

The Kaput Fed Put

As we all know, one of the strongest forces on the stock market is the Federal Reserve because its policies influence the level and direction of interest rates. Since the 2008-09 financial crisis, we have been investing in stocks and bonds with the wind at our back; the advantage of the so-called “Fed Put”.

A “put” option is a financial tool that offers insurance against a downward move of a given security. It allows the holder to sell (“put”) a security at a pre-determined price, even though the price of the security has dropped.

Since the 2008-09 financial crisis, the Federal Reserve has been providing insurance against a potentially falling stock market by lowering interest rates and instituting its massive bond-buying programs collectively known as quantitative easing (QE). This aggressive expansionary monetary program has become known as the “Fed Put”.

From the late November release of the minutes from the Federal Reserve’s October meeting, we read that Federal Reserve officials agreed that no more interest rate cuts will be necessary. The meeting summary stated that interest rates are low enough “to support the outlook of moderate growth, a strong labor market, and inflation near the Committee’s symmetric 2 percent objective.”

This means that we will no longer be investing with the advantage of the Fed Put pushing up stock and bond prices. The Fed Put is kaput.

Of course, the Federal Reserve is standing ready to change its policy when there is a significant change in the economy, or perhaps a perceived change in economic expectations caused by extraordinary events. With the market extended into all-time high territory, it is highly unlikely that any such changes would be good. If the economy slows, fears of an upcoming recession would be stoked (again). On the other hand, if continued economic strength begins pushing up inflation, interest rates would rise which would reverse the favorable forces we have been enjoying from the Fed Put.



Gray Cardiff, Editor

The *Sound Advice* model portfolio is in a defensive posture and hedged to reduce risk. It is up 10.3 percent so far this year.

Investment returns in prior years have been calculated independently by the Hulbert Financial Group and concur with ours. They are as follows:

From 2000-2018
9.5% Annually versus.
2.8% from the S&P 500

The Portfolio

With the markets at extended levels, we believe it is a dangerous time. The S&P 500 stocks are expected to earn \$158.80 in 2019. With the S&P 500 index at 3140.98, the price/earnings (P/E) ratio is still close to 19.78, substantially higher than at the peak of the previous bull market when it was 17.09 at the end of the third quarter of 2007.

Our *Sound Advice* Diffusion Index of Lagging Indicators (page 11) is still giving us a Caution Signal by revealing that the economy is strong enough to put upward pressure on interest rates. Our *Sound Advice* Risk Indicator (page 10) remains substantially above 2.0, revealing that it is a very high-risk time for stocks. Accordingly, our investing approach continues to be defensive.

We continue to recommend that you keep a substantial amount of cash on the sidelines. We cannot tell you how much, because we are not familiar with your particular financial situation, but it should be substantial to you. All recommendations are summarized in the table on page 9. This table is updated and live on our website.

Our portfolio recommendations are made regarding the money you have allocated to the stock market, and in accordance with our current cautionary mode. We believe our selections are exceptionally strong values; trading at a significant discount to the rest of the market, which should give them buoyancy in both good and bad market conditions over the longer term. To add downside protection, we continue to recommend hedging your portfolio.

ProShares UltraShort S&P 500 (SDS) essentially short-sells the market and will benefit from down-drafts in the S&P 500. It is designed to produce two times the daily fluctuations of the S&P 500 index. A decline of say, 1.0 percent in the S&P 500 will cause SDS to increase by 2.0 percent. Conversely, an increase in the S&P 500 will cause SDS to decline in the same fashion. We have been tracking SDS and confirmed that it is performing as it should, with daily premiums and discounts within 0.5 percent. It is also very liquid.

Real Estate Selections

The *Sound Advice* portfolio only includes real estate stocks offering an extraordinary value now. An established method of evaluating real estate is to measure the cash yield before any debt service. In real estate parlance, this is called a capitalization (cap) rate. Like a bond yield, a lower cap rate means a higher asset price. Currently, a cap rate of 7 percent is considered reasonable for the quality and location of the properties held by our recommended companies.

Real Estate Preferred Stocks

We are recommending three preferred stocks because they are inherently defensive and are yielding above 6 percent. They have first claim to the company's cash flow for their dividends. Only after the preferred dividend is satisfied, can the remaining cash flow be used to pay the dividend on the company's common stock. Additionally, these are *cumulative* preferred stocks, which means that any missed preferred dividends must be paid in full first before common stock dividends could be paid.

Like most preferred stocks, the number of outstanding shares is relatively small, which means the daily trading volume is also relatively small. We recommend using limit orders that specify your purchase price (instead of market orders which can be executed at any price). Because the volume is light, there is usually a large spread between the "bid" and "ask" price. Placing your price close to the midpoint usually works, or you can place your limit lower and wait for a price dip. We also recommend being patient with your purchase. It could take a while to fill.

RPT Realty 7.25% Series D Cumulative Convertible Perpetual Preferred is a convertible preferred stock, convertible into 3.6711 shares of the common stock (RPT). The conversion value of the common stock is

close to the price of the preferred stock, which gives the preferred stock nearly the same upside as the common stock. The annual dividend is \$3.62 which provides a yield of 6.2 percent.

The value of RPT's real estate portfolio is \$2.45 billion. Adding the company's other assets and subtracting its liabilities leaves an equity of \$19.48 per common share (RPT). Currently RPT is trading at a 25.6 percent discount to that value.

The Company

RPT Realty is a real estate investment trust (REIT) currently owning 49 shopping centers across the eastern US, consisting of town center, urban-infill neighborhoods, and power center properties with national chain store tenants, market-leading supermarket tenants, as well as a strong lineup of smaller national retailers. Centers also include entertainment components, including theaters, fitness centers, and restaurants.

Although the company has been operating for 60+ years, it is under new management. Its name was changed one year ago, from Ramco-Gershenson Properties Trust, after the departure of Dennis Gershenson, who served as the company's President, CEO, and Chairman of the Board. The company's culture and business objectives have changed since new management took over. The new CEO, Brian Harper, and his new executive team is repositioning the company's portfolio of shopping centers by selling off those which are not scalable, or in less desirable locations, while expanding those in the best locations.

The company is also modernizing its shopping centers by seeking retailers that successfully meld on-line services in concert with brick-and-mortar locations, offering online sales with options to pick up in the store. Most retailers, both small and large (such as Amazon groceries) are finding they need an on-line presence with delivery options from a nearby retail location. The new strategy is also aimed at securing more tenants that will drive visits to the center several times a week, such as fitness centers including Equinox and SoulCycle, salons including Sephora and Ulta, as well as restaurants and movie theaters.

Unlike most preferred stocks, **RPT Realty 7.25% Series D Cumulative Convertible Perpetual Preferred** does not have a call feature, which is why they are "Perpetual." Each share has a "liquidation preference" of \$50 per share in the event the company is liquidated

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due to bankruptcy, but that preference does not allow the company to call (redeem) the preferred shares. However, the company does have the right to convert the preferred shares into common shares if the common stock rises above 130 percent of the conversion price, which means the common stock would have to rise above \$17.28 per share. At that price, the conversion value would raise the price of the preferred above \$65. In the event such a conversion took place, a decision could be made at that time whether to keep the common stock or not.

Its ticker symbol varies depending on the device you are using or the brokerage service. It is often quoted as RPT.PD, but on the iPhone it is RPT'D, and Fidelity uses RPTPRD. In any case, this is the only RPT preferred stock for RPT Realty.

RLJ \$1.95 Series A Cumulative Convertible Preferred Shares is a strange but interesting Preferred stock. Its ticker symbol varies depending on the device you are using or the brokerage service. It is often quoted as RLJ.PA, but on the iPhone it is RLJ'A, and Fidelity uses RLJPRA. In any case, this is the only RLJ preferred stock, and it came from RLJ's acquisition of Felcor Properties.

Normally, preferred stocks have a call provision whereby the company can buy them back at a certain price (par value) at a certain date (call date). However, this preferred does not have this provision. Out of the hundreds of preferred stocks trading on the exchanges, there are only a few without call provisions, and this is one of them. The fact that it is not callable means this stock has unusual upside potential.

The only way the company could redeem this preferred stock is if RLJ common rose to \$115.82 per share. In that event, the company could exchange 0.286 common shares for each share of preferred. That would require an enormous rise in RLJ from its current price which would take a long time under the most bullish scenarios. The value of this preferred would rise to \$32.50, a substantial increase from the current price. We are not expecting such a meteoric rise in the foreseeable future. Instead, the upside potential comes from a drop in the yield on this preferred, which is highly likely.

This preferred stock pays \$1.95 annually per share (which must be paid before the common stock dividend) providing a yield of 6.8 percent. If the yield drops to, say 5 percent, which would still be a good value, the price of this preferred would rise substantially because there is no call provision. At a 5 percent yield, the price of this stock would be \$39 per share, a 37 percent increase. Meanwhile, the yield is excellent. It is also quite secure.

Hersha's Preferred D is callable on 5/31/2021, which can be exercised later at the company's option, at \$25

per share. The annual dividend is \$1.64 per share which provides a yield of 6.6 percent. Ticker symbols also vary from HT.PD, HT'D for an iPhone, and Fidelity uses HTPRD. We recommend using a limit order at or below \$25 and waiting to let the market come to you. To pay more than \$25 would reduce your overall return.

Real Estate Common Stocks

In addition to their preferred stocks, we are also recommending the common stocks of **RLJ Lodging Trust (RLJ)** and **Hersha Hospitality (HT)** which are in the hospitality industry.

A major drag on this industry has been the proliferation of Airbnb and similar competition. However, this is changing in major metro areas. New York City is the most recent to pass a measure prohibiting transient rentals of fewer than 30 days at a time without the host being present. San Diego, Los Angeles, San Francisco, Boston, Washington DC, Philadelphia and Miami have also passed similar measures.

RLJ Lodging Trust (RLJ) is worth \$33.86 per share which is substantially higher than the current price. RLJ has a large and diversified portfolio, with 151 hotel properties with 28,800 rooms located in 25 states and the District of Columbia. The majority are located in business districts within major metropolitan areas where business travelers represent the majority of the demand. We believe the net operating income (and thus the value of the stock) is primed to improve as the company executes its mission to sell its non-core assets since the August 2017 merger with FelCor, and to renovate and upgrade significant properties.

Hersha Hospitality (HT) is worth \$22.23 per share, substantially greater than the current price of the stock. Net operating income from the real estate portfolio is bound to increase from major renovations to hotels in Philadelphia, Boston, and New York, along with the ramp up at Cadillac and Parrot Key after the 2017 Florida hurricanes. Of course, increases in net operating income will also increase the net asset value of the company's portfolio along with the value of the stock.

Real Estate Mutual Fund

Third Avenue Real Estate Value Investor Fund (TVRVX) is a global real estate fund which means it is not confined to US real estate with low cap rates. Management looks for growth more than current income by focusing on real estate operating companies which, unlike REITs, can reinvest profits back into the business. Management also searches for opportunities in different aspects of a real estate company's capital structure by investing in senior debt in addition to equity. Also, unlike the typical REIT, management will go to cash when asset prices are generally high. Cash is preserved for scooping up opportunities.

Hospitality REITs Comparison Table

Company	Symbol	Recent Stock Price	Dividend Yield	Stock Market Cap Rate	Portfolio Value @ 7% Cap Rate (\$Millions)	Stock Value	Discount (-) Premium (+)
RLJ Lodging	RLJ	17.09	7.7%	11.4%	7,684	34.58	-50.6%
Hersha	HT	14.18	7.9%	8.3%	2,378	23.60	-39.9%
Service Properties	SVC	23.29	8.8%	12.3%	12,418	55.98	-58.4%
Host Hotels & Resorts	HST	17.49	4.6%	10.0%	21	26.27	-33.4%
Apple Hospitality	APLE	16.26	7.4%	8.6%	6,372	21.59	-24.7%

The table above shows the “Stock Market Cap Rate” (what the stock price is paying for the underlying real estate portfolio) for several comparable hospitality stocks. The “Stock Value” column shows the current value of the stock assuming the underlying portfolios are valued using a cap rate of 7.0 percent, which is close to the average cap rate on recent hotel transactions. The last column shows the discount or premium at which the stock is trading based on a 7.0 percent cap rate valuation of each company’s real estate portfolio.

Service Properties (formerly Hospitality Properties - HPT) is trading at a large discount. However, this company is externally managed by RMR which charges high fees and suppresses value. As long as RMR continues to externally manage HPT, we do not expect to see significant growth. **Host Hotels and Properties (HST)** is very small, with only 749 thousand shares outstanding, which may lead to excessive volatility. Growth may be limited by its small capitalization.

This fund is loaded with good values substantially below their net asset values (NAV) with strong growth prospects. Management has a similar approach to ours because it is very price conscious, especially in relation to net asset value. Just as we do at *Sound Advice*, they eat their own cooking – they invest a substantial amount of their personal assets into their funds.

Energy & Natural Resource Selections – Common Stocks

Chevron (CVX) is poised for production growth of 3 percent or more during the next several years from its holdings in the Permian Basin as well as from its massive Australian projects. Of course, how this translates to earnings depends on oil prices. Because Chevron is constantly lowering its production costs, and as long as oil prices continue to meander in the vicinity of today’s price, earnings growth is likely to grow in the vicinity of 6 percent.

As we point out regularly, Chevron is an integrated oil company, which means it has operations in production as well as refining. This gives CVX diversification because the company’s oil and gas production (upstream) benefits from rising oil and gas prices while the refining operations (downstream) tend to benefit from lower oil prices. This diversification adds financial stability during times of volatile oil prices. CVX has an attractive and sacrosanct dividend that provides an attractive yield. This means we can continue to expect annual increases in the dividend which is already providing an attractive yield.

Valero Energy (VLO) will benefit from new marine fuel regulations taking place in January requiring all vessels sailing in international waters to use the more environmentally friendly low-sulfur diesel fuel, which needs extensive refining and is more profitable for refiners. This new requirement is expected to boost annual demand for low-sulfur diesel fuel by four-fold beginning next year. Valero’s earnings are expected to jump from close to \$5.00 per share in 2019 to over \$9.00 next year.

Valero has the flexibility to refine substantial quantities of both US light sweet (low sulfur) as well as heavy sour crude, which bodes well for next year as well as the longer term. Valero also has access to the US pipeline network for delivery to its gulf coast locations. This flexibility allows the company to capture the highest margins among its competitors because it can take advantage of the temporary local gluts of crude, whether it’s low or high-quality crude, or light sweet or heavy sour, and receive the best discounts for its feedstocks.

Energy & Natural Resource Selections – Mutual Funds

Adams Natural Resources (PEO) is a closed-end fund, which means it trades like a stock and can be bought and sold during market hours. The price of PEO is not tied directly to the NAV of the underlying portfolio, so it can trade at a discount or a premium. This is an advantage now because PEO is currently trading at a substantial discount to its NAV. In addition, PEO also has a lower expense ratio of 0.78 percent, versus the industry average of 1.14 percent.

PEO is a candidate for steady income because it has an objective and recent history of making quarterly distributions that add up to at least 6 percent annually. These distributions are usually a mix of dividends and long-term capital gains. This fund has been in operation since 1929 and has 80+ years of distribution history.

Fidelity Select Natural Gas Fund (FSNGX) is an open-end fund which means it trades at the NAV of its portfolio set at the close of the market each day. It is a diversified way to participate in the growth of the natural gas industry through strong companies.

Natural gas provides the same energy as oil for pennies on the dollar, and natural gas is more environmentally friendly. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. However, with the current market price for natural gas at \$2.31 for one million BTUs, 5.8 million BTUs will cost \$13.40. Thus, with a barrel of Brent crude oil costing \$60, the same amount of energy is available for 22 cents on the dollar if it is in the form of natural gas rather than oil.

The updated chart shows the historic relationship between the costs of these two forms of energy. The red line shows the price of a barrel of oil since the mid-1970s. The green line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. The fact that natural gas provides energy for pennies on the dollar translates into an expanding natural gas industry.

Medically-Related Selections

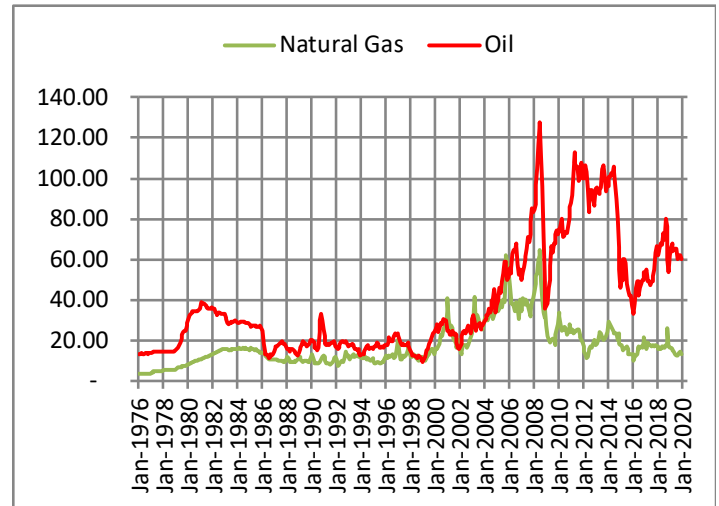
Both of our selections make medical devices and products which are well-suited for an aging population. They are defensive in nature because they are not largely dependent on economic conditions. They also avoid the current uncertainties over drug pricing and patent expirations facing pharmaceutical companies.

Boston Scientific (BSX) has been a global medical technology leader for three decades by providing a range of high-performance solutions aimed at addressing medical needs and reducing healthcare costs. The company's stream of new inventions acquisitions continues to add to promising growth prospects.

The latest November announcement was regarding positive test results for two devices within the peripheral drug-eluting product portfolio, including the Drug-Coated Balloon (DCB) as well as from the Eluvia Drug-Eluting Vascular Stent (DES).

Stryker (SYK) provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine

The Cost of Energy Equivalents of Oil and Natural Gas



products. Its orthopaedic devices for artificial knees and hips lead the industry. SYK has a very high return on equity which is propelled by its strong balance sheet and its ability to make strategic acquisitions.

The latest acquisition in November was for Wright Medical for \$5 billion with a targeted close in the second half of 2020. Stryker believes the acquisition will bring cost reduction synergies within the next few years and will introduce an innovative product line, eventually combining with Stryker's prior acquisition of the MAKO robotic platform, offering the best shoulder implants in the industry.

The Best in Biotech ETFs

Biotech companies offer the most explosive profits in the healthcare industry. Biotechnology has become a major industry and the source of the world's top breakthrough drugs. However, stocks of individual biotech companies are often volatile and can have unforeseen risks, which makes diversification essential. This diversification can be accomplished by investing in a diversified biotech electronically traded fund (ETF) investing exclusively in a portfolio of biotech companies. We are recommending two top performers.

ARK Genomic Revolution Multi-Sector (ARKG) is an actively managed biotech ETF investing in companies that are expected to benefit from extending and enhancing the quality of human life by incorporating technological and scientific developments and advancements stemming from mapping the human genome. Breakthroughs and advancements have cut the cost substantially of mapping the human genome which is opening up new opportunities and making this sector the cutting edge of new innovations.

Virtus LifeSci Biotech Products (BBP) is a passively managed biotech ETF that weighs the portfolio selections essentially equally, as opposed to weighing selections according to market capitalization. This is an important aspect because biotech ETFs weighing their portfolio selections essentially equally have been the best performers by far because they have larger investments in smaller biotechnology companies which are acquisition targets for large pharmaceutical companies looking for ways to revitalize their drug portfolios by scooping up smaller companies.

BBP tracks the performance of the LifeSci Biotechnology Products Index, which tracks the performance of biotechnology companies, and covers companies that design drugs ranging from entrepreneurial start-ups to global giants that have completed multiple human clinical trials and have received FDA approval to sell and market at least one drug.

Financials

It does not make sense that short-term bonds yield essentially the same as long-term bonds. Investors are getting very little for many years of additional risk. Such a flat yield curve is unusual and not a historical norm. The yield curve will not remain flat indefinitely. As it steepens, banks will prosper. That eventual return to historical norms is why these stocks present an extraordinary value.

JP Morgan Chase (JPM) is a good value, especially in comparison to the rest of the market. At the relatively modest P/E ratio of, say 14, JPM would be \$142 which is substantially above the current stock price.

Wells Fargo (WFC) is also a good value. At a P/E ratio of 14, WFC would be \$65, substantially above the current stock price. Growth has been flat, largely because of the Federal Reserve's limit on its asset growth as punishment for its shady business practices in recent years. The limit expires at the end of this year which should unleash better growth. Meanwhile, the bank has been buying back substantial amounts of WFC stock which is reasonable to expect to continue next year because of the company's relatively unleveraged balance sheet.

Small Caps

Numerous studies show that small caps perform better over the long run than the market as a whole. Small Caps are pure plays on the early stages of new industries and inventions. They have more dynamic and entrepreneurial management, and they are much more likely to be the target of an acquisition or merger, which is usually quite profitable.

Third Avenue Small-Cap Value Investor Fund (TVSVX) invests in companies with small capitalizations

using the same value-oriented approach as it does with its real estate value fund (TVRVX). Management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value, and the ability to consistently grow NAV, with an initial targeted holding period of three to five years. A patient and price conscious acquisition is a critical first step in both protecting capital and in realizing an attractive investment return.

Special Situations

The rest of our portfolio falls into other market sectors, with companies that are presenting extraordinary values within their respective industries. Here they are in alphabetical order.

Apple (AAPL) has risen sharply which makes it somewhat extended. The company has \$206 billion in cash in the company's coffers which amounts to \$46 per share. Subtracting this cash from the current price of \$267 per share means we are actually paying close to \$221 per share for the company. This puts the P/E at 18.6, based on the trailing 12 months earnings of \$11.89 per share. Although this is still less than the rest of the market, it is relatively high for AAPL and does not present a particularly good value. We prefer waiting for a pull-back to \$248 which would put the cash-adjusted P/E close to 17. Accordingly, we are recommending holding for now and not adding to current positions.

Carnival Cruise Lines (CCL) is very cheap, with a P/E close to 10, especially when compared to the rest of the market. Such a low P/E anticipates very little or no growth. During the last 5 years, the median P/E has averaged close to 19. At the reasonably conservative standard valuation of 15 times earnings, the stock belongs in the vicinity of \$66 per share.

CCL has long-term growth prospects because of the company's dominance in the industry, efficiencies of scale, favorable demographic trends driving a lasting increase in demand, the company's extensive share repurchase program, and last but not least, the value the stock price is currently presenting.

The company recently announced that it signed the agreement with the Norwegian marine battery supplier, Corvus Energy, to electrify its first cruise ship with a 10 mega-watt battery power supply. Providing the installation and operation goes well, it will serve as the prototype for Carnival's "Green Cruising" program. This would be a game-changer because the cost of oil is the company's largest and most critical operating expense.

Intel (INTC) has the size, diversity, and industry dominance, to make a relatively safe investment in a high-growth, and often high-risk business. Intel can leverage new technology into its existing large platform without introducing unacceptable risks. A history of

established cash flow and an attractive dividend, along with the currently low P/E ratio diminishes the risk profile of this stock.

International Business Machines (IBM) has settled back to its previous low-point, offering an incredible value. Even at a modest P/E of 12, the stock would be over \$153 per share. The \$6.00 per share dividend provides a 4.5 percent yield and a floor under the price of the stock. Any prospect of growth should propel the stock from here, and there are several prospects.

The Red Hat acquisition has launched IBM into the enormous and growing hybrid data center market, allowing customers to modernize legacy cloud services so that they can work on both private cloud platforms as well as public platforms including IBM Cloud, Amazon AWS, Microsoft Azure, Google Cloud, and even Alibaba. This so-called “hybrid multi-cloud” approach is in line with industry trends and should bring new growth to IBM.

Another driver of growth is the company’s so-called “Strategic Imperatives” which offers cognitive solutions through its artificial intelligence (AI) platform, it calls “Watson”, which can “think” like a human. Watson is incorporating massive databases into AI in a wide range of industries. Weather prediction through IBM’s The Weather Company is predicting less snow and rain in December than last year. This factor, along with economic data is leading Watson to expect holiday consumer spending to be up 4.07 percent compared with last year,

NCR Corp (NCR) reported third quarter earnings in November of \$0.76 per share, beating the consensus expectation of \$0.66 per share. NCR is now expected to earn \$0.74 for the coming quarter and \$2.78 for the current fiscal year. Even with the recent rise in stock price, the P/E is still only 12, far below the rest of the market.

NCR makes automatic tellers (ATMs), retail point-of-sale (POS) workstations, self-service kiosks, and other self-service checkout systems. 485 million people use NCR products every day, and there is room for substantial growth in the US and around the world.

NCR owns nearly three-quarters of the burgeoning self-checkout market. Using their smartphones, or a handheld scanner provided by the store, customers scan items from the shelves as they add them to their cart. At checkout, they input either device into the register, and it spits out the tally.

ETFs for Rising Bond Yields

Although bond yields have been rising in recent months, thirty-year treasury bonds have close to the same yield as short-term treasury bonds, which does not make sense.

Our recommended ETFs are essentially short-selling bonds and will prosper from rising bond yields. They differ in the amount of leverage used. You can choose among

them depending on your investment objectives and risk tolerance.

The **Direxion Daily 20 Plus Year Bear 3 Shares (TMV)** uses 3:1 leverage.

The **Proshares UltraShort Lehman 20 Plus Year Treasury (TBT)** uses 2:1 leverage.

The **Proshares Short 20 Plus Year Treasury (TBF)** uses no leverage.

The price action of these ETFs is based on the changes in long-term Treasury bond indexes, only in the opposite direction, and then multiplied by the leverage each ETF uses. For example, a decline of say, 1.0 percent in their respective benchmark bond indexes will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent.

Inflation is widely reported by changes in the consumer price index (CPI) on both goods and services which is becoming outdated. The services sector has become far greater throughout the world and now represents a majority of the world’s GDP. In the US, the services sector represents **80 percent** of GDP, and in this sector, inflation has been running higher than widely perceived. One of the Commerce Department’s economic indicators is the *Change in the CPI for Services*, which has been steadily logging in annual increases of 2.4 to 2.8 percent over the last seven months. The latest reading for October was a 2.9 percent annual increase.

Today’s low yields of 2.2 percent on long-term treasury bonds are not sustainable because they offer nothing in real terms (after adjusting for inflation). This has not been the case historically, as can be seen from the following table.

Years	30 Yr Note (Avg. Yield)	CPI Annual Increase	Real Rate
1980-84	12.0	7.6	4.4
1985-89	8.4	3.6	4.8
1990-94	7.7	3.7	4.0
1995-99	6.3	2.4	3.9
2000-04	5.7	2.6	3.1
2005-09	4.5	2.6	1.9
2010-14	3.6	2.0	1.6
2015-18	2.9	1.9	0.9
Average			3.1
Current Inflation Rate			2.0
Theoretical Target Yield			5.1
Average Since 2000			1.9
Current Inflation Rate			2.0
Theoretical Target Yield			3.9

We can see from history since 1980, that investors have demanded a real return of 3.1% on long-term treasury bonds. With today's inflation rate above 2 percent, 30-year treasury bonds should be yielding more than 5 percent. If we only look at recent history, since 2000, a low inflationary period, investors have demanded a real return of 1.9 percent. This would put the yield on long-term treasury bond yields close to 4 percent. Accordingly, even in a low inflationary environment, the yields on long-term treasuries are way too low and belong much higher. The stock market won't like a rise in bond yields because low bond yields have been propelling the stock market to today's heights.

The table below shows the impact on the prices of our selected ETFs at the end of 2020 at various long-term treasury bond yields. The first row shows today's ETF prices with long-term Treasury bonds yielding 2.2 percent. Note that the price of these ETFs would rise dramatically with yields at 4 percent, and even more so at 5 percent.

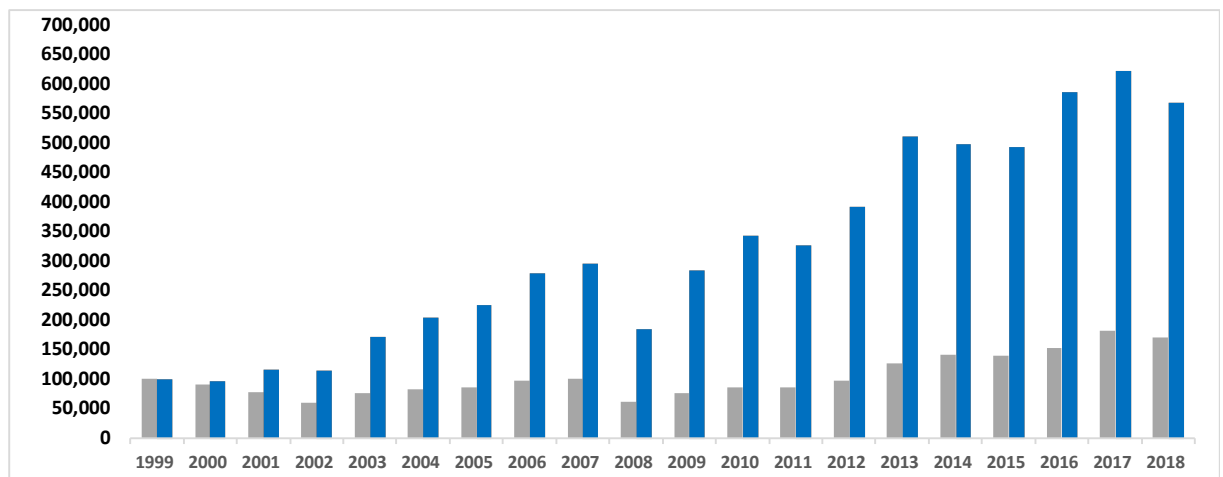
The Erosion Factor

As we point out regularly, these ETFs suffer from erosion because they decline slightly faster than they increase with an equivalent change in bond yields, particularly with higher leverage. To gauge this factor, we can assume that Treasury bond yields simply tread water, rising and falling by an unusually large amount, say, 0.03 percentage points (3 basis points) every day, and thus go nowhere. By the end of 2020, TMV would decline to \$10.15 (5.2 percent), TBT to \$24.26 (2.6 percent), and TBF to \$18.81 (0.9 percent). While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

Bond Yields	ETF Prices		
	TBF	TBT	TMV
2.20	19.07	25.06	10.83
3.50	22.99	35.35	17.50
4.00	24.82	40.99	21.69
4.50	26.75	47.37	26.75
5.00	28.79	54.58	32.86

Sound Advice vs the S&P 500

This chart shows the growth of \$100,000 invested in the S&P 500 (in gray), which would have grown to \$170,645, versus \$100,000 invested in the *Sound Advice* recommendations (in blue), which would have grown to \$561,174.



Hedges	Symbol	Price / NAV	Yield	Action	Limit
S&P 500 ProShares Ultra Short ETF	SDS	\$26.39	0.00%	BUY	\$27.71
Real Estate					
Hersha Hospitality Trust	HT	\$14.18	7.90%	BUY	\$14.89
Hersha Hospitality Trust - Preferred D *	HTPRD	\$24.72	6.59%	BUY	\$24.96
RLJ Hospitality Trust	RLJ	\$17.09	7.72%	BUY	\$17.94
RLJ Lodging Trust - Preferred A *	RLJPRA	\$28.49	6.84%	BUY	\$29.50
RPT Realty 7.25% Preferred D *	RPTPRD	\$58.68	6.18%	BUY	\$60.00
Third Avenue Real Estate Value Investor *	TVRVX	\$28.94	1.41%	BUY	\$30.00
Energy/Natural Resources					
Adams Natural Resource Fund	PEO	\$15.40	6.00%	BUY	\$16.17
Chevron	CVX	\$117.13	3.82%	BUY	\$122.99
Fidelity Select Nat Gas Fund *	FSNGX	\$15.93	0.00%	BUY	\$17.00
Valero	VLO	\$95.49	3.77%	BUY	\$100.26
Medically Related					
Boston Scientific	BSX	\$43.25	0.00%	BUY	\$45.41
Genomic Revolution Multi-Sector	ARKG	\$34.92	0.00%	BUY	\$36.67
Stryker Corp	SYK	\$204.86	1.02%	BUY	\$215.10
Virtus LifeSci Biotech Products	BBP	\$44.11	0.00%	BUY	\$46.32
Financials					
JP Morgan Chase	JPM	\$131.76	2.73%	BUY	\$138.35
Wells Fargo	WFC	\$54.46	3.16%	BUY	\$57.18
Small Caps					
Third Avenue Small-Cap Value Investor Fund *	TVSVX	\$18.85	0.37%	BUY	\$19.50
Special Situations					
Apple	AAPL	\$267.25	1.09%	HOLD	\$248.00
Carnival Cruise Lines	CCL	\$45.08	4.44%	BUY	\$47.33
Intel	INTC	\$58.05	2.07%	BUY	\$60.95
International Business Machines	IBM	\$134.45	4.46%	BUY	\$141.17
NCR Corp	NCR	\$32.83	0.00%	BUY	\$34.47
ETFs for Rising Interest Rates					
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	\$10.83	0.00%	BUY	\$11.37
ETF - ProShares Short 20+ Year Trsry	TBF	\$19.07	0.00%	BUY	\$20.02
ETF - ProShares UltraShort 20+ Year Trsry	TBT	\$25.06	0.00%	BUY	\$26.31

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

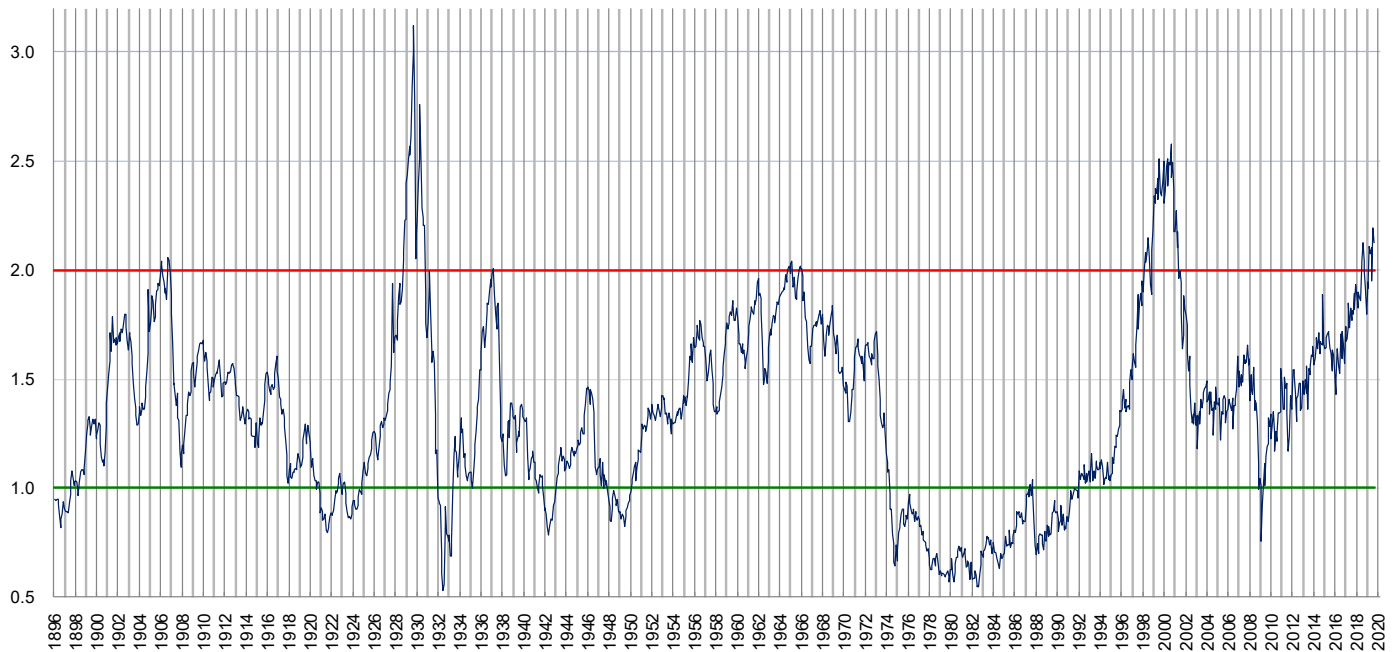
* It is not possible to offer live pricing..

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 \$465 million, or 26.5 times more money than by simply holding stocks though the ups and downs.

A brief walk through history shows just how reliable this indicator is. The first recorded time the Risk Indicator rose above 2.0 was in February 1906, after the eight-year-old Dow-Jones average doubled since 1903. The market peaked in September of 1906. A massive sell-off in October would later be labeled the Panic of 1907. Stock prices trended downward for 14 more years until the end of 1921 while, searing inflation after World War I boosted house prices 48 percent. The combination of falling stock prices and rising real estate prices forced the Risk Indicator to fall below 1.0 in 1920, just in time for the Roaring 20's when stock prices tripled. Then, in October 1928, the Risk Indicator rose above 2.0 again. On Tuesday, September 3, 1929, the Dow

The New York Times

"Cardiff's equation reveals an elegant financial minuet as each market takes turns outperforming the other."

peaked at 318.17. The October crash marked the beginning of a decline that lasted until July 8, 1932. Houses had declined only by 15 percent compared with the 85 percent loss in stocks. The relative superior performance of houses caused our Risk Indicator to fall below 1.0 at the beginning of 1932.

As America's GNP began posting positive gains and with 46 percent growth in three short years, stock prices would triple. Then the Risk Indicator crossed 2.0 in March 1937. This time, the signal came only one month after the zenith in stock prices. As stock prices retreated 50 percent, house prices remained relatively steady, causing the Risk Indicator to fall below 1.0 again in June 1941, within 9 months from the bottom.

As U.S. corporations expanded to meet growing demand, and the economy came to a rolling boil during the Eisenhower years, the stately rise would multiply stock prices by ten times until November 1964, when the Risk Indicator crossed over 2.0 again. The stock market would continue to climb into 1968, and then crash in 1975, wiping out the inflation-adjusted gains scored by investors since 1954. However, a switch to an investment in houses would avoid all that and double in price by the time the next signal came for stocks in May 1974, as the Risk Indicator fell below 1.0 again, as the Dow careened below 700.

It would not be until March 1998 when the Risk Indicator would cross 2.0 again, after stocks were up by more than tenfold. The Dot-Com bubble would push stocks higher into early 2000, but then began another 50 percent retracement. A switch to houses would produce a 44 percent gain through the end of 2008 while stock prices were lower by 17 percent. In February 2009, with the Dow careening down through the 700s once again, the Risk Indicator quietly dropped below 1.0 to 0.77 as the S&P tumbled under 700. Since then, the stock market has delivered stunning gains as the S&P 500 has quadrupled. For the sixth time in the last 123 years, the Risk Indicator rose above 2.0 again in July 2018.

With the latest median house price at \$326,700 in September and with the S&P 500 at 3141.28, the Sound Advice Risk Indicator reads 2.31, revealing the risk in stocks is high.

As remarkable as the **Sound Advice** Risk Indicator has been, it does not pinpoint the exact time. In the past 123 years, its signal has ranged from being only one month after the zenith to as much as four years early. While the Risk Indicator has been early, it has never been wrong. An expensive crash was inevitable. A 50 percent decline took a 100 percent recovery just to break even.

To help us narrow down the timing as well as gage the potential severity of an upcoming decline, we have our Diffusion Indexes.

Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

Track Record of the SoundAdvice Diffusion Indexes

After each "Aggressive" signal, the S&P 500 climbed an average of 31 percent. During "Caution" signals, the S&P 500 either crashed, meandered, or climbed, recording an average increase of 3.5 percent.

Aggressive	S&P	Caution	S&P
Sep-74	68.1	Apr-76	101.9
Jul-76	104.2	Dec-76	104.7
Oct-78	100.6	Jun-79	101.7
Nov-79	100.0	Oct-83	167.7
Aug-84	164.5	Jun-85	188.9
Jul-86	240.2	Aug-87	329.4
Feb-88	258.1	Jun-88	270.7
Mar-89	280.0	Mar-93	449.7
Mar-95	493.2	Dec-98	1,141.0
Jun-00	1,429.4	Dec-00	1,320.3
Jun-03	974.5	May-05	1,191.5
Jun-06	1,276.7	Mar-08	1,325.4
Apr-09	848.2	Mar-12	1,370.3
Mar-15	2,080.0	May-15	2,111.9
Sep-17	2,492.8	Jan-18	2,823.8
Ave +/-	31.6%		4.2%

If the Supercycles identified by our Risk Indicator are the solemn, inexorable seasons that roll across the market's landscape, business cycles are the highly visible, sometimes serene but frequently blustery fronts and storms that we actually perceive as weather. The Risk Indicator has given us a reliable tool to determine the investment season in the stock market. This information is all-important; there will be no heat waves in January, no blizzards in July. But in our search for fair winds, we need to know more than the season. We also must be able to predict the shorter-term weather -- the bull and bear markets that fluctuate along the path of Supercycles.

The data we need is contained in the leading and lagging economic indicators published monthly by The Conference Board. 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 in stocks.

To construct our **Sound Advice** Diffusion Indexes, we observe changes in each of our selected indicators over a six-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. In order for all of the leading economic indicators to be giving off a zero value compared to six months before, it is nearly certain that the soft economy is providing an atmosphere for stable or declining interest rates.

This Diffusion Index gave us a zero reading in April, 2009, 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.

Current Status

The Diffusion Index of LAGGING Indicators climbed to 100 percent for December, giving us a new Caution Signal in January, very close to the peak in the market. **The latest data for October caused a 100 percent reading, revealing that the US economy is strong enough to put upward pressures on interest rates.**

Our next signal will come from the Diffusion Index of LEADING Indicators, when it drops to zero, which would take a surprising softening in the US economy. **The latest reading for this Diffusion Index is 33.3 percent.**

Concurrence

There are times when signals from the **Sound Advice** Risk Indicator and the Diffusion indexes are out of sync, when one is signaling caution and the other is not. This occurred in August 1987, when the Diffusion Index of Lagging Indicators switched into caution mode, just prior to the October 1987 Crash that took stocks sharply for a brief period. Non-concurrence also occurred in March of 2008, when the Diffusion Index of Lagging Indicators switched into caution mode, just prior to the 2008-09 bear market crash. Both of these crashes were brutal, but relatively short-lived. Once the Risk Indicator plunged below 1.0, a very profitable bull market followed.

Then there are times when both indicators concur, signaling the same thing at roughly the same time. This happens when the Risk Indicator is above 2.0, indicating the end of a supercycle, and the Diffusion Index of Lagging Indicators switches into caution mode, indicating the end of a business cycle. Of course, this concurrence indicates that a more vicious and potentially longer-lasting bear market, or series of bear markets, is bound to follow, eventually taking stock prices down substantially – usually by 50 percent -- until the Risk Indicator falls below 1.0 again. We have this concurrence today.

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