if a significant amount has floating interest rates or if much of it matures in 2025 for refinancing. We should also avoid stocks with high P/E ratios and little or no dividend yield because they will be less attractive than bonds.

### The Sound Advice Diffusion Indexes

We rely on the *Sound Advice* Diffusion Indexes (page 10) because they have an accurate track record of predicting major stock market trends for the last 50 years. They work by observing changes in the most sensitive leading and lagging economic indicators. During “Aggressive” signals over the last 50 years, the S&P 500 climbed an average of 31.5 percent. The market has undergone corrections but has never crashed. All market crashes have occurred during “Caution” signals. When the stock market was not crashing, the S&P 500 either meandered, climbed moderately, or declined in an extended bear market, recording an average decline of 0.6 percent.



**Gray Emerson Cardiff,**  
**Editor Since 1988**

Since the beginning of 2000 through the end of 2024, the *Sound Advice* Model Portfolio produced an average annual return of 8.9 percent versus 5.9 percent for the traditional S&P 500 Index, compounding to 1.9 times more capital growth.

At the beginning of 2022, we were in “Caution” mode which proved prophetic. The S&P 500 Index ended the year down 19.4 percent. As a result of heeding our caution signal and positioning our holdings accordingly, the Sound Advice portfolio gained 4.02 percent in 2022. In addition to telling us the general direction of stocks ahead, the “Caution” signal told us where to invest, such as areas that would benefit from rising inflation and interest rates while hedging for downside profits. Our Diffusion Indexes changed from “Caution” to “Aggressive” at the beginning of 2023. That signal proved prophetic as we began a new bull market.

## Prospects for 2025

Most investors believe that the S&P 500 Index is a reliable broad measure of the stock market, but it is not. The top ten stocks comprise a whopping 39 percent of the S&P 500 Index. They are Apple, Microsoft, Amazon, Nvidia, Alphabet Class A (Google Class A & C), Tesla, Meta Platforms Class A, Broadcom, Berkshire Hathaway, and JP Morgan. Because of their large capitalization, these 10 stocks are responsible for distorting it. On average, the price/earnings ratio of these 10 stocks is 62! This is an astronomically high value by historical standards which can be categorized as a bubble.

Priced for future high growth rates, any disappointments are bound to let the air out of these lofty price/earnings ratios. One potential catalyst for undermining growth rates was announced in the last week of January. News about China’s AI chat program, DeepSeek, reported operating on 50 to 75 percent less power than Nvidia’s AI platform. This could bring stiff competition and lower growth expectations for US high-tech companies who are spending massively on AI.

Since the beginning of the last bull market in 2009, the TTM P/E ratio of the traditional S&P Index has averaged 22.0. At today’s earnings of \$210 for the Index, the average TTM P/E ratio equates to a value of 4,628 for the S&P Index, which is 23 percent lower than it is today.

One standard deviation from the average TTM P/E since 2009 is 4.5 percentage points, which means this P/E ratio has been within plus or minus this amount 68 percent of the time, for a range of 17.5 to 26.5. The current P/E ratio of 28.7 is more than one standard deviation above the average, which means this Index currently has hidden risks with limited upside.

Another sign that the traditional S&P 500 Index is inflated is revealed from the *Sound Advice* Risk Indicator (page 9), which compares the Index to house prices for more than 125 years. The latest reading is 3.23, which puts the S&P 500 Index far above the high-risk watermark of 2.0.

Performance in 2025 will likely be best earned by investing in individual stocks or industry sectors with ETFs, and not from the traditional popular indexes.

## The Sound Advice Recommendations

We eat our own cooking at Sound Advice. The [Sound Advice Diversified Growth Fund](#) invests exclusively in the *Sound Advice* Model Portfolio recommendations. The editor of Sound Advice for 36 years, Gray Cardiff, manages the Sound Advice Fund and is also an investor on a side-by-side basis with the other investors. You can request a prospectus for Sound Advice Fund on the log-in page you used to download this issue of Sound Advice.

## The Sound Advice Model Portfolio

Our individual stock recommendations are special situations offering a compelling value proposition. We are also recommending liquid electronically traded funds (ETFs) investing in sectors that are bound to benefit in the months and years ahead. All recommendations, as well as their dividend yields and buy/hold/sell recommendations, are summarized in the table on page 8 and sorted by investment objective categories and then in alphabetical order.

### Downside Hedges

We include downside hedges as part of the portfolio to reduce risk and dampen volatility by profiting during adverse market conditions. Minimizing losses, even at the expense of limiting the upside, has been our key strategy for outperforming the market over the long run.

[ProShares UltraShort S&P 500 \(SDS\)](#) is designed to produce two times the daily fluctuations of the traditional S&P 500 Index, only in reverse. For example, a decline of say, 1.0 percent in the Index will cause SDS to increase by 2.0 percent. Conversely, an increase in the Index will cause SDS to decline by 2.0 percent.

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The Russell 2000 Index

The Russell Index is comprised of small and mid-sized domestic companies which tend to be more volatile than the overall market, especially during market corrections. The following two ETFs below can also be used as a downside hedge because they short sell the Russell 2000 index. They differ in the leverage employed, which you can choose one according to your investment objectives and risk tolerance.

**ProShares UltraShort Russell2000 (TWM)** is designed to produce two times the daily fluctuations of the Russell 2000 index. A decline of say, 1.0 percent in the Russell 2000 will cause TWM to increase by 2.0 percent. Conversely, an increase in the Russell 2000 will cause TWM to decline in the same fashion. TWM had a reverse 5:1 split on November 7, which reduce the number of shares to one-fifth and raised the price by 5 times.

**ProShares UltraShort Pro Russell2000 (SRTY)** is designed to produce three times the daily fluctuations of the Russell 2000 index.

Special Situations

The following stocks are individual companies presenting extraordinary values within their respective industries. Here they are in alphabetical order:

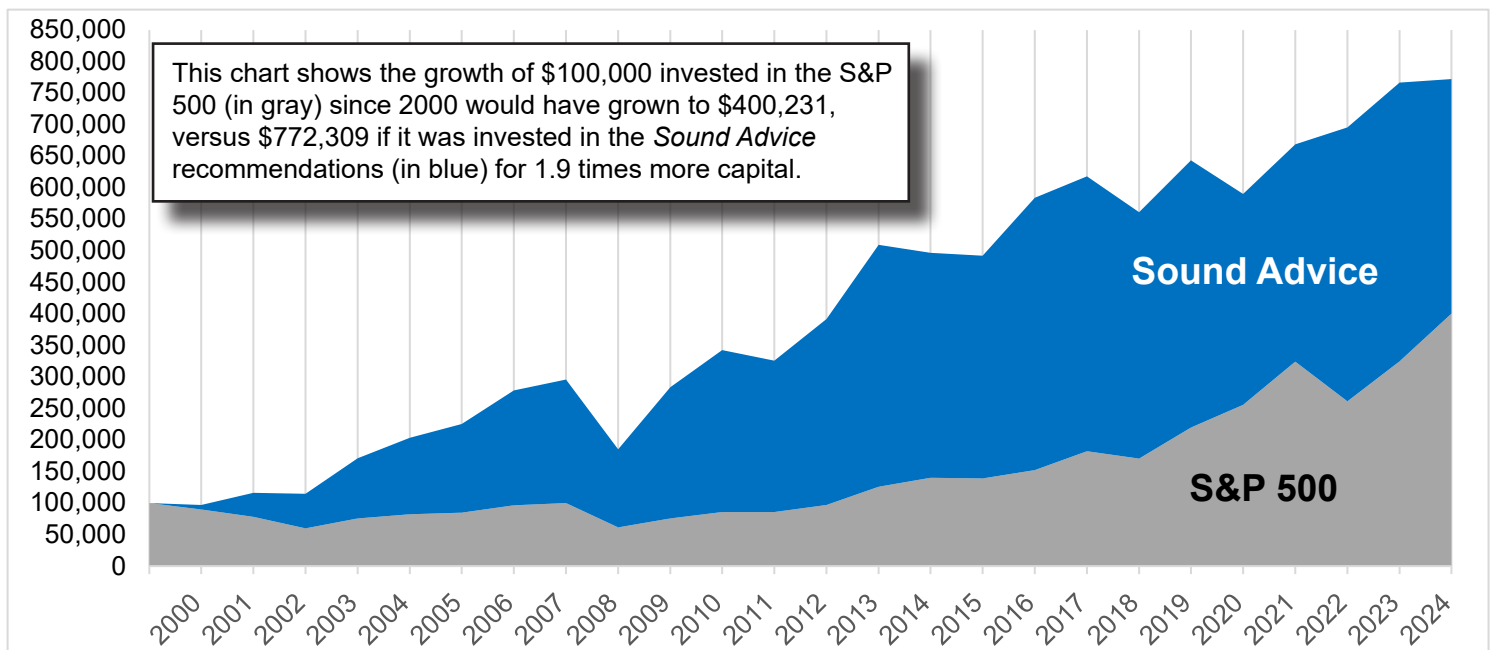
**Apple (AAPL)** was added to the portfolio in 2016 at \$29.08 per share. AAPL has become inflated with a lofty P/E ratio which is anticipating an unrealistically high growth rate. We recommend holding AAPL for now and adding to your position under \$150 per share. This price target puts the TTM P/E close to 23, which is good value for AAPL’s long-term prospects.

**Cisco Systems (CSCO)** is a value play in AI because it supplies the backbone of data center networking equipment and software. The longer-term upside growth potential is not anticipated by the current stock price, as evidenced by a relatively low P/E and an attractive dividend yield.

The purchase of the cybersecurity company Splunk is a good strategic fit because it will give Cisco a much-needed boost to its cloud security offerings. Splunk’s primary business is the backbone security system in data centers, providing customers with AI and other tools to analyze their data and detect security threats.

Cisco and NVIDIA are collaborating to deliver artificial intelligence (AI) infrastructure solutions for data centers that are easy to deploy and manage the massive computing power that enterprises need to incorporate AI. These two companies are now deepening their partnership in data centers to assist enterprise customers with scalable and automated AI cluster management, automated troubleshooting, “best-in-class” customer experiences.

Sound Advice versus the S&P 500



**Crown and Castle International (CCI)** continues to offer an attractive buying opportunity with a very high dividend yield which management has promised to maintain and believes CCI is positioned to return to the company's long-term annual dividend per share growth target of 7% to 8% beyond 2025. The demand for mission-critical data transportation is bound to continue to rise, especially with the oncoming explosive load from AI deployments.

This company has an extensive portfolio of mission critical communication infrastructure assets comprised of 40,000 cell towers, 115,000 small cells, and 90,000 route miles of fiber concentrated in the top US markets. These assets are difficult to create because of scarce locations in urban areas, zoning and governmental regulations, and sheer cost. These assets are leased to credit-worthy tenants with pre-determined escalating rent clauses.

**JP Morgan Chase (JPM)** is a good value for what is considered the world's highest quality banking enterprise with diversified businesses and prudent underwriting policies. Deregulation of the industry will be a substantial benefit to JPM. The annual dividend increased again in 2024 to \$4.60, continuing a long history of growing dividends.

**Moderna (MRNA)** is a pure investment play on Messenger RNA (mRNA) technology. This revolutionary technology is on a path to provide solutions for not only vaccines, but for cures and treatments for the most deadly and debilitating diseases haunting humanity.

In January, the Department of Health and Human Services provided Moderna with \$590 million "to accelerate the development of mRNA-based pandemic influenza vaccines and enhance (its) mRNA platform capabilities."

The sharp decline in recent months bound to be providing a long-term buying opportunity.

Management believes that the company's cash reserves will be sufficient to sustain the business while it develops other vaccines and treatments through its 40+ programs in development. Overall, Moderna's mRNA platform is expected to involve 15 revolutionary RNA vaccines, drugs, and treatments during the next five years.

Perhaps the most substantial upside potential is from developments regarding the ability to see fragments of cancer cells in a blood draw, allowing the detection of cancer in early stages, before it graduates into more serious later stages. Data will be transmitted through the cloud to Moderna's IT system, and AI algorithms will be used to compare an individual's particular cancer cell mutation to the hundreds of thousands of possibilities and to the treatments that are currently effective. Management says Moderna will be able to analyze and develop a treatment customized for an individual patient within 30 days of the blood draw, and over time with more and more data, the process will become more efficient and accurate.

**RLJ Lodging Trust (RLJ)** raised its dividend for the third quarter by 50 percent. The annual rate is now 60 cents per share for a yield close to six percent. The increased dividend is well-covered by the company's cash flow.

RLJ has a large and diversified portfolio of hotel properties, with 97 premium-branded, high-margin, focused-service and compact full-service hotels located in 23 states and Washington DC. This is a low-leveraged REIT because the company's debt is only 46 percent of its (book value) assets.

The portfolio's net operating income (NOI) for the trailing four quarters ending in the most recent third quarter of 2024 was \$384 million. Using a conservative cap rate of 7.5 percent produces a portfolio value of \$5.124 billion. Adding other assets and subtracting liabilities leaves the company equity of \$3.21 billion. After subtracting the liquidation value of the company's only preferred stock of \$322 million leaves equity for the common shareholders of \$2.89 billion. Dividing that equity by the 153 million shares of RLJ outstanding translates to a net asset value of \$18.88 per share – close to double the current price of the stock price.

**RLJ's \$1.95 Series A Cumulative Convertible Preferred (RLJPRA)** is RLJ's only preferred stock, with a liquidation preference of \$25 per share, which is the maximum value that would be received from an acquisition of the company. Use limit orders at \$25 or lower to accumulate this preferred stock for a safe annual yield close to 8 percent. The dividends for this preferred only consume 10 percent of the company's cash income and must be paid before common dividends, making the yield highly secure.

### Special Situations in Energy

Trump Administration promises to lower the cost of energy by increasing supply through "Drill Baby Drill". The objective is to increase US oil production by three million barrels per day by 2028. The US was the world's largest oil producer at nearly 14 million barrels per day in 2024. Realistically, it will take time to increase production by three million barrels per day.

The US imports 3.8 million barrels per day from Canada which now have a 10 percent tariff, and 450 thousand barrels per day from Mexico which now have a 25 percent tariff. This imported oil just got more expensive and perhaps less available.

Iran, the funding source of funding to Hamas and Hezbollah, is a likely imminent target of financial sanctions at the very least. Cutting off Iran's exports alone would account for two million barrels per day. Reducing Russia's ability to export by just ten percent of its ten million barrels per day of production with sanctions would add up to a complete offset. Notably, the enforcement will come long before the US has had time to ramp up production.

In mid-January, the US announced sweeping sanctions on Russia's oil trade. As a result, nearly 160 oil tankers will not be allowed into India's ports after a "wind-down" period ending in March. Two large Russian oil trading companies were also sanctioned, Surgutneftegas and Gazprom Neft, which shipped approximately 970,000 barrels a day of oil by sea in 2024. This is nearly 30% of Russia's seaborne exports and more than the global supply surplus the International Energy Agency was projecting for 2025.

In late January, President Trump started urging Saudi Arabia to lower oil prices, which is contrary to the interests of OPEC. Saudi Arabia views its role as the stabilizing force against substantial swings in oil prices. It is unlikely to see much more than a gratuitous lowering of oil prices from this part of the world.

Seventy-four percent of US energy consumption comes from oil and gas, and that is not likely to change anytime soon.

To directly benefit the industry, the Trump Administration is removing regulations which will bring down production and operating costs, along with allowing new pipelines to transport oil and gas products to more domestic markets and to the US coasts for exporting to overseas markets. Additionally, the ban on LNG exports is being reversed to allow US supplies to travel to the rest of the world where it is desperately needed, especially if Russian and Iranian supplies are to be avoided.

Our following energy selections present stellar values for long-term profits and increasing dividend income.

**Chevron (CVX)** reported fourth quarter earnings at the end of January of \$2.06 per share below Wall Street's \$2.11 expectation. Profits were down industry-wide for 2024, primarily because activity waned in the US and China. In Late January, Chevron announced starting up oil production at its 50 percent ownership of the giant Tengiz oil field in Kazakhstan that will produce boost production by 260,000 barrels per day. CVX has an attractive dividend yield above four percent with a history of dividend increases.

**Exxon Mobil (XOM)** also reported fourth quarter earnings at the end of January of \$1.67 per share, beating expectations of \$1.56. Low production costs and production from its immense Guyana field boosted earnings despite lower oil prices and lower refining margins. XOM also has an attractive dividend yield above 3.5 percent with a history of dividend increases.

**Halliburton (HAL)** is a premier oil field services company. With a substantial presence in the US, Halliburton derives a larger share of its revenues from North America than its primary competitors, SLB Inc and Baker Hughes. The Trump Administration's "Drill Baby Drill" policies are bound to benefit HAL.

Prior to the election, HAL was already having a decent year thanks to its technological innovations that are tailor made for the unconventional reservoirs in the US. Halliburton's recently introduced directional drilling system, the iCruise CX system, is a rotary steerable tool and LOGIX drilling automation platform that makes it possible to reliably drill in curves and laterally in a single run. This new technology has been rapidly deployed in the Permian Basin so far this year and growth is bound to be substantial as drilling activity increases throughout the US.

Other relatively new Halliburton technologies include the Zeus platform, electric pumping units, Octiv Auto Frac, and Sensori subsurface measurement. These systems increase efficiency and replace outdated and costly diesel generators as power sources for onsite drilling with generators capable of using natural gas, LNG, and a variety of other fuels that are available on the drilling site.

**Valero Energy (VLO)** was added to the portfolio several years ago at \$60.41 per share. As earnings have grown, VLO is still a bargain with a relatively low P/E and attractive dividend yield. Valero makes its money from the "crack spread", which is the profit margin derived from purchasing crude oil, turning it into refined products such as gasoline and jet fuel, and selling those refined products.

Valero has the unique ability to achieve discounts for its crude oil feedstocks because it can refine a variety of crude oil types. This flexibility and access allow Valero to capture the highest margins among its competitors because it can take advantage of the temporary gluts of crude, whether it's low or high-quality crude or light sweet (low sulfur) or

heavy sour (high sulfur) crude, to obtain the best available discounts for its feedstocks. The company's refineries also have access to the US pipeline network from its gulf coast locations.

Valero's "green energy" joint venture with Diamond Green Diesel is producing renewable diesel at large profit margins. Renewable diesel is made from animal or plant waste material which reduces greenhouse gas emissions up to 80 percent because it only releases as much carbon dioxide as the material originally contained. Renewable diesel does not congeal at low temperatures which means it can be easily transported through pipelines.

At the end of January, Valero reported earnings that were sustained by higher profits from renewable Diesel production despite lower profits from oil refining.

### Equally Weighted S&P 500

**Invesco S&P 500 Equal Weight ETF (ticker symbol RSP)** invests in all the S&P 500 stocks but on an equally weighted basis and rebalances its portfolio each quarter to maintain its equal weights. This rebalancing process preserves value by reducing stocks that have recently outperformed while adding recent laggards. This preservation of value explains the superior performance over the traditional S&P 500 Index recently and over the long-term.

From the beginning of 2000 through the end of 2024, RSP has outperformed all the major indexes, with an annual percentage rate (APR) of 6.9%. This compares to the Dow Jones Industrials with an APR of 5.7%; the Russell 2000 with an APR of 5.2%; the Nasdaq Composite with an APR of 6.6%; as well as the traditional S&P 500 Index with an APR of 5.9%. These returns compare to the APR of 8.9% from the Sound Advice recommendations over the same period.

### Sector ETFs

Included in the *Sound Advice* model portfolio are the following electronically traded funds (ETFs) investing in sectors that are bound to benefit in the months and years ahead from fundamental changes in geopolitical, medical, and economic landscapes. These ETFs contain a portfolio of stocks, much like a mutual fund but ETFs are liquid and trade like stocks with their own ticker symbols. Their prices are determined by the value of the portfolio of stocks they hold.

#### Artificial Intelligence

**Global Robotics and Automation Index ETF (ROBO)** is investing in the key to making the world's companies more efficient -- robotics and automation. Approximately half of the portfolio is in robotics technologies, and the other half is in the technology controlling the robots – sensing, computing actuation, and artificial intelligence (AI). This is a diversified way of investing in AI which is the next technological frontier and will be playing an increasingly greater role in the way companies operate around the world.

#### Biotech ETFs

Biotech companies offer explosive profits because they are the source of the world's top breakthrough vaccines and treatments. Their stocks are often volatile, making diversification essential. This can be accomplished by investing in a diversified electronically traded fund (ETF) investing exclusively in a portfolio of biotech companies.

**ARK Genomic Revolution Multi-Sector (ARKG)** is an actively managed biotech ETF investing in companies expected to benefit by incorporating technological and scientific developments, along with advancements stemming from mapping the human genome. Technological breakthroughs in artificial intelligence and other high-tech advancements have cut the cost substantially of opening new opportunities and putting this sector on the cutting edge of many new innovations.

#### Balanced Sector ETFs

The following ETFs rebalance their holdings quarterly to equalize the values, which offers a greater degree of evenly weighted diversification and adds stability as well as safety to a portfolio. This practice often provides a superior performance because it offers upside from stocks that are often under-weighted in the portfolios of other ETFs and mutual funds.

**Virtus LifeSci Biotech Products (BBP)** is a passively managed biotech ETF that weighs the portfolio selections essentially equally, as opposed to the more typical practice of weighing selections according to market capitalization.

This is an important aspect because biotech ETFs who weigh their portfolio selections essentially equally have been the best performers because they have larger investments in smaller biotechnology companies which have become acquisition targets for large pharmaceutical companies looking for ways to expand.

#### Health Care

Health care stocks have several traits that make them desirable long-term investments. They are well-suited for an aging population, which exerts disproportionate demands on the health care industry. As the world's population continues to age, this trend is inexorable, making the health care sector defensive in nature and more insulated from economic cycles than other sectors. Health care companies are also prime candidates for new AI technologies that are bound to improve efficiency and accelerate growth.

One of the main criticisms of most health care ETFs is that they are dominated by a relatively small number of large companies, such as Johnson & Johnson, which distort the performance of the typical health care ETF portfolio.

**Invesco's S&P 500 Equal Weight Health Care ETF (RSPH)** tracks the S&P 500 Equal Weight Health Care Index, which tracks 65 health care stocks represented in the S&P 500, but weights each holding evenly. Both the Index and RSPH are rebalanced quarterly. This approach has given RSPH a better performance than the large health care ETFs.

#### Consumer Staples

**Invesco S&P 500 Equal Weight Consumer Staples ETF (RSPS)** invests in consumer staple stocks within the S&P 500 Index. Consumer staples are those unexciting products we use every day without much thought, ranging from food, beverages (including alcohol), household goods (including cleaning supplies), and hygiene products. These are products that people are unable (or unwilling) to remove from their budgets regardless of their financial situation. The nature of these products makes this sector defensive and much less vulnerable to recessions and bear markets.

#### US Infrastructure

The Infrastructure Investment and Jobs Act, enacted in November 2021, targeted \$1.2 trillion to fund improvements, repairs, and upgrades for a wide range of infrastructure needs, from bridges and highways to water and electric grid systems. This infrastructure spending will benefit both of the following two ETFs in the years ahead.

**Invesco S&P SmallCap Industrials ETF (PSCI)** is based on the S&P SmallCap 600 Capped Industrials Index which is designed to measure the overall performance of the securities of US industrial companies with small capitalizations (caps). These domestic companies are engaged in the business of providing industrial products and services, including engineering, heavy machinery, construction, electrical equipment, aerospace, and defense, as well as general manufacturing. They will reflect the positive impacts more strongly than larger companies from an increase in infrastructure spending. Small cap construction companies are also typically domestic companies operating inside the US, and construction projects tend to employ local companies as subcontractors even when general contractors may be national companies.

**Invesco S&P 500 Equal Weight Materials ETF (RSPM)** invests in the companies that comprise the S&P 500 Equal Weight Materials Index. The portfolio contains prime examples of basic materials companies outside of the oil and gas industries. Basic materials companies are bound to benefit in the years ahead with increased infrastructure spending.

## Portfolio Summary Table

Growth with Income	Symbol	Price	Yield	Action	Limit *
Crown and Castle	CCI	\$89.28	7.01%	BUY	\$93.74
Chevron	CVX	\$149.19	4.37%	BUY	\$156.65
Cisco Systems	CSCO	\$60.60	2.64%	BUY	\$63.63
Halliberton	HAL	\$26.02	2.61%	BUY	\$27.32
Invesco Consumer Staples ETF	RSPS	\$29.62	2.90%	BUY	\$31.10
Exxon Mobil	XOM	\$106.83	3.71%	BUY	\$112.17
RLJ Lodging	RLJ	\$9.75	6.15%	BUY	\$10.75
RLJ Preferred A	RLJPRA	\$25.07	7.78%	BUY	\$25.00
Valero	VLO	\$133.00	3.22%	BUY	\$139.65
Growth	Symbol	Price	Yield	Action	Limit *
Apple	AAPL	\$236.00	0.42%	HOLD	\$150.00
Genomic Revolution Multi-Sector	ARKG	\$26.84	0.00%	BUY	\$28.18
Golbal Robotics & Automation ETF	ROBO	\$59.12	0.20%	BUY	\$62.08
Invesco Basic Materials ETF	RSPM	\$34.16	1.99%	BUY	\$35.87
Invesco Health Care ETF	RSPH	\$31.26	0.64%	BUY	\$32.82
Invesco Small Cap Industrials ETF	PSCI	\$139.48	0.68%	BUY	\$146.45
JP Morgan Chase	JPM	\$267.30	1.87%	BUY	\$280.67
Moderna	MRNA	\$39.42	0.00%	BUY	\$41.39
S&P 500 Equal Weight ETF	RSP	\$181.24	1.46%	BUY	\$190.30
Virtus LifeSci Biotech Products	BBP	\$62.34	0.00%	BUY	\$65.46
Hedges	Symbol	Price	Yield	Action	Limit *
ProShares UltraShort S&P 500	SDS	\$18.77	0.00%	BUY	\$19.71
ProShares UltraShort Russell2000	TWM	\$42.42	0.00%	BUY	\$44.54
ProShares UltraShort Pro Russell2000	SRTY	\$17.47	0.00%	BUY	\$18.34

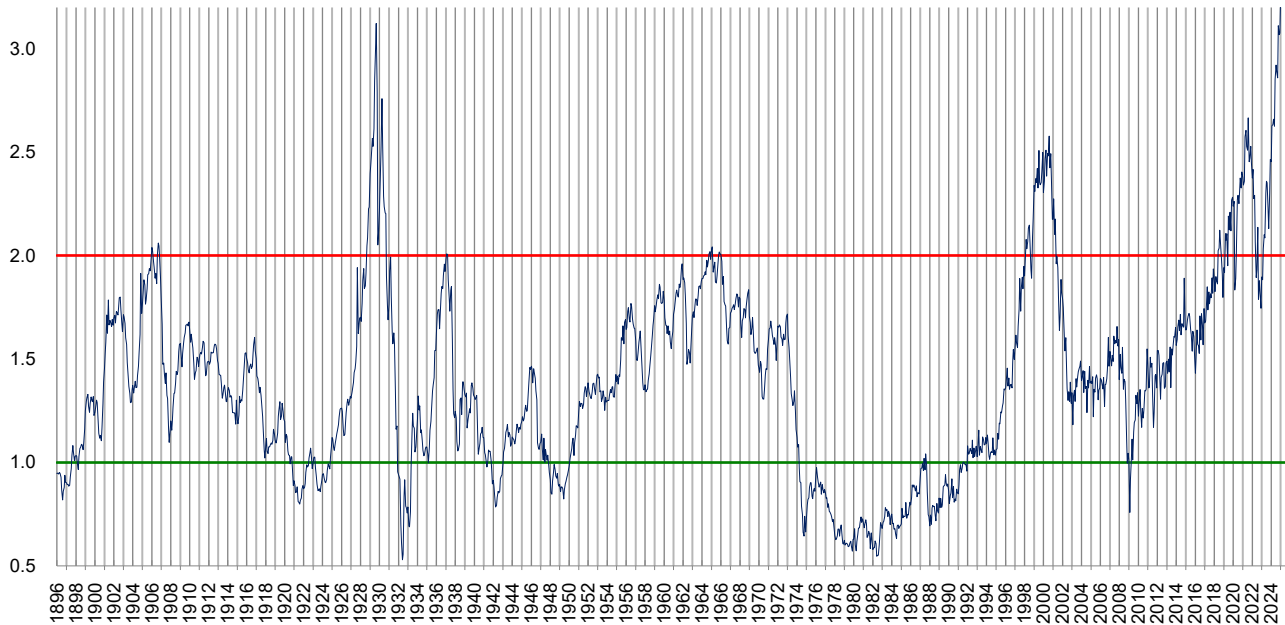
\* **Note to the table:** The right hand column is the highest recommended price limit for purchases.

**General Comments:** Our statistics are based on the assumption that \$10,000 is invested in each position. When a new position is added, we assume the same \$10,000 amount is invested in the new recommendation. When we recommend adding to a particular position, as we have done over the years, we assume another \$10,000 is invested again in that position.

If you are picking and choosing, you can focus on the sector of the portfolio that matches your investment objectives. Alternatively, you may have a higher degree of comfort with certain industries, funds, or stocks because of past experience or your profession. In that case, you may want to invest more heavily in one sector, or in one or more individual recommendations.

As always, broad diversification will temper volatility, add to safety, and improve long-term performance.

Capital Competition: Real Estate versus Stocks:  
The SoundAdvice Risk Indicator



There are few forces that are more important to a market’s destiny than the amount of capital that is available to it. In a normal situation, capital will flow easily between markets as their underlying conditions change. But if a market becomes dangerously superheated, it will absorb a larger proportion of available investment capital than economic conditions and market demand can justify. This change will be reflected not only in the rising market’s prices but also in the prices of competing markets, which will be lower than their underlying fundamentals would indicate they should be. Over the last 120+ years, we can see this titanic struggle between the stock market and its foremost competitor for investment dollars: real estate.

To reveal this phenomenon, we have set up an equation based on the ratio of the S&P 500 Stock Index to median price of new houses for each month over the last 100+ years. This equation exhibits an elegant financial minuet as each market has taken turns outperforming the other.

As we look at the historical data, we find that there is a range in which the price disparities are so strong that they are too great to be accounted for by the fundamental economic conditions underlying each market. Every time prices get into these danger zones it has meant that the prices in one market or the other have gone too high, and that they are in imminent danger of falling.

We label this new tool the **Sound Advice** “Risk Indicator,” since it will allow us to locate the point at which prices are so high when compared to competing markets that they have come loose from their moorings and are on the verge of declining or under performing the other market.

What is too high? When stock prices are very high relative to house prices, the **Sound Advice** Risk Indicator will rise over the line marked 2.0, revealing a high-risk time for stocks. In contrast, when the indicator drops below the line marked 1.0, it means that it is a very low-risk time to buy stocks. Notice from the chart how the **Sound Advice** Risk Indicator has oscillated back and forth, revealing the ongoing struggle between stocks and houses for investment capital. We have labeled these long vacillations Supercycles.

But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing, had an investor followed the signals of the **Sound Advice** Risk Indicator, he or she would have made \$558 million versus \$35 million by simply holding stocks through the ups and downs, or 16 times more money.

**The New York Times**

*“Cardiff’s equation reveals an elegant financial minuet as each market takes turns outperforming the other.”*

With the latest median house price at 402,500 in November 2024 (the latest data) and with the S&P 500 averaging 6040 in January, the **Sound Advice** Risk Indicator read 3.23.



**The 2025 Edition:**

## **The Science of Making Money in the Stock Market**

By Gray Emerson Cardiff

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## **Business Cycles and Stocks: The SoundAdvice Diffusion Indexes**

The Risk Indicator reveals long macro cycles. An analogy can be made to the way radio waves work. Long radio waves have frequencies which are assigned to various radio stations, allowing you to distinguish them on your radio. Riding along the path of these long waves are short waves that produce the sound you actually hear on a particular station. These short waves are like the bull and bear markets revealed by the Diffusion Indexes.

While the path of the long cycles revealed by the Risk Indicator may be in a certain direction, there are bull and bear markets along the way. Of course, these relatively short bull and bear markets are significant during our investing careers. Even during times when the Sound Advice Risk Indicator is above the “low risk” reading, such as it is now, there have been substantial bull markets. We will rely on our Diffusion Indexes to reveal when that will be.

The data we need is contained in the leading and lagging economic indicators. We have hand picked the most sensitive of these economic indicators to produce our “Diffusion Indexes” which function with amazing accuracy as predictors of the birth of cyclical bull and bear markets.

To construct our *Sound Advice* Diffusion Indexes, we observe changes in each of our selected indicators over a five-month period, and take the percentage of those increasing.

When the *Sound Advice* Diffusion Index of LEADING Indicators drops to zero, it is time to buy stocks aggressively, regardless of how negative the atmosphere may be. This is not just an empirical coincidence. It is also logical. When all three the leading economic indicators decline compared to five months earlier, it reveals that the soft economy is providing an atmosphere for declining short-term interest rates. This Diffusion Index gave us a zero reading in December 2008, close to the bottom, officially giving us an “Aggressive” signal. That signal came at a time when the Risk Indicator was below 1.0, which revealed that Supercycle 5 came to an end, and that Supercycle 6 was born.

The *Sound Advice* 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 reading reveals that the US economy is strong enough to put upward pressures on interest rates.

### **A Powerful Overriding Force**

Most of the time, the Diffusion Indexes are excellent detectors of the natural business cycle and a path to the science of making money in the stock market. However, the forces of the natural business cycle can be dominated by extraordinary changes in monetary policy during emergency situations.

The COVID-19 pandemic was the most recent example. In mid-March 2020, the Federal Reserve declared the institution of its fourth “Quantitative Easing” (QE) program whereby it dropped the Federal Funds rate to zero and commenced buying massing amounts of US Treasury bonds. With its mighty power, the Fed drove

## Track Record of the SoundAdvice Diffusion Indexes

During the last 49+years, after each “Aggressive” signal, the S&P 500 climbed an average of 31.5 percent. During “Caution” signals, the S&P 500 either crashed, meandered, or climbed, recording an average decrease of 0.6 percent.

Signal Dates (Month-Year)			
Aggressive	S&P 500	Caution	S&P 500
Sep-74	68.12	Apr-76	101.9
Jul-76	104.20	Dec-76	104.7
Oct-78	100.58	Jun-79	101.7
Nov-79	100.00	Oct-83	167.7
Aug-84	164.48	Jun-85	188.9
Jul-86	240.18	Aug-87	329.4
Feb-88	258.13	Jun-88	270.7
Mar-89	280.00	Mar-93	449.7
Mar-95	493.15	Dec-98	1,141.0
Jun-00	1,429.40	Dec-00	1,320.3
Jun-03	974.50	May-05	1,191.5
Jun-06	1,276.66	Mar-08	1,325.4
Dec-08 (1)	865.58	Apr 10 (2)	1,197.3
Sep 10 (3)	1,122.08	Jun 12 (4)	1,359.8
Sep-12 (5)	1,437.82	Nov 14 (6)	2,044.6
Mar-15	2,079.99	May-15	2,111.9
Sep-17	2,492.84	Feb-18	2,705.2
Mar-20 (7)	2,761.98	Nov 21 (8)	4,667.4
Dec-22	3,912.38		
Ave +/-	31.5%		-0.6%

### Quantitative Easing (QE) Overriding Signals

- (1) QE-1 announced 4 months before Aggressive signal
- (2) QE-1 terminated into existing Caution signal
- (3) QE-2 announced but already in Aggressive mode
- (4) QE-2 terminated into existing Caution signal
- (5) QE-3 announced, changed to Aggressive mode
- (6) QE-3 terminated into existing Caution signal
- (7) QE-4 announced, changed to Aggressive mode
- (8) QE-4 terminated into existing Caution signal

down interest rates and infused massive amounts of liquidity into the US economy. The money supply mushroomed.

At times like this, we need to ignore readings from the Diffusion Indexes. Interest rates are dropping by the Federal Reserve’s mandate, just as if the Diffusion Index of Leading Indicators had plunged to zero. Conversely, whenever the Federal Reserve declares an end to its QE program, we return to our Diffusion Indexes to follow their readings. If the Diffusion Index has moved to a “Caution” signal during the QE program, we should follow that reading. This is the most likely pattern of events because the economy will likely have strengthened in order for the Federal Reserve to end its QE program.

The impact of the Federal Reserve’s four QE programs on existing Diffusion Index signals are noted in the footnotes under the track record table.

### Current Status

The latest leading and lagging economic indicators were published in late January for the month of December.

Our current “Aggressive” mode was established by a zero reading for the Diffusion Index of LEADING Indicators in December 2022 based on the indicators for November 2022. The latest reading is 100 percent.

**Our next signal will be a “Caution” signal from a 100 percent reading on the Diffusion Index of LAGGING Indicators which recorded zero percent based on the latest indicators.**