



The *Sound Advice* portfolio is up 10.1 percent so far this year as compared to 5.3 percent for the S&P 500. If we look back to the beginning of last year, the portfolio is up 40.9 percent as compared to 19.4 percent for the S&P500. We have an average gain of 58.8 percent based on the prices at which each stock, ETF, or mutual fund was originally recommended.

Hulbert's independent rankings of investment newsletters are out for 2013. *Sound Advice* made the Honor Roll again, this time for its performance in both up and down markets since March, 2000. This follows the induction into Hulbert's Honor Roll in 2011 and 2012 for performance in both up and down markets since 1998.

The idea behind Hulbert's Honor Roll is the performance in both up and down markets. Hulbert says:

"It shouldn't be that difficult...But it is. A newsletter that consistently does well when the stock market is going up tends to be a big loser when the market heads south -- and vice versa. This in turn suggests that making it into the Honor Roll really means something..."

In my experience, for example, most who say that they have a high risk tolerance are kidding themselves..it is one thing to say this now, after the fact. It is quite another thing for an investor not to do so in the heat of the moment."

Yes, indeed. After all, the heat of the moment is when markets are often at their extremes, and mistakes are very costly.

However, this is also the time when the opportunities are greatest -- so great that we do not need high risk investments to capture extraordinary profits. More importantly, our timing does not have to be perfect.

-Gray Emerson Cardiff

A Light at the End of the Tunnel

The Federal Reserve Bank of Philadelphia compiles a "Beige Book" which measures economic vitality across the US. Based on data collected for the Beige Book in December, (during the uncertainties of the Fiscal Cliff) the Federal Reserve reported "...the twelve Federal Reserve Districts indicated that economic activity has expanded since the previous Beige Book report, with all twelve Districts characterizing the pace of growth as either modest or moderate... Economic activity across the United States expanded at either a moderate or modest pace in recent weeks with consumer spending picking up."

Although the fourth quarter GDP was slightly negative, the list of economic indicators reported in mid-January confirmed the economic expansion in December. Industrial production rose substantially across the board including manufacturing, mining output, and utility output. Manufacturing also saw solid gains including primary metals, electronic products, motor vehicles and auto parts. Even capacity utilization inched ahead which ordinarily rises late in an economic expansion.

The Institute for Supply Management's manufacturing purchasing managers' index increased to 50.7 in December from 49.5 in November. (A reading above 50 indicates expanding activity.)

The hand-picked leading and lagging economic indicators that make up our Diffusion Indexes (see page 14) all climbed in December, causing 100 percent readings on both the Leading and Lagging Diffusion Indexes. This does not happen very often.

Although businesses blamed uncertainty over tax and spending policies in Washington for holding back on their hiring, manufacturing payrolls still increased by 25,000. December jobless claims dropped to a 5-year low.

Housing, a primary pillar of the economy that has been missing and dragging down the economy in recent years, continued its recovery in December. Housing starts jumped 12.1 percent in December. Housing building permits were also strong. New foreclosures rates dropped close to a near 6-year low. The peak in foreclosures two years ago is clearly behind us now.

The economy is clearly recovering, even in the face of the debates in Washington.

The December Meeting

Just after the first of the year, the notes from the Federal Reserve's December meeting were made public and revealed that several members of the Fed's policy making committee argued that purchases of Treasury securities and mortgage-backed securities should be reduced or ended "*well before the end of 2013.*" The concerns include the potential disruption of financial markets and the delicate balance between encouraging private borrowing and unleashing speculation.

Then in mid-January, Federal Reserve officials voiced increased concern that record-low interest rates are overheating markets for assets from farmland to junk bonds, which could heighten risks when they reverse their unprecedented bond purchases.

Kansas City Federal Reserve President Esther George said *“Prices of assets such as bonds, agricultural land, and high-yield and leveraged loans are at historically high levels. We must not ignore the possibility that the low-interest rate policy may be creating incentives that lead to future financial imbalances.”*

Dennis Lockart, president of the Atlanta Federal Reserve, said he sees a *“legitimate concern” in the growth of the Fed’s balance sheet with the additional purchases of mortgage-backed bonds and Treasuries...The expansion also poses greater challenges for the central bank’s eventual withdrawal of stimulus...I’m very comfortable that when the time comes, the exit “can be carried out in an orderly way... Still, the bigger the balance sheet [amount of Treasury securities owned by the Federal Reserve], the more the unknown factor.”*

Philadelphia Federal Reserve President, Charles Plosser, said that Federal Reserve officials are *“worried”* and *“working very hard on trying to make sure that we are aware of where imbalances or distortions are showing up and we don’t go too far down the road before we try to address those.”*

Bernanke himself raised the same concern, saying the central bank has to *“pay very close attention to the costs and the risks [of its policies].”*

When the Federal Reserve begins to shrink its portfolio of Treasury securities, bond investors will start to worry about an avalanche of inventory hitting the market; forcing bond prices down and yields up.

In January, Lawrence Goodman, president of the Center for Financial Stability (an independent, nonpartisan, and nonprofit think tank dedicated to financial markets for the benefit of investors, officials, and the public) said *“There are extreme market distortions occurring due to the unusual monetary policy. The upshot is we are seeing increasing debate in FOMC [Federal Open Market Committee] meetings.”* The Center also pointed out *“The price they [investors] are paying for income from bonds versus stocks is close to the highest level since 1920”.*

In January, there was a definite change in the media regarding the wisdom of holding long-term bonds now. Commentaries now focus on whether the Federal Reserve’s exit will be “Messy”. Reasons given for the recent upswing in the stock market now cite money coming out of the bond markets and into stocks. That makes sense, and there is a lot more where that came from.

After its January 30th FOMC meeting, the Federal Reserve announced no changes in its monetary policy, that it will continue to keep its key interest rate near zero (the Federal funds rate), and to continue its bond buying program.

We need to keep in mind that while the Federal Reserve has complete control of short-term interest rates by setting the Federal funds rate, it does not have complete control over the bond market. That is because the bond market is far larger than the Federal Reserve’s coffers, and is subject

to powerful market forces. Long-term bond yields will start to increase as the economy gathers strength. In addition, as with all markets, the bond market will anticipate events ahead of time, especially the Fed’s withdrawal from its quantitative easing program. The recent upticks in 30-year Treasury bond yields in January, from 2.95 to 3.20 percent, suggest this process already started.

These upticks have pushed up our “No-Brainers”, the reverse ETFs that will benefit strongly from a rise in yields on long-term Treasury bonds. They all advanced this year:

The most responsive ETF, the **Direxion Daily 20 Plus Year Bear 3 Shares (TMV-NYSE)** which uses 3 to one leverage, is up 10.9 percent.

The **Proshares Ultrashort Lehman 20 Plus Year Treasury (TBT-NYSE)** which uses 2:1 leverage, is up 7.2 percent.

The **Proshares Short 20 Plus Year Treasury (TBF-NYSE)** which uses no leverage, is up 3.5 percent.

These ETFs climbed in close proportion to the leverage they mirror.

In the aftermath of any recession, bond yields and long-term interest rates always rise. It is as simple as that. In view of the economic strength that is gathering, the rise in Treasury bond yields has begun.

The rise in bond yields is not likely to be a smooth ascent, particularly in February as the March 1st deadline approaches for the automatic sequester of \$1.2 trillion in spending cuts. This will be a cloud over an otherwise improving economy, and Congressional negotiating is likely to continue to the last minute. We recommend using any weakness in the prices of our No-Brainer ETFs to accumulate more shares if you are not fully invested.

As we pointed out last month, the rise in long-term Treasury bond yields does not have to be large to bring us exceptional profits. With a rise in yields to 4.75 percent, TMV should more than triple. TBT should more than double, and TBF should rise more than 50 percent. Keep in mind that 4.75 percent is still a historically low yield on long-term Treasury bonds. Gains could be considerably higher.

The Best Real Estate Mutual Fund

Choosing the best real estate mutual fund is not easy. There are 15+ no-load REIT funds from which to choose, and sorting them out is a project. We have done that recently, and here are the results.

The first question is: Why invest in a real estate mutual fund, and why now? The answer is simple. Most of the time, above average investment returns can be earned. In 2012, US REITs outperformed the broader equity market. The Morgan Stanley Capital International (MSCI) Index of US REITs, a benchmark index that measures the performance of publicly traded equity US REITs, rose 17.77 percent during the year, exceeding the 16 percent delivered by the

The Performance of Real Estate Mutual Funds



S&P 500 in an exceptional year. That superior performance was not just in 2012. Last year was the fourth year in a row the US REIT index beat the market.

Over the last ten years, investing in the S&P 500 stocks and reinvesting all of the dividends would have produced an annual return of 6.98 percent. By contrast, the MSCI Index of US REITs rose 11.58 percent annually on average.

Therefore, just finding a REIT mutual fund that matches the averages will likely bring you investment returns that are superior and more reliable than the stock market as a whole. However, as you will see, that is not all that easy to do. It is even harder to find a REIT mutual fund that does consistently better than the index, but as you will see, they exist.

Moreover, at certain times, investment returns are exceptional from REIT funds, especially the funds that perform consistently better than the averages. We believe this is one of those times.

The Big Cycle

We all know about business cycles and their impact on investments. However, the business cycle is particularly powerful on real estate because financing is typically employed. Not only does financing introduce leverage, but

its availability and cost can either starve the market or pump it up. Often these cycles are long and span a generation, so the majority of investors do not remember or know about them.

The best time to invest in real estate is after it has crashed and has begun to recover. At these times, lenders are nervous and they are just beginning to lend again, albeit very carefully after having been burned by loose policies prior to the crash when values were high. Also at these times, with lending shut off as a result of the crash and the economy is in the tank, there has been no significant development of new properties for several years. As the economy recovers, shortages in supply start to appear, and rental rates begin to escalate. As memories fade and lenders relax their grips on their growing stashes of money, liquidity returns to real estate, and we are off to the races again. Over the span of many years, real estate prices recover steadily and handsomely.

During the economic expansion, the investment returns are excellent. First, for each 5 percent increase in rental income, net operating income (after operating expenses) increases by a larger percentage, from 7 to 10+ percent, depending on the type of real estate and level of expenses, because expenses are relatively fixed. Since the value of

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the real estate is measured by the net operating income, the value goes up sharply.

Not to get bogged down in too many numbers, but a brief illustration is important. A property with, say, \$15,400 in rental income and operating expenses of \$5,390 (35 percent of income), would have an annual net operating income of \$10,010. Today, capitalization rates are around 7 percent, which puts the value of the property at \$143,000 ($\$10,010/0.07$). Lets say the mortgage is \$75,000 (approximately 50 percent of value), which leaves an equity of \$68,000.

Now, let's raise the rent by merely 5 percent. Assuming expenses stay the same, the net operating income increases to \$10,780. At a 7 percent capitalization rate, the property is worth \$154,000. Subtracting the mortgage leaves an equity of \$79,000. Note that this is a growth in equity of 16.2 percent, all from a mere 5 percent increase in rental income.

This simple example illustrates why commercial real estate can do so well during even a modest recovery; why real estate mutual funds make sense most of the time -- especially during the expansive phase of the business cycle.

Which Fund is the Best?

The orange line on the chart above is the MSCI Index of US REITs. Over the last ten years, this index has increased at the annual rate 11.58 percent.

The green line below the orange line on the chart is the (MSCI) World Index of REITs which increased at an annual rate of 7.42 percent. The performance of most REIT mutual funds (that have been around 10 years) lies between the World Index (green line) and the US Index (orange line).

The largest REIT mutual fund, the **Vanguard Index Fund (VGSIX)**, is designed to match the MSCI Index of US REITs. It attempts to replicate the index by investing all, or substantially all, of its assets in the stocks that make up the index, holding each stock in approximately the same proportion as its weighting in the index. It has done so very well over the last 10 years. If we invested \$10,000 in this fund ten years ago, we would have \$29,886 for an annual return of 11.57 percent, practically matching the US REIT Index.

Fidelity Real Estate Fund (FRESX) also closely matched the US REIT Index, with an annual return of 11.56.

Two funds were close seconds. **The American Century Real Estate Fund (REACX)** with an annual return of 11.25 percent, and the **ASTON/Harrison Street Real Estate N Fund (ARFCX)** with an annual return of 11.24 percent. Five other funds did not do as well.

The **SSgA Clarion Real Estate Institutional (SSREX)** out-performed the US REIT Index before 2009 but has since not kept pace. It turned in an annual return of 10.47 percent.

The **Third Avenue Real Estate Value Institutional fund (TAREX)** had an annual return of 9.99 percent.

Rank	Fund Symbol	Growth of \$10K	Annual Returns	
			10 Year	5 Year
1	CGMRX	57,766	19.17	11.14
2	NBRFX	35,478	13.50	7.70
3	CSRSX	33,055	12.70	6.31
4	MRESX	32,358	12.46	7.18
5	MUSDX	32,043	12.35	4.78
6	DFREX	30,291	11.72	7.78
	US Index	29,913	11.58	5.58
7	VGSIX	29,886	11.57	5.94
8	FRESX	29,860	11.56	4.92
9	REACX	29,040	11.25	4.02
10	ARFCX	29,014	11.24	5.10
11	SSREX	27,067	10.47	2.49
12	TAREX	25,914	9.99	1.52
13	AIGYX	24,534	9.39	3.98
14	FFREX	23,243	8.80	2.61
15	REPIX	18,095	6.11	(5.18)

The **Alpine Realty Income & Growth Institutional Fund (AIGYX)** under-performed the World Index at times, but still turned in an annual return of 9.39.

The **Forward Real Estate Investor Fund (FFREX)** returned 8.80 percent annually.

The **ProFunds Real Estate Ultra Sector Investor Class Fund (REPIX)** out-performed the US Index before mid-2008 but since has under-performed the World Index. It had an annual return of 6.67 percent.

Six REIT mutual funds performed better than the Index of US REITs during the last 10 years.

The **DFA Real Estate Securities I Fund (DFREX)** did slightly better, with an annual return of 11.72 percent.

Morgan Stanley Institutional US Real Estate P Fund (MUSDX) provided an annual return of 12.35 percent for those who could afford to invest a minimum of \$1.0 million (\$100K for an IRA).

Managers Real Estate Securities (MRESX) matched the US REIT index into 2009 and since out-performed it, turning in an annual return of 12.46 percent.

Cohen & Steers Realty Shares (CSRSX) consistently out-performed the US Index, furnishing an annual return of 12.70 percent.

The **Neuberger Berman Real Estate Trust (NBRFX)** did even better, turning in an annual return of 13.50 percent.

The best performer -- by far -- was the **CGM Real Estate Fund (CGMRX)** shown by the blue line on the chart. This fund furnished an annual return of 19.17 percent. Investing \$10,000 in this fund grew into \$57,774. This fund's performance was a head and shoulders above the US REIT

Index (orange line) as well as the performance turned in by all other real estate funds.

The table summarizes these results for all funds. Also shown are the 5-year returns, which descend in a similar fashion.

As you can see from the chart, CGMRX put on quite a fireworks show between 2003 and 2007 (+89.7%, +35.5%, +27%, +29%, +34.4%). We made a 145% profit during that period.

CGMRX is not your average REIT fund. Ken Heebner, has run the fund since its inception in 1995 and is known as "The Mad Bomber" because he considered a maverick among real estate fund managers. As evidenced by his track record, he strays away from the pack from time to time. As evidenced by his success, these have been wise moves.

There are times when Heebner holds ten percent or less of the 270 stocks in the average REIT fund portfolio. In addition, he will invest substantially more than the average REIT fund in his top 10 holdings when he believes it appropriate. Heebner will also venture out of pure real estate investments from time to time.

We got back into CGMRX again after the 2008-09 crash in REIT prices. So far, we have a profit of 63 percent, and we believe that this fund is poised for considerably more gains ahead as the economy recovers.

Portfolio Updates

Here are updates on the rest of our recommendations in alphabetical order. The table on page 7 details buy limits and other information on each recommendation, and organizes them by investment objective.

Agrium (AGU) is up 13.9 percent this year, after climbing 48 percent in 2012. We have a profit of 850 percent. This is the largest farm products retailer in North America and a wholesaler to the rest of the world.

Emerging market nations will have to import foodstuffs from the more advanced countries or use fertilizer to improve their crop yields to meet their needs. Either way means more worldwide use of fertilizers.

There is an ongoing battle with Jana partners, AGU's largest stockholder. Jana wants AGU to spin off the retail arm, contending that it would sell at a higher multiple. Management argues that AGU works better as a whole because the retail arm increases operating efficiencies, provides market intelligence, and furnishes counter-cyclical cash flow.

AGU is expected to earn \$10.00 per share this year, which

puts it under 12 times earnings. This price earnings (P/E) ratio is below average and very low for a company with a history of growth and future growth prospects. Accordingly, AGU remains undervalued.

AMN Healthcare (AHS) is up 3.7 percent this year, after climbing 160 percent last year. We have a profit of 126 percent.

AMN Healthcare provides temporary healthcare staffing services to the healthcare industry, ranging from nurses to physicians. The rationale for buying AMN Healthcare was a two-fer. AHS is not just an opportunity to invest in healthcare, which is traditionally a non-cyclical industry, but it is also a chance to buy into a healthcare business that will benefit from a recovery in the economy.

Growth expectations are high for AHS because an estimated 10,000 people are now turning 65 every day in the US. As the aging of the population continues, the healthcare industry will grow substantially.

However, these growth expectations have caused the stock to climb to the point where the price is now close to 24 times 2013 earnings estimated at \$0.45 a share. This price/earnings ratio is at a hefty premium to the average of its peer group. We think this stock has gotten ahead of itself and recommend holding for now while waiting for a pull-back to invest more.

Associated Estates Realty Corp (AEC) is the most undervalued apartment REIT in the sector. The equity of its apartment portfolio translates into a stock value of \$27 per share. So the stock is trading at a steep discount. It pays a nice yield as well. We have a small profit, and expect more ahead.

Boston Scientific (BSX) is a classic turnaround story. It has had flat earnings but expects to see growth from its Subcutaneous Implantable Defibrillator (S-ICD) which is implanted under the skin without touching the heart or blood vessels.

There are vast new markets for ICDs in India and China. A brighter day is bound to be ahead. Based on the depressed price of this stock, gains from the current low price should be substantial.

Chesapeake Energy (CHK) is up 21 percent since we added it to the portfolio last year. It was cheap for three reasons: low natural gas prices, poor corporate governance, and a cash shortfall. There has been substantial progress on all of these aspects.

First, natural gas prices have climbed significantly since our recommendation. Secondly, Carl Icahn bought stake in 2012, and has been instrumental in removing the founder,



Aubrey McClendon, as chairman of the board and replacing several other board members. Then on January 30th, McClendon suddenly retired (at age 53) which caused the stock to jump. Icahn's activity is putting pressure on the board to maximize shareholder value. And finally, CHK has sold \$11.6 billion of \$14 billion in targeted divestments to straighten out its cash squeeze.

CHK's remaining natural gas and oil assets are extensive and offer a large upside. As of December 12, 2012, Morningstar's fair value estimate is still \$26 a share which is more than 50 percent greater than the current price of the stock.

Commonwealth REIT (CWH) has considerable upside from here. The equity in the underlying real estate portfolio works out to be \$32.76 per share, even using a 9 percent capitalization rate (which is conservative these days) to evaluate the real estate. CWH should start to move when sustained growth in FFO begins to materialize.

Comcast (CMCSA) climbed inexorably in 2012 and was up 57 percent as the company saw steady growth in its cable and high-speed data customer base. It is up another 4.5 percent this year, extending our profit to 116 percent.

CMCSA is also an indirect play on the real estate recovery. The housing recession has had a dampening effect as foreclosures and the accompanying financial stress has reduced customers. New signs of life in the housing market will be a strong benefit.

However, the current price/earnings (P/E) ratio is above 17 based on the 2013 estimate of \$2.25. This is above the average P/E for the S&P 500. We prefer to snag good companies at better valuations that allow more headroom from profits. Accordingly, we advise holding for now.

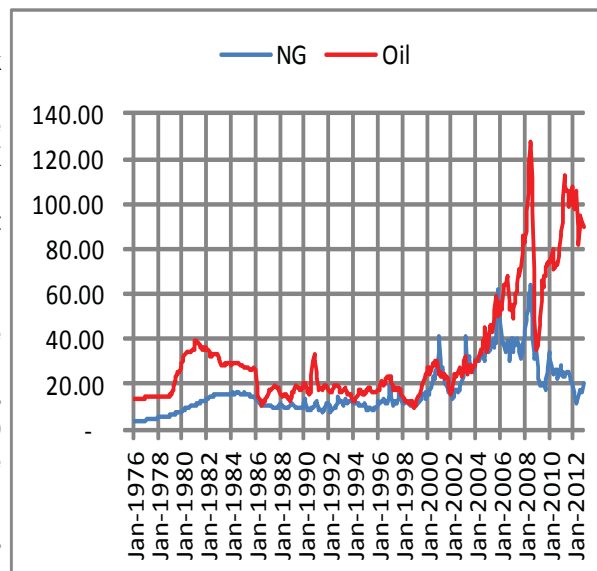
Fidelity Select Natural Gas Fund (FSNGX) is the only mutual fund that concentrates on the natural gas industry. It is one of Fidelity's stable of tightly focused sector funds.

FSNGX is a diversified play on the yawning gap between the energy equivalents of oil and natural gas. One barrel of oil provides approximately 5.8 million British Thermal Units (BTUs) of energy. So if a barrel of oil is say, \$100, that is the cost of 5.8 million BTUs of energy.

On the other hand, the market price for natural gas is close to \$3.00 for one million BTUs. To buy 5.8 million BTUs will cost \$17.40 (5.8x\$3.00). So the same amount of energy is available for approximately 17.40 cents on the dollar -- if it is in the form of natural gas.

As the chart shows, this is not a normal situation. The red line shows the price of a barrel of oil since the mid-1970s.

The Cost of Energy Equivalents of Oil and Natural Gas



The blue line shows the price of natural gas multiplied by 5.8 to approximate the same amount of energy contained in a barrel of oil. Note that for most of the time (36 years), the two forms of energy are closely aligned. This stands to reason. After all, energy is energy, and it should cost approximately the same regardless of the form in which it comes. However, that is not the case today. Note the current yawning gap between the costs of these two forms of equivalent amounts of energy. For 5.8 million BTUs, it costs approximately \$100 if it is in the form of oil, but only \$17.40 in the form of natural gas.

The US is self-sufficient in natural gas with only 9 percent imported from Canada. At 17.4 cents on the dollar versus oil, natural gas is bound to have a growing role in America's energy needs as well as independence from importing oil.

This fund is well positioned to benefit from an expanding natural gas industry.

Hambrecht & Quist Life Sciences Fund (HQL) was up 26 percent last year and is up 7.7 percent this year, extending our profit to 59 percent. The most explosive profits in the entire healthcare industry can be found here in biotech companies. This is a volatile sector, so diversification is crucial. HQL is a superior way to gain exposure to biotech on a diversified basis.

The climb in the price of HQL has brought the price/earnings (P/E) ratio of the underlying portfolio to 25. Although these are typically young promising companies which tend to carry high multiples, we are not anxious to chase a P/E of 25. Accordingly, we recommend accumulating shares on weakness.

Leucadia (LUK) was up 5 percent last year and up 6.3 percent this year, leaving us with a 24 percent profit. This is a holding company with a portfolio in excess of \$9 billion of assets in beef processing, manufacturing, gaming entertainment, real estate activities, medical product development, and winery operations.

Its two principals, Ian Cumming and Joseph Steinberg, have been compared to Warren Buffett in their success at identifying lucrative investments that can be purchased substantially below their intrinsic value. In fact, Buffet continues to team up with the Leucadia team on joint venture investments. Several holdings are directly partnered with Warren Buffett.

Skillful investing has produced double digit growth rates in its assets since 1979. After a bad year in 2008, assets have

Income With Growth	Sym	Exchange	Price	Yield	Limit	Action
Associated Estates Realty Corp	AEC	NYSE	\$ 16.29	4.67%	\$ 18.00	BUY
CommonWealth REIT	CWH	NYSE	\$ 16.92	5.91%	\$ 20.00	BUY
Retail Opportunity Investment Corp	ROIC	NASDAQ	\$ 13.03	4.30%	\$ 15.00	BUY
Diversified Growth						
CGM Realty Fund	CGMRX	800-343-5678	\$ 30.72	0.85%	\$ -	BUY
Comcast	CMCSA	NASDAQ	\$ 39.03	1.67%	\$ 36.00	HOLD
Leucadia National Corp.	LUK	NYSE	\$ 25.30	3.95%	\$ 28.00	BUY
Masco	MAS	NYSE	\$ 18.22	1.65%	\$ 14.00	HOLD
Paychex	PAYX	NASDAQ	\$ 32.28	3.97%	\$ 32.00	HOLD
Pfizer	PFE	NYSE	\$ 27.51	3.20%	\$ 28.00	BUY
Stryker Corp.	SYK	NYSE	\$ 63.38	1.34%	\$ 64.00	BUY
Xerox	XRX	NYSE	\$ 8.16	2.08%	\$ 10.00	BUY
Energy/Natural Resources						
Agrium	AGU	NYSE/TSE	\$ 113.73	1.76%	\$ 120.00	BUY
Chesapeake Energy Corp	CHK	NYSE	\$ 20.11	1.74%	\$ 22.00	BUY
Fidelity Select Nat. Gas Fund	FSNGX	800-544-8888	\$ 33.36	0.16%	\$ -	BUY
Tetra Tech	TTEK	NASDAQ	\$ 28.60	0.00%	\$ 30.00	BUY
USAA Precious Metals & Minerals	USAGX	800-862-6909	\$ 24.60	0.33%	\$ -	BUY
Aggressive Growth						
AMN Healthcare	AHS	NYSE	\$ 11.98	0.00%	\$ 10.50	HOLD
Boston Scientific	BSX	NYSE	\$ 7.31	0.00%	\$ 8.50	BUY
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	NYSE	\$ 60.13	0.00%	\$ -	BUY
ETF - ProShares Short 20+ Year Trsry	TBF	NYSE	\$ 30.42	0.00%	\$ -	BUY
ETF - ProShares UltraShort 20+ Year Trsry	TBT	NYSE	\$ 68.02	0.00%	\$ -	BUY
H&Q Life Sciences Fund	HQL	NYSE	\$ 15.61	6.92%	\$ 15.00	HOLD
Maxim Integrated	MXIM	NASDAQ	\$ 31.74	2.77%	\$ 30.00	BUY
Symantec	SYMC	NASDAQ	\$ 21.98	0.00%	\$ 22.00	BUY
Tellabs	TLAB	NASDAQ	\$ 2.22	3.60%	\$ 3.00	BUY

Prices are as of 1/30/2013. See our website for live pricing and buy limits.

<http://www.soundadvice-newsletter.com/members>

Yields on funds do not include distributions of capital gains. Note that all fund distributions fluctuate annually.

since grown by 150 percent according to Morningstar. The nature of their most recent investments in start-up biotech and energy companies offer a very large profit potential while affording relatively low risk. We think that LUK is valued well below the market prices of its disparate parts, with a very low debt-to-equity ratio. LUK's holdings currently translate into a P/E ratio of 11.9, substantially below the market averages. It remains undervalued.

Masco (MAS) was up 59 percent last year and up another 9.4 percent this year, extending our profit to 147 percent. MAS manufactures a wide range of products for home construction and remodeling --everything from kitchen cabinets and faucets to windows and paint.

We added MAS to the portfolio at \$7.49 after the shares got hammered during the recession. However, the share price has rocketed, bringing the price/earnings ratio to 29

times the 2013 earning estimates of \$0.60 a share. This high price/earnings ratio is already anticipating a steep growth rate. We would wait for a substantial pull back to accumulate more shares.

Maxim Integrated Products (MXIM) was up 13 percent last year and up 8 percent this year, extending our profit to 62 percent. MXIM specializes in analog circuits which are essential for receiving and interpreting digital inputs. A cell phone is a perfect example. After receiving a digital signal, it must be transformed into an analog format so that we can hear it.

The strong demand for cell phones has boosted MXIM's consumer business. Samsung's cell phones and tablets are now contributing to 40 percent of MXIM's revenues and 30 percent of earnings.

MXIM also makes integrated power management chips (PMIC) for portable device makers to extend battery lives. This is enabling MXIM to command premium pricing and capture more content of its products in smartphones. MXIM provides all power management, charging, and USB multiplexing requirements for Samsung's Galaxy S3 smartphone. MXIM's products in this successful smartphone is substantially higher than in prior smartphones. Samsung's newest signature smartphone, the Galaxy S IV, is likely to launch in the first half of 2013.

The importance of Samsung is growing, but MXIM is starting to sell integrated power management chips to other smartphone manufacturers who are aiming for growth in lower-priced handsets in emerging markets.

MXIM is in excellent financial health with \$1.0 billion of cash and plenty of cash flow to support operations. The investment and resources necessary to develop MXIM's high-performance analog chips takes years to develop which is an entry barrier for new competition. Once developed, these chips have long and profitable product lives.

Paychex (PAYX) was up slightly last year and up 3.8 percent this year, extending our profit to 20 percent. PAYX is the second-largest provider of payroll services to small to medium sized companies serving a total of approximately 567,000 payroll clients. Accordingly, its revenues and earnings directly mirror the employment situation.

PAYX recently increased its dividend (close to 4 percent) and announced a share buy-back program of \$350 million of the common stock through May 31, 2014.

The price/earnings ratio is currently close to 20 based on 2013 earnings estimated at \$1.60. While we are still comfortable at this price, we would recommend not chasing it higher.

The balance sheet is pristine with no long-term debt exposure. There is further growth ahead with a recovery in the economy. Morningstar's fair value estimate is \$38 per share.

Pfizer (PFE) was up 16 percent last year and another 9.7 percent this year, extending our profit to 64 percent. We added PFE to the portfolio when it became dirt cheap as the expiration date approached on its blockbuster drug, Lipitor. Pfizer is the world's largest pharmaceutical firm, with annual sales near \$60 billion. Pfizer's large size gives it economy of scale and the resources to finance the research and development of new drugs. It has more than 80 drugs in the development stage and 90 in the discovery stage.

PFE has an extensive sales force to market its products in nations where growth and increasing wealth is strong, including Brazil, Russia, India, China, and Turkey, and PFE has devoted the resources to arm its sales force with plenty of data for marketing.

Retail Opportunities Investment Corp (ROIC) was up 8 percent last year and has continued its uptrend this year,

extending our profit to 21 percent. This REIT began as an IPO in October 2009, just after the REIT sector had been decimated by the 2008 melt-down. It started with a fresh slate in a real estate market replete with bargains. It is a simple model: buy distressed retail properties with high-quality demographics, refurbish them, and then lease them at a premium.

In 2012, ROIC acquired \$278 million of shopping centers including in the fourth quarter. It currently has contracts to acquire four more well-located centers at major intersections within densely populated communities with steady cash flow from well-established anchor retailers. Funds from operations (FFO) more than cover the dividend. As new properties are added, along with tenant upgrades, FFO should continue to rise, along with the dividend, and push the price of this REIT upward.

Stryker (SYK) was up 10 percent in 2012 and is up 15.6 percent so far this year, extending our profit to 52 percent. SYK is best known for its orthopedic devices: artificial knees and hips. SYK also provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products.

In January, SYK surprised Wall Street with higher than expected sales, cash flow, and earnings from strength across the board in its US operations.

Reconstructive implants account for 45 percent of SYK's revenues, and more profits are assured by accelerating demand for joint replacements on aging baby boomers. As life expectancies continue to increase, and obesity trends continue, more and more hip, knee, and spinal procedures will be needed.

Stryker's cash-rich balance sheet (with over \$2 billion in net cash) along with very little debt, and robust cash flow, gives SYK multiple avenues for growth through mergers and acquisitions. Management has been buying back shares and has steadily increased its dividend.

Symantec (SYMC) was up 20 percent in 2012, and up another 16.8 percent this year, giving us a profit of 31 percent. SYMC is the dominant supplier of software for computer security and protection against viruses and other nuisances. Until 2012, the company has suffered from operational inefficiency and lack of direction. In July, 2012, Steve Bennett was hired as the new CEO. Bennett had a successful 23-year career at General Electric and a 7-year role as the CEO at Intuit. Bennett was brought in to streamline operations and give stronger direction. So far, it looks like the change is working. Revenue has increased 5 consecutive quarters.

The most recent fourth quarter of 2012 saw sales rise 7.8 percent on its data storage and server management products – its core business.

New markets are opening up as the world moves to increase usage of smart phones and other mobile devices

which means expanding business for SYMC's flagship brand, Norton.

SYMC recently announced "Norton Zone" which allows users to safely access, sync and share photos, videos and documents from any of their PC, Mac, Android, or iPhones and iPads. The beta test version is out now and the full-featured version is scheduled to be released this year.

SYMC has a large base of customers that provide recurring revenues of approximately 85 percent of total revenue, and growth is assured from the expanding use in cloud computing along with the commensurate need for security software.

Tellabs (TLAB) designs and manufactures hardware for the telecommunications industry, which in a world of exploding demand for wireless communications should be a bonanza of a business. However, Tellabs has been slow to move its product lines as telecom service migrates into wireless.

In January the law firm of Glancy Binkow & Goldberg announced it is investigating potential claims concerning possible allegations that certain statements issued by the Company between October 26, 2010 and April 26, 2011 concerning Tellabs' business, operations and prospects were false and misleading. Generally stockholders do not see much from class action suits, and we do not believe a suit is material to the company. In any case, perhaps this class action suit will bring more of management's attention toward improving shareholder value.

TLAB paid a cash dividend of \$1.00 per share in December so that stockholders would receive the special 15 percent tax rate effective in 2012. Even after the dividend payout, the company still has current (liquid) net assets of \$2.77 per share.

Adding in its other assets, including properties and equipment (less depreciation), the net assets total \$3.11 per share. In our calculation, we have excluded paper asset entries that are held on the Company's balance sheet which include Goodwill and Intangible assets amounting to \$.035 per share. At the current stock price, we are buying the company's current net assets at a discount, and at a larger discount to all of its assets.

The company plans to buy back up to \$224.6 million of TLAB shares which will reduce the float by 20 percent.

Now that the explosion of smart phones, tablet computers and wireless communication is testing the limits of telecom infrastructure, Tellabs should be able to gain a significant portion of that market. We think there is very little downside risk and nothing but upside.

Tetra Tech (TTEK) was up 22 percent in 2012 and is up 8 percent so far this year, extending our profit to 85 percent. TTEK is a leading company in water technologies and environmental remediation. TTEK recently announces it is consolidating its engineering and architectural departments with its environmental consulting departments which is

likely to result in more efficient operations. TTEK also has a healthy balance sheet.

TTEK currently has a record backlog of work totaling \$2.2 billion. Recent large contracts include technical support for the U.S. Environmental Protection Agency (EPA) to monitor water quality conditions. Other recent contracts include remediating NASA's Kennedy Space Center and Cape Canaveral Air Force Station, along with environmental remediation services at US Navy, Marine Corps, and other Department of Defense locations primarily in California and the southwestern United States.

The greatest growth potential lies outside the United States in China and India, where environmental concerns have been at best an afterthought. Only now are these governments starting to recognize the consequences. As these and other governments around the world make this a priority, Tetra Tech should be a prime beneficiary.

USAA Precious Metals & Minerals Fund (USAGX) was down 13 percent last year and continued to slip in 2013, leaving us at break even.

However, when the economy gets more traction, USAGX will benefit from the Federal Reserve's QE-3 program which is printing money to make its massive purchases of Treasuries and mortgage-backed securities. All these extra dollars will raise inflationary expectations and cause the value of U.S. currency to continue declining. Precious metals will be a direct beneficiary.

USAGX is the best diversified way to invest in precious metals. It regularly ranks among the top-performing funds, and has constantly out-performed precious metal equities for ten years.

Xerox (XRX) has climbed 10.2 percent this year as Wall Street recognizes that XRX has growth prospects again. This company is no longer just a copier maker. Although it is still focusing on the high end of the color printing market which still rewards technological improvements, the company is transforming from a seller of printers and copiers to a company providing services on those machines. The revenue from services is more profitable and less cyclical and now accounts for half of XRX's revenues.

XRX is also adding business process outsourcing and information technology (I.T.) outsourcing. XRX landed several large outsourcing contracts in 2012, including the \$848 million contract to overhaul the I.T. system for the state of Texas. XRX also landed the contract to manage California's Medicaid programs for the next 10 years. With sales approaching \$23 billion, XRX is the world's leading company for business process and document management.

XRX is expected to post earnings close to \$1.00 per share this year. The current stock price is less than 9 times earnings, which is incredibly low for a company with growth prospects. Any kind of recovery will bring a high capital gain. Morningstar's fair value estimate of the stock is currently \$11 per share.

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 100+ 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 in which we divide the Standard and Poor's 500 Stock Index average by the median price of a new house 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 can, therefore, label this new tool the SoundAdvice "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 underperforming the other market.

What is too high? When stock prices are very high relative to house prices, the SoundAdvice 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 SoundAdvice 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.

The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a \$25,000 investment would have grown to \$8,835,059 in stocks and to \$1,306,383 in houses.

But though an investment beginning with \$25,000 in 1895 could have made money being in either stocks or housing and simply leaving it there over such a long period of time, had the investor followed the signals of the SoundAdvice Risk Indicator he would have made \$351,157,299, or 39.7 times more money—the difference between profits the buy-and-hold stock market strategy would have yielded by itself and the profits that the SoundAdvice Risk Indicator would have provided.

These figures illustrate why it is so important to remain aware of the Supercycles that are at work within markets.

The SoundAdvice Risk Indicator

The latest reading for the Sound Advice Risk Indicator is 1.51. This reading reveals that stock prices are close to average in relation to house prices. The February 2009 reading of 0.77 marked the low for this cycle as well as the beginning of Supercycle 6.

See *The Science of Making Money in Turbulent Markets* for a complete explanation of the Sound Advice Risk Indicator and its track record. (You received a copy of this book with your subscription, and you will also receive an updated copy when you renew your subscription.)



Business Cycles and Stocks: The SoundAdvice Diffusion Indexes

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 SoundAdvice Diffusion Indexes, we observe changes in each of our selected indicators over a six-month period. For every indicator that is unchanged from its value during the six month span, we will attach a value of one half point (0.5). If an indicator falls below its level six months prior, it will be given a value of zero. If an indicator is higher than it was six months before, it is assigned a value of 1.0. The sum of all of these figures will be expressed as a percentage of the total number of indicators. If, for example, one indicator is up (+1) at the end of a six-month period, one is unchanged (+0.5), and one is down (0), the diffusion index will be $(1.5)/3$ or 50 percent.

When the SoundAdvice 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 economy as a whole must be very soft, which is the atmosphere necessary to produce a lasting decline in interest rates.

The Diffusion Index of Leading Indicators: As far back as February and March 2009 we were projecting that our Diffusion Index of leading indicators soon would hit zero and mark an important buying opportunity. We made that projection by assuming that the leading indicators would not improve in the current economic environment. In fact that signal arrived in March, very close to the bottom, officially giving us an "Aggressive" signal. The market subsequently climbed 61 percent.

An "Aggressive" signal coming at a time when the Risk Indicator was below 1.0 revealed that Supercycle 5 came to an end, and that Supercycle 6 was born.

The SoundAdvice 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 which reveals that the economy is about to put upward pressures on interest rates. This index hit 100% in March 2012 (reported in April - very close to the peak of the market) telling us to move to a cautious approach.

Our next signal will come from a zero reading from our Diffusion Index of Leading Indicators. The latest reading is 100 percent.

Each month we project into future months the current readings for our hand-picked individual leading economic indicators that go into our Diffusion Index of Leading Indicators. We do this to see if a zero reading will be recorded assuming the readings stayed the same. However, due to significant increases in all of the leading indicators, we will not see a new signal (zero reading) in the months ahead unless the economy shows significant weakness.

Track Record of the SoundAdvice Diffusion Indexes

If we had followed the signals from our Diffusion Indexes over the years, we would have done very well indeed. The results are shown below. After each "Aggressive" signal, the S&P 500 climbed an average of 34.4 percent. During "Caution" signals, the S&P 500 declined an average of 0.9 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
Ave +/-	34.4%		-0.9%

See *The Science of Making Money in Turbulent Markets* for a complete explanation of the SoundAdvice Diffusion Indexes and their track record. (You received a copy of this book with your paid subscription, and you will also receive an updated copy when you renew your subscription.)

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