Gray Cardiff's

SOUND ADVICE

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The blame game rolls on about whom to blame for the subprime debacle . The perp walk began with naïve/greedy borrowers who believed the sleazy brokers who assured them that regardless of the consequences should rates rise of the teaser mortgages they took out, they could refinance as soon as their mortgaged homes had appreciated enough. Then the spotlight moved on to the Wall Street lenders who bought those dodgy mortgages, bundled them together into collateralized mortgage obligations, and sold them to the next level of perps, who were gullible enough to believe that despite those mortgages' shakiness, if you let the Wall Street wizards work their magic, they could turn them into AAA-rated paper. Of course, that trick required the cooperation of the rating agencies. The real estate industry played its part almost to the bitter end predicting higher prices for homes. Each can be understood if not forgiven, since each's self-interest got in the way of doing the right thing. But there is one unnamed coconspirator not easily understood. What can we say about the Maestro of the Federal Reserve, Alan Greenspan, who repeatedly denied a bubble had formed in the housing market, and had the gall at the very moment he knew the Fed soon would be raising interest rates, which would be the first tug in the unraveling of the housing boom, to laud the crazy loans that made all this possible. Looking back on how Greenspan blessed creative mortgages, the best comparison I can think of is Ken Lay, who as he realized the house of cards we called Enron was starting to collapse encouraged his employees to buy more shares.

--Gray Emerson Cardiff

Killers and Killees

"To make a killing" is one of those terms that spark envy for the killer. We rarely think about the other side of the deal, the killee. However, in the current market, all we hear about are the killees, the victims: homeowners who bought bigger houses than they could afford because credit was cheap and due diligence negligent, shareholders in REITs that held these mortgages, hedge funds that were loaded with derivatives based on such mortgages, and all those who suddenly find the credit markets too chaotic to set realistic prices. The overall market is in pain but anything related to mortgages is in the grave.

But there are plenty of killers out there. Indeed, fortunes already have been made by whoever was short whatever has collapsed. Were you a shareholder in a now bankrupt mortgage REIT? You were wiped out. Were you short their shares? You made a killing. Did you load up on collateralized loan obligations, the debt private equity groups used to make their deals? You got killed. Were you short those bonds? As interest rates for such shaky loans vaulted higher and prices collapsed, you made a killing.

Right now the credit markets remain in shock. People are fleeing to Treasuries, driving down their yields, but everything else—regardless of its degree of creditworthiness but especially anything tainted by an association with mortgages and deal-related debt—has taken a beating, and someone out there already has begun to gather those assets from frantic holders who either are so leveraged themselves that they have to sell those assets or just cannot tolerate owning something the market refuses to value precisely. So they sell at prices dictated by an anxious market.These are the times that guys like Marty Whitman, Warren Buffett, and Joseph Steinberg and Ian Cumming at Leucadia (with whom Buffett has partnered before in something called "Berkadia" to capitalize on mispriced debt) live for. As they always have, such investors are making fortunes from OPM: Other People's Mistakes and, in the case of Berkadia, use Other People's Money to do the deals.

Should garden-variety investors like us be diving in? The areas of maximum pain are among the homebuilders, mortgage REITs, finan-

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cial stocks with significant exposure to derivatives built from mortgage paper and other collateralized debt, and all those whose businesses prospered because they were tied into those sectors: furniture, home improvement, consumer electronics etc. We are not ready to recommend any mortgage REITs, though some of the preferred shares among the most troubled mortgage companies that have a shot at survival offer yields above 25%–provided they survive. Financial stocks with modest exposure to mortgage derivatives and REITs whose portfolios currently are no longer trading at a premium to the value of their real estate portfolios are becoming more attractive.For example, **American International Group** looks attractive to us because of exaggeration of its liabilities for subprimes. Provided we find the right situation, we hope to feature a banged-up financial stock in the October issue.

Of course, there is the possibility as the housing market turns even colder and homeowners acknowledge that their ATMs, I mean homes, have ceased to spew out equity that the hero of the U.S. economy, the consumer, will curl up into a ball and cease consuming conspicuously. At that point, the idea that the housing/mortgage debacle was "contained" will cease.

The result would be recession, which would hurt most stocks. Though our portfolio has many defensive positions in consumer non-durables, healthcare, and staples, a severe downturn in the U.S. economy would be painful. The Pollyannas tell us that even with a moribund U.S. economy, the rest of the globe is so prosperous now that maybe American companies would do well enough from their international sales to continue to grow profits. Maybe.

This morning, just as we were putting the finishing touches on this issue, Wall Street is being rocked by a very, very disappointing non-farm jobs report that shows a 4000 job contraction, not the anticipated 115,000 growth, which convinces everyone that we are teetering on the edge of recession.

We are not working on an imminent recession scenario, because our friends in Washington will do everything within their powers to avoid or at least postpone the event. Shortly after this letter reaches you, the Federal Open Market Committee meets on September 18, and we'll see whether the odds as we write, which predict a 100% probability of a 25 basis point cut and a 75% probability of a 50 basis point cut, are on target. When you have 100% probability, that quarter point cut is already priced into most people's expectations. A 75% probability also means the majority anticipates the more drastic cut. Katie bar the door if we don't get a 25 basis point drop, and even if it's 25 basis points, there will be disappointment from the 50-basis-point crowd. So don't boldly jump into the market either in anticipation of a rate cut or even if one materializes, since any Fed action would evidence real problems in the U.S. economy, not necessarilly the return of happy days.

It's not all bad news. One immediate consequence of the conviction the Fed must lower rates has been a sharp drop for the dollar and a robust rally in gold, which now reverses the weakness gold experienced as the dollar strengthened on the now vanished prospect the Fed would be raising rates, an expectation that was alive and well just two months ago. If you were adding shares of **American Century Global Gold Fund** on weakness, you are now reaping the benefits.

So, what do we do? We're taking a wait-and-see approach, buying what combines a solid company with a beaten-down price. For example, the three names we highlight this month are all asset hoards buried beneath temporary problems, some of them the direct consequence of ambitious acquisitions, and at current prices have slight downside risk and considerable upside potential. On dark days haunted by fears of recession, the market gravitates to companies that provide staples, or offer services such as healthcare that cannot be neglected even in a slowing economy. Hence, firms like JNJ are doubly attractive, cheap and necessary, even in a limping economy. Prudent buying at these moments, though never exhilarating usually is profitable. ***SA***

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Three Busted Acquisitions

Sound Advice has done well by buying other people's mistakes and misfortunes, that is, stocks of companies that have fallen on hard times either due to management missteps or through no fault of their own have suffered from the normal business cycle. We try to buy stocks when they are cold, and then wait till Wall Street decides circumstances have changed. This month, rather than introduce a new recommendation, we want to highlight three deep-value positions in our portfolio, which beyond their absolutely cheap prices share one other characteristic. Each is the result of a busted acquisition: **Symantec (SYMC—Nasdaq)**, which acquired Veritas, **Sprint-Nextel (S—NYSE)**, which acquired Nextel, and **Boston Scientific (BSX—NYSE)**, which acquired Guidant.

Big mergers are seductive, and usually very profitable for the acquired companies' shareholders. For the acquiring companies' shareholders, the outcomes usually are less satisfying, since, as academic studies have illustrated, such deals often occur when the acquirer's stock is near its high, which not only emboldens management but also provides the currency to finance an overpriced deal built on unrealistic assumptions about cost savings and immediate benefits. The most far-fetched deals, pitched as brilliant strategies for "diversification" are guaranteed to be flops. Consider two bizarre buys fueled by flush energy company coffers: Mobil Oil's purchase of Montgomery Ward, the department store chain in the 1970s or Occidental Petroleum's purchase of Iowa Beef in the 1980s. But even acquisitions that make sense at least in their components can lead to big problems, and for value investors like us big opportunities.

SYMANTEC AND VERITAS

Recommended in the May 2006 issue, the old Symantec had thrived by designing and selling security and efficiency software for PCs. Its market centered on consumers and small businesses, though there was some revenue from mid-sized customers as well. In the previous year, Symantec management had concluded that to turbo charge growth it needed to make an acquisition, and not just a targeted, strategic acquisition to buttress its core products but something big, something bold, something that would radically change what Symantec had been. Not that growth wasn't already strong. In the previous quarter, SYMC's earnings had been up 63%, a stock-split was announced, and shares were being bought back. SYMC was a hot stock. Nonetheless, management also was aware that some Internet Service Providers were starting to offer free security software against viruses and worms, while all were racing to incorporate ways to filter out risky emails before they even reached subscribers' computers. Microsoft was developing Vista, the next generation of Windows, that would incorporate anti-virus tools. The market for add-on security software was starting to change in ways that hurt Symantec.

Symantec's CEO, John Thompson, was on record as wanting to get into corporate software sales, and Veritas, a designer of enterprise software necessary to manage vast corporate databases, was available. Immediately investors criticized the prospective deal. Not only were the companies different in their products and markets but also Symantec was proposing to purchase a slower grower. It was increasing sales at a 17.5% clip, Veritas at 13%. Finally, observers were shocked at how rich a premium Symantec offered.

Before the deal was announced, the two companies had a market cap of $31.4 billion (Veritas had a $10.6 billion market cap, and with the deal premium, Symantec paid $13.5 billion). Nearly three years later, the combined corporations have a market cap of $16.9 billion. Depending on how you want to measure the deal's consequences: the combined companies are now worth about half of their pre-announcement price, or the combined companies today are valued at less than Symantec alone was before the deal materialized. In the most simplistic sense, today's buyer of Symantec shares gets Veritas for free.

Of course, plenty of things went wrong since the deal was launched. The costs of incorporating Veritas were higher than expected, and the savings expected have been lower. However, the notion that there was little or no overlap between the two companies has proved shortsighted. In fact, the paired companies are making inroads in the corporate security market. EMC, which a dominant company in Veritas' sector, in mid-2006 validated Symantec's decision by itself acquiring RSA Security, which specialized in securing corporate database networks.

Why do we think Symantec is undervalued? As we pointed out in the original recommendation, historical valuations then were at levels that in the past coincided with market bottoms for SYMC. Those valuations remain compelling today even though one of the most worrisome problems (aside from how much Symantec was paying for Veritas), that Microsoft's soon-to-be-rolled-out Vista operating system with its security functions would destroy Symantec's sales of computer security software, has diminished.

Symantec is cheap not just in the context of its own history but when compared to its peers. As of the end of the last fiscal year (March 31, 2007), Symantec derives about two thirds of its sales from security-related products and one-third from corporate data management software, the old Veritas. If we use those numbers to weight valuations, we find that Symantec is trading cheaply compared to peers in each sector. For example, in the slower-growth database management business, EMC, which has added a security component to its corporate data management core business trades at a Price/Earnings ratio of 32.3, a Price/Sales of 3.7, Price/Book of 3.7, and Price/Cash Flow of 17.5. McAfee, the best comparison for Symantec's consumer and small business security segment, trades at a Price/Earnings ratio of 43.1, a Price /Book of 4.6, a Price /Sales of 5.8, and a Price /Cash Flow of 16.1. McAfee, which is the closest comparison to what Symantec does in the consumer-small business security sector, trades at a Price/Ernings ratio of 42.4, Price/Book of 4.5, Price/Sales of 5.7, and a Price/Cash Flow 15.8. Symantec, trades at a Price/Earnings of 45.9, a Price/Book of 1.5, a Price/Sales of 3.5 and Price/Cash Flow of 11.2. Though it derives two-thirds of its earnings from its original consumer/small business sales, valuation ratios reflect only the Veritas/EMC model. We think that is a mistake. McAfee, since Symantec grabbed Veritas, is up about 13%,while EMC is up about 40%. Symantec is up 7% since we bought it, but remains 42% off since the merger's eve. Today's buyer of SYMC gets the computer security business plus Veritas for substantially less than SYMC cost.

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Is this a guarantee of rich profits? We're not so foolish to promise anything when it comes to stocks, but we are confident that when a company has lost investor confidence, as Symantec did when it acquired Veritas, Wall Street requires time to forget, time to reconsider, time to be surprised when after a few quarters of rising numbers, someone "discovers" how underpriced a stock is. Symantec, like the other two tarnished merger stocks, fits the bill. We recommend buying shares up to $21.

SPRINT AND NEXTEL

Sprint-Nextel, introduced this February, ranks as the third largest cellular phone service provider behind AT&T's Cingular and Verizon (a partnership between Verizon and UK-based Vodafone). As with the Symantec and Boston Scientific decisions, the acquisition was not irrational, though it was expensive ($35 billion). Sprint needed to keep pace with its peers, especially after AT&T/SBC with two giant gulps leaped to the lead in subscribers. But unlike the fat premiums paid by Symantec and Boston Scientific, Sprint's costs fit comfortably with what AT&T (at the time known as SBC) paid for AT&T Wireless back in 2004 ($41 billion) and the $86 billion AT&T paid in 2006 to acquire all of BellSouth in order to capture the 40% balance of Cingular it did not own As Ed Whitacre, AT&T's CEO crowed after sealing the BellSouth deal, "The biggest asset we bought here was Cingular…We are about to become a company with wireless at its heart." Indeed, while landline phone revenue was dwindling, cell phone use was booming. During 2006, AT&T shares had leaped by 50% almost entirely because investors cheered its snapping up the rest of Cingular.

Why, if Sprint-Nextel is the only national pure-play cellular network (after the merger, Sprint spun off its landline business) did it not benefit from enthusiasm about wireless? Why are the shares today trading 28% below the price at which Sprint alone was trading before the deal was announced? Sure, since then Sprint-Nextel reduced its market cap when it spun off its landline business as Embarq that was worth about $12.5 billion in equity and debt, but clearly the shares have suffered as the merged companies have struggled.

First of all, the difference between AT&T buying the rest of the integrated Cingular network and Sprint buying Nextel was that AT&T bought more of what it already owned. Sprint bought not only a different corporate culture but also a very different customer base and technology. It's the difference between marrying someone you sat next to in college versus marrying a mail-order bride who doesn't even speak your language. But while wedding bells were chiming, Sprint executives saw only a happy marriage and overlooked the inevitable pitfalls ahead.

The marriage has been rocky. Until the most recent quarter, Sprint-Nextel had been losing subscribers, and even in the last quarter which for the first time showed a slight increase in subscribers (16,000) that number is piddling compared to the 1.5 million new subscribers Verizon claimed. Worse yet, not all subscribers are equal, and Sprint-Nextel was having its biggest retention problems with Nextel customers, who tended to generate higher Average Revenue Per User than the old Sprint customers. Nextel had catered to high-end corporate and government clients who used more billable minutes and relied on their cell phones for data transmission, a more expensive service. The Sprint customer base consisted primarily of individual consumers, and many of them were on pre-paid accounts, a relatively low-margin business. Why were Nextel customers bailing? Sprint and Nextel used different technologies that to some extent were incompatible, which hurt service and irritated them.

Sprint-Nextel projects that it will take as long as another four years to create a seamless transmission network, which means for now it must scramble to keep subscribers from canceling. Furthermore, in addition to the costs of making that happen, Sprint-Nextel has set out an ambitious plan to deploy WiMax, potentially a blockbuster next generation technology to WiFi, that permits wireless transmission of broadband signals from as far away as 31 miles. In theory, WiMax could leapfrog the need for fiber optic connections into homes and offices. Standard & Poor's wireless telecom analyst, Kenneth Leon, considers WiMax "will be a disruptive force to incumbent wireless carriers." Indeed, WiMax has the potential to be disruptive not just for existing wireless service but for cable and DSL broadband providers as well, since it can project broadband without the need for the socalled essential"last-mile" hardwire into homes and offices consumers currently require. For Sprint Nextel, which will be the first of the majors widely to deploy this next-generation technology that extends wireless networks from current wifi's 1000' foot range to up to 31 miles, the costs will consume $800 million of the $8.5 billion planned capital expenditures in 2007, and much more in following years."

To reserve bandwidth for WiMax, Sprint-Nextel partnered up with Comcast, Time Warner Cable and Advance/New House Communications to bid $2.4 billion in the most recent FCC broadband auction of radio frequencies. All of this new capacity is located in large cities, exactly where Sprint-Nextel's cable partners are competing against AT&T and Verizon to sell bundled service that includes not just TV, Internet and telephone, which the cable companies already offer, the so-called triple play, but also cell phone access, the four-way play. Indeed, some have speculated that Comcast is interested in more than just a partnership with Sprint-Nextel, and might bid for it to lock up exclusive control of its wireless network.

For that matter, rumors about Sprint-Nextel's attractiveness to bigger acquirers recur: a foreign telecom company that wants to enter the U.S. market or even an Internet company that wants to add to its content the means to communicate it. We're aware of the talk, and ignore it, since it is the fundamental cheapness of Sprint-Nextel that attracts us and makes it a subject for takeover rumors. Let's look at where S stands in terms of historical valuations.

There is no point in looking at the Price/Earnings ratio, since management is pouring cash into integrating Nextel and preparing for WiMax, which minimizes what reaches the bottom line. However, other ratios are compelling. Price/Cash Flow is at 5.8, Price/Sales is at 1.4, and Price/Book Value is 1. Historically, Sprint reached these low ratios at bottoms in its stock price. The balance sheet, despite the costs incurred in acquiring and integrating Nextel, remains healthy, and management is buying back shares at prices we think are cheap, an excellent use of cash flow. We recommend buying S up to $24.

BOSTON SCIENTIFIC AND GUIDANT

Boston Scientific, which was this January's recommendation, had made a rational strategic decision to broaden its business from being seen solely as a maker of stents to include heart-rhythm devices when it acquired Guidant, the second largest maker of defibrillators, pacemakers and other gizmos to restore or keep hearts beating at proper rates. Unfortunately management was so intent on making the deal that they paid an irrational price not just in dollars but in concessions that have resulted in a busted stock.

Sound Advice on Three Busted Acquisitions

On December 2, 2005, the eve of jumping into a bidding war with **Johnson & Johnson** for Guidant, BSX shares traded at $27.33 and the company had a market cap of approximately $22.4 billion with total debt of $2.5 billion. Less than two years later, BSX trades at $13.20 and has a market cap of $19.7 billion with total debt of $8.9 billion. Given that Boston paid $27.5 billion for Guidant, even if we use the lowest price offered by JNJ that Guidant accepted—$23.5 billion including debt—the present price of BSX implies that Boston Scientific is an unredeemable disaster. We disagree. Instead, we see an opportunity to buy Boston Scientific at a low point for the company at a bargain price and to get as a bonus Guidant's rhythm monitoring business for almost nothing.

BSX IN ICU

How did Boston Scientific end up in the Intensive Care Unit? BSX became one very hot stock beginning in May 2001 when we first recommended it to subscribers. Shortly thereafter, BSX surprised competitors by bringing its drug-coated stent to the U.S. market, making it and **JNJ** the only providers of these cutting-edge devices. Until their introduction, patients who received uncoated stents often experienced restenosis, the renarrowing of vessels where stents had been inserted. Stents coated with drugs to reduce inflammation and restenosis were expected to alleviate much of the problem. BSX saw its stock shoot up from $8 (adjusted for a 2:1 split) when we featured it to a high of $44 in mid-2004, at which point investors decided that the stock of a company that essentially had one blockbuster product, the drug-coated stent, was too pricey. By the time Boston Scientific's management decided to correct that weakness with an acquisition the shares had declined nearly 40% from their high.

Guidant as well had its problems by the time Boston Scientific bought it. Indeed, Johnson & Johnson, which in December 2004 had offered to buy Guidant for $73 a share, reduced that offer to $63 after Guidant reported that 26 of its implanted defibrillators had failed, and in one case resulted in death. More problems with pacemakers followed, and eventually Guidant had to withdraw 56% of its installed devices. Eventually, after Boston Scientific and JNJ tried to outbid each other, BSX topped JNJ's final offer of $24.2 billion—just 5% less than its original bid for an unimpaired Guidant—with an $80 a share offer or $27.2 billion.

The market immediately judged Boston Scientific had overpaid, and dropped BSX shares by 24% within a month after its bid had prevailed. And that was before the really bad news started. Since then Guidant continued to have manufacturing problems, and the use of heart rhythm devices in general diminished as patients and physicians became anxious about their reliability. Meanwhile, drug-coated stents came to be doubted after a volley of consistently negative research was published last year that suggested drug-coated stents as compared to the older bare stents resulted in higher incidents of heart attacks and deaths. Drug-coated stent sales plummeted. In short, by the time we recommended Boston Scientific in January, shares were just above $18, and the valuations were compelling. We noted that valuations at that point were at levels that in the past had coincided with price bottoms for BSX.

As it turned out, unlike SYMC and S, which have gained a bit since introduction, BSX shows that what is cheap can get cheaper, and now we are looking at even lower valuations. At this point, the question becomes not how cheap BSX is but what evidence exists that circumstances are improving. First, Guidant seems to be getting back on track after having settled a significant portion of its legal problems, and has received FDA approval to restart production and is primed to introduce new products. Recently, the same Swedish researchers, who had produced the most damaging preliminary reports about risks associated with drug-coated stents, have concluded based on much more complete data that the original concerns were not warranted, which should reassure cardiologists and patients. Also, though Boston Scientific's current generation of drug-coated stents is a step behind what will soon be introduced by Abbot Labs, BSX has a license to sell its own version of that stent, and is making excellent progress in bringing out the next generation of its own design. Finally, though it gets little attention, Boston Scientific is building a nice business in endosurgical tools used in minimally invasive surgery, and even had considered spinning it off to help reduce debt.

When does all this translate into higher earnings and stock price? We can't say, but we believe that the August lows for the shares represent a hard bottom. Earlier this year, **Dodge & Cox**, the most successful mainstream value investment fund family we know, began to buy BSX at higher-than-current prices. Buying busted stocks is a lonely business, so we appreciate such compatible company. We would be a buyer up to $16. ***SA***

Portfolio Updates

The closing day for this month's portfolio, September 7, opened with a thud when worrisome non-farm job numbers triggered anxiety about recession. On the day, the Dow was off 1.9% as was the Nasdaq, while the S&P ended down 1.7%. For the entire month, the Dow was down 1%, while the S&P ended flat, and the Nasdaq eked out a 0.8% rise. The *Sound Advice* portfolio was off 0.8%.

Whole Foods Markets, the August recommendation, bucked the trend, adding 2% as it completed the acquisition of Wild Oats, which the FTC had blocked for months. WFMI has a full plate now, continuing its own expansion and digesting the Wild Oats locations, some of which will be closed and most others will be turned into mini-versions of the grander Whole-Foods-style stores. Provided the public continues to be concerned about the safety and quality of what we eat—which seems likely—and Mackey can continue to spread the gospel of healthy eating at premium prices, WFMI will prosper.

Among the few sectors to show strength were oils and energy service, which in part reflects global growth and in part dollar weakness. **Royal Dutch** jumped 7.7%, ditto **Transocean**, and **Icon Energy Fund**, weighted toward the service sector, was up 7.1%. Oil closed today at pennies under $77 on anxieties over potential unrest in Nigeria and cat-and-mouse saber rattling between Syria and Israel. It doesn't help that the sixth anniversary of 9/11 is just days away. Natural gas, however, did not participate in the rally, and **EnCana** ended the month down 1.5%. We are partial to energy, but think that the natural gas stocks are the most attractive right now. Even without a hurricane to disrupt the Gulf of Mexico production, we expect to see higher prices as fall's cooler weather sets in.

Other commodities had a mixed performance. **Anglo-American**, which has resumed using the ticker symbol AAUK now that it has completed the spinoff of some of its businesses, added 5.5% despite getting clobbered when the market fell sharply on our last day. Indeed, energy stocks along with metals were weak today, which suggests that recession fears are breeding worries that it's not just the U.S. economy which would weaken. Hence, we saw **CSX** drop for the month. <u>We have done well with CSX (+155% over six years), and are selling it now</u>. **American Century Global Gold Fund** roared back on the strength not just of geopolitical concerns but also on the weakness of the Greenback. BGEIX added 2.2%. However, **Coeur d'Alene** faltered again, as its company specific problems tripped it up. Though we believe Coeur eventually will prevail over its problems, their persistence has convinced us to <u>sell CDE</u>. We suggest you move your money into BGEIX.

Food stocks split: **ConAgra** gave back 1.7% while **Sara Lee** gained 3.5%, <u>We are selling CAG from the portfolio</u> both because it has realized the potential we saw in it when initially recommending the shares and also because we want to slim down the portfolio. SLE and ConAgra both needed to reorganize sprawling businesses, and CAG started earlier and had the easier task. Sara Lee is just now getting its legs after spinning and selling off not only some of its food businesses but also its extensive clothing lines and other peripheral divisions. We think it has the greater potential. **Coca Cola Enterprises** added 1.5% and our other bottler, **Molson Coors**, did even better, tacking on 7.9%. **Agrium**, the fertilizer company, straddles both food and energy (it uses natural gas as a feedstock for its nitrogen fertilizers, and benefits from cheaper western Canadian natural gas prices), and was our best performer this month, up 12.9%.

Healthcare had some of our best and worst performers. **Odyssey Healthcare**, the hospice service provider, continues to lose ground without any particular news since the last quarter's poor results, which reflected problems we recognized going in. ODSY dropped 13%. **Schering-Plough** added 8.6% and

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Sound Advice Portfolio for September 2007

Income With Growth	Symbol	Exchange/ Phone	Price/ N.A.V.*	Yield**	Buy Limit	ACTION
HRPT Properties	HRP	NYSE	$9.55	8.80%	$11.50	BUY
Diversified Growth					.	
Agrium	AGU	NYSE/TSE	$46.73	0.24%	$47.00	BUY
American International	AIG	NYSE	$63.55	0.79%	$75.00	BUY
Boston Scientific	BSX	NYSE	$13.21	0.00%	$16.00	BUY
Coca-Cola Enterprises	CCE	NYSE	$24.03	1.00%	$26.00	BUY
ConAgra	CAG	NYSE	$25.52	2.82%	N/A	**SELL**
CSX Corporation	CSX	NYSE	$40.19	1.00%	N/A	**SELL**
Disney	DIS	NYSE	$33.59	0.92%	$37.00	BUY
Dodge & Cox Intl.Fund	DODFX	800-621-3979	$46.94	1.21%	N/A	BUY
Excelsior Value & Restructuring	UMBIX	800-446-1012	$55.49	0.87%	N/A	BUY
Fastenal	FAST	NASDAQ	$43.48	0.97%	$50.00	BUY
Fidelity Japan Fund	FJPNX	800-544-8888	$16.92	0.00%	N/A	BUY
Gabelli Global Telecom	GABTX	800-422-3554	$25.73	0.54%	N/A	BUY
Honeywell	HON	NYSE	$54.71	1.66%	$64.00	BUY
Insituform Technologies	INSU	NASDAQ	$15.86	0.00%	$20.00	BUY
Johnson & Johnson	JNJ	NYSE	$61.68	2.43%	$69.00	BUY
Liberty Capital	LCAPA	NASDAQ	$114.28	0.00%	$130.00	BUY
Mattel	MAT	NYSE	$21.30	3.05%	**$26.00**	BUY
Microsoft	MSFT	NASDAQ	$28.44	1.41%	$34.00	BUY
Molson Coors Brewing	TAP	NYSE	$89.24	0.92%	$100.00	BUY
Newell Rubbermaid	NWL	NYSE	$25.37	3.31%	$32.00	BUY
New York Times Co.	NYT	NYSE	$21.26	3.29%	$27.00	BUY
Odyssey Healthcare	ODSY	NASDAQ	$9.57	0.00%	**$12.00**	BUY
Perrigo	PRGO	NASDAQ	$21.16	0.85%	$23.00	BUY
Sara Lee	SLE	NYSE	$15.97	2.50%	$20.00	BUY
Schering-Plough	SGP	NYSE	$29.54	0.74%	$37.00	BUY
Sony	SNE	NYSE	$47.31	0.45%	$59.00	BUY
Sprint Nextel	S	NYSE	$17.96	0.56%	$24.00	BUY
Superior Industries	SUP	NYSE	$19.25	3.32%	$24.00	BUY
Tetra Tech	TTEK	NASDAQ	$21.18	0.00%	$26.00	BUY
Third Avenue Value Fund	TAVFX	800-443-1021	$61.57	5.42%	N/A	BUY
United Parcel	UPS	NYSE	$74.13	2.05%	$82.00	BUY
Wal-Mart Stores	WMT	NYSE	$42.39	1.58%	$52.00	BUY
Whole Foods Markets	WFMI	NASDAQ	$43.13	1.58%	$48.00	BUY
WisdomTree Dividend Top 100 Fd	DTN	NYSE	$58.41	3.16%	N/A	BUY
Xerox	XRX	NYSE	$17.02	0.00%	$21.00	BUY
Energy/Natural Resources						
American Cent. Gold Fund	BGEIX	800-826-8323	$19.23	0.26%	N/A	BUY
Anglo-American PLC* **	**AAUK**	NASDAQ	$28.21	3.47%	$36.00	BUY
Coeur d'Alene	CDE	NYSE	$3.50	0.00%	N/A	**SELL**
EnCana	ECA	NYSE/TSE	$59.01	1.02%	$75.00	BUY
Icon Energy Fund	ICENX	800-764-0442	$39.68	8.47%	N/A	BUY
Plum Creek Timber	PCL	NYSE	$40.53	3.95%	$46.00	BUY
Royal Dutch Petroleum	RDS.A	NYSE	$79.85	3.07%	$87.00	BUY
Transocean	RIG	NYSE	$108.52	0.00%	$112.00	BUY
Aggressive Growth						
Comcast	CMCSA	NASDAQ	$25.00	0.00%	$30.00	BUY
Discovery Holdings	DISCA	Nasdaq	$25.41	0.00%	$27.00	BUY
Electronic Data Systems	EDS	NYSE	$21.93	0.91%	$30.00	BUY
Getty Images	GYI	GYI	$30.95	0.00%	$42.00	BUY
Liberty Global	LBTYA	NASDAQ	$41.34	0.00%	$50.00	BUY
Maxim Integrated	MXIM	NASDAQ	$30.05	1.89%	$38.00	BUY
Mitsubishi UFJ Financial	MTU	NYSE	$9.14	1.04%	N/A	**SELL**
The Prudent Bear Fund	BEARX	800-711-1848	$6.01	1.66%	N/A	BUY
Symantec	SYMC	NASDAQ	$17.87	0.56%	$22.00	BUY
Time Warner	TWX	NYSE	$18.37	1.20%	$24.00	BUY
Western Digital	WDC	NYSE	$22.37	0.00%	$25.00	BUY

Prices as of the market close on Friday, September 7, 2007
****Yield represents all distributions during current calendar year divided by share price.***
*****Anglo-American resumed using AAUK as its ticker symbol***

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

Johnson & Johnson 1.6%. Along with JNJ, **Boston Scientific** benefited from more positive news on the benefits of drug-coated stents (see page six) and added 1%. Even **Perrigo**, which ended down 1.7%, spent the month recovering from investors' petulant response to very good results for the quarter. We think PRGO remains underappreciated.

As the drop in CSX suggests, nearly anything associated with economic growth had trouble. **Tetra Tech** dropped 11%, though our other infrastructure position, **Insituform**, ended microscopically up, which is OK in a month like this. **Fastenal** gave back 8.7% and **Wal-Mart** 7.5%. **Mattel**, which seems to recall China-produced toys every week, dropped 7.6% as investors try to calculate the dollar and reputational costs of MAT's failure to monitor its suppliers.

Outside the U.S. we had mixed results: **Dodge & Cox International Stock Fund** added 1.3% and **Gabelli (GAMCO) Global Telecom Fund**, which has more exposure outside the U.S. than domestically, tacked on 5%. However, Japanese stocks were weak. **Fidelity Japan Fund**, which has a new non-Japanese manager, dropped 3.1% and **Sony** 1.4%, while **Mitsubishi UFJ Financial** fell 8.1%. Though we think Japanese banks eventually will benefit when the central bank starts to raise rates seriously and lets the Yen rise, its stubborn refusal to slacken off the artificial stimulants it has relied on in nursing their economy out of disinflation, we've had enough, and will take our long-term triple-digit profit and move on. We are selling MTU.

Technology stocks, though clearly associated with growth, sported a few good performers. **Western Digital** benefited from Seagate's optimistic projection, and added 10%, though **Microsoft** dipped 0.6% and **Symantec** was unchanged. **Xerox** recovered from last month, adding 5.9%. **EDS** dropped 5%. Among media stocks, the **Liberty Media** offspring were consistently strong: **Discovery Holdings**, our best performer for the year (+58%) tacked on another 3.4%, **Liberty Global**, the cable company working in Latin America, Europe and Asia, added 1.8%, and **Liberty Capital**, the holding company, crept up 0.8%. **Disney** added 1.3%, though **Time Warner** dropped an equal amount. Until TWX can extract profits consistently from its AOL arm, the parent company will not reach the full value we think it deserves. ***SA***

The Sound Advice Market Indicators

The Diffusion Index of Lagging Indicators gives "Sell" 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 38 percent of the indicators are above their levels of six months earlier.

The Diffusion Index of Leading Indicators gives "Buy" 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 a "Buy". 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 above. Between each "Buy" signal and each "Sell" signal, the S&P 500 rose substantially without exception. The average gain was 32 percent, not counting dividends. On an annualized bases the gain was 17 percent per year. Confining stock investing to these times would have produced substantially more profits than a single buy-and-hold strategy.

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

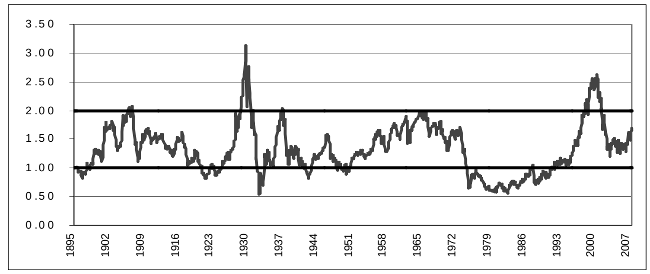
During the intervening periods between "Sell" signals and "Buy" signals, the market was all over the place — sometimes crashing, sometimes meandering, and occasionally advancing. On average, the S&P 500 increased 6.8 percent during these times. On an annualized basis, not counting dividends, the gain was a paltry 0.6 percent per year, a return that could have easily been beaten many times over with safe investments such as

Sound Advice Market Indicators for September 2007

Treasuries, short-term bonds or other low-risk investments.

To assess whether a market crash is likely after a "Sell" 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 “Sell" 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 “Buy" 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 percent.

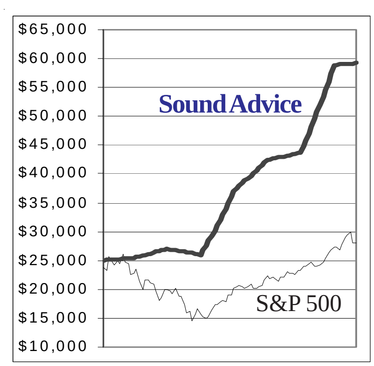
Conversely, the market does not suffer lasting declines after “Sell" signals when the risk level is low. For example, the “Buy Signal” in November 1974 was one month from the bottom of that bear market, and came at a time when the Risk Indicator was below 1.0. Consequently, this “Buy" signal also marked 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 “Sell" 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.



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 1.59.

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 recommend remaining fully invested in the ***Sound Advice*** model portfolio at all times. We use the ***Sound Advice*** Market Indicators to influence our approach and nature of our recommendations. When “sell” 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 “buy” 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 (110% more profits than the S&P 500 since 1/1/2000). The chart below shows how *Sound Advice* recommendations have performed over time versus the S&P 500. ***SA***



Since 1-1-2000

Sound Advice versus the S&P 500

An Investment of $25,000 becomes:

Start Date	S&P 500	Annual Return	Sound Advice*	Annual Return	Advantage Over S&P
From 1/1/2000	$28,108	1.6%	**$59,229**	**12.0%**	**$31,121**
From 1/1/2003	$45,041	13.6%	**$56,726**	**19.6%**	**$11,685**
From 1/1/2006	$30,070	12.2%	**$33,757**	**20.9%**	**$3,687**

* These returns assume an equal amount is invested in all ***Sound Advice*** Model portfolio positions at the time of the initial recommendation.

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