SoundAdvice **The Best Risk-Adjusted Returns in Both Up & Down Markets from 2000-2015** - Hulbert's Financial Digest

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The New Energy Boom

The *Sound Advice* Portfolio is up 3.1 percent so far this year, as compared to 1.8 percent for the S&P 500. We have an average profit of 59.6 percent based on the prices at which each position was recommended.

-- Gray Emerson Cardiff, Editor

The top goal of President Trump's "America First Energy Plan", is to make the US energy independent. Here are the bullet points on his website, https://www.donaldjtrump.com/policies/energy:

- **Make America energy independent, create millions of new jobs, and protect clean air and clean water. We will conserve our natural habitats, reserves and resources. We will unleash an energy revolution that will bring vast new wealth to our country.**
- **Declare American energy dominance a strategic economic and foreign policy goal of the United States.**
- **Unleash America's $50 trillion in untapped shale, oil, and natural gas reserves, plus hundreds of years in clean coal reserves.**
- **Become, and stay, totally independent of any need to import energy from the OPEC cartel or any nations hostile to our interests.**
- **Open onshore and offshore leasing on federal lands, eliminate moratorium on coal leasing, and open shale energy deposits.**
- **Encourage the use of natural gas and other American energy resources that will both reduce emissions but also reduce the price of energy and increase our economic output.**
- **Rescind all job-destroying Obama executive actions. Mr. Trump will reduce and eliminate all barriers to responsible energy production, creating at least a half million jobs a year, $30 billion in higher wages, and cheaper energy.**

The US imports 8.4 million barrels per day, which is close to the 9 million barrels per day produced domestically. To be completely energy independent, US production would need to essentially double. Trump claims this is achievable because "America has 1.5 times as much oil as the combined proven resources of all OPEC countries; we have more Natural Gas than Russia, Iran, Qatar and Saudi Arabia combined; we have three times more coal than Russia."

Our job as investors is not to be political, but to assess the ramifications to our holdings. Trump's goals make it hard to imagine a more bullish environment for the oil and gas industry. In addition, Trump's appointees couldn't be more pro-energy. It starts with Rick Perry, Trump's choice for Secretary of the Energy Department. Mr. Perry is the ex-governor of Texas and once vowed to abolish the department he now heads, a vow he now regrets. In his confirmation testimony to the Senate Energy and Resources Committee, Perry stressed that he is not willing to "compromise economic growth, the affordability of energy or American jobs" to address climate change.

Scott Pruitt, nominated for Environmental Protection Agency (EPA) Administrator has sued the EPA 14 times, and 8 are yet to be resolved. During his confirmation hearing, Pruitt suggested that his trouble with the EPA was federal overreach.

Whether or not energy independence is achievable, the reduction in regulations and the effort to try is bound to strongly benefit all of our energy holdings.

Chesapeake Energy (CHK) has a portfolio of close to 8 million net acres of oil and gas assets in the Haynesville/Bossier, Marcellus, Eagle Ford, Powder River Basin, Utica, and Anadarko Basin regions. CHK made major strides

in reducing debt in 2016 by $2.5 billion to $10.9 billion which is a 50 percent reduction since 2011. It has also lowered drilling costs by 50 percent since 2011 to $4.10 per barrel of oil equivalent (BBOE).

As a further indication of the company's turnaround, in January, CHK announced that it would be reinstating dividends on its preferred stocks.

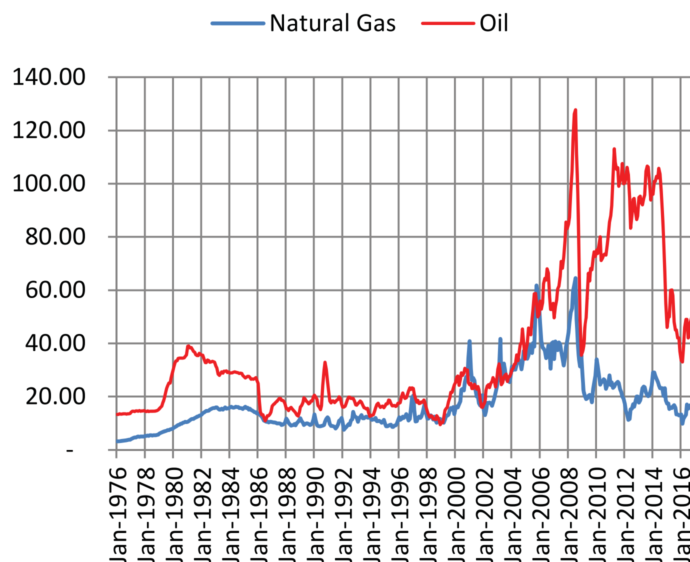
A game-changer for CHK is its "Prop-a-geddon" well (named after the sand used to prop open hydraulically fracked shale to increase production flow) in the Haynesville Shale near Shreveport, LA. This well is 2 miles deep and another 2 miles horizontally, double the standard distances.The large scale of this well could prove to produce for 75 percent less than typical costs.

Chevron (CVX is a vertically integrated oil company which means it has operations in all phases, from exploring and drilling (upstream), to transporting and refining (downstream). Profits vary from these stages of production, depending on price demand for oil and for refined products. High oil prices boost margins from drilling but squeeze margins from refining. When oil prices are low, profit margins expand from refining. Management has pronounced the annual dividend as "sacrosanct" which provides an attractive yield and limits the downside risk.

Toward the end of January, CVX reported fourth quarter earnings of 22 cents per share, after taking an $872 million one-time charge. This was the second consecutive profitable quarter, although earnings were below expectations of 64 cents, they would have been 68 cents without the one-time charge. CVX also cited weak refining margins because of rising crude oil prices.

Chevron has a huge proved reserve base of 11.2 billion barrels of oil equivalent to tap for growth. Two leading projects began production during the second half of 2016. The Bangka project in Indonesia began producing in August 2016, and the Alder project in the North Sea started in November 2016. One of the large Australian LNG projects, Gorgon, started production in 2016, and the other large Australian LNG project, Wheatstone, is scheduled to commence in mid-2017. The Tengiz field in Kazakhstan is another area of focus in 2017, along with the company's 2 million acres in the prolific Permian Basin.

Fidelity Select Natural Gas Fund (FSNGX) is a diversified way to participate in the recovery 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. At, say $53 a barrel, that is the cost of 5.8 million BTUs. However, with the current market price for natural gas at $3.12 for one million BTUs, 5.8 million BTUs will cost $21.70. So the same amount of energy is available for approximately 34 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 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. The fact that natural gas provides energy for pennies on the dollar will translate into an expanding natural gas industry.

ICON Energy Fund Class S (ICENX) is also a diversified way to participate in the recovery with a basket of substantial companies. The hallmark of this fund has been its ability to look for changes within the energy sector to capture value, rather than simply depending on rising oil prices. This fund is a good way to capture today's values and profit from the recovery and changing landscape on a diversified basis with professional management.

Freeport-McMoRan (FCX) is in our energy sector because it acquired substantial oil and gas assets at the top of the market in 2013 and took on close to $20 billion of debt to do so. To survive the downturn, the company has been selling assets to reduce its debt burden. FCX sold $6.6 billion in non-core assets in 2016, and reduced debt by $8 billion down to $11.8 billion. The company states than there are no additional asset sales required. In late January, FCX reported disappointing fourth quarter earnings of 25 cents per share and reversed a loss from one year ago. Although it was a profitable quarter, expectations were for 35 cents per share. FCX is also negotiating with the Indonesian government regarding the ability to export out of the country from the Grasberg mine.

FCX is the world's largest copper producer. Copper prices typically rise during economic expansions because of the wide use of copper for new construction. Low copper prices in recent years have forced miners to cut back on exploration and development which has been reducing supplies. Projections from industry analysts call for shortages to begin appearing from as early as this year to the next few years. Trump's infrastructure spending will be a large boost, and the amount and timing of the actual spending will play a significant role.

Transocean (RIG) makes deep-water drilling rigs and leases them to major oil producers around the world. RIG has been sharply impacted because the utilization of its rigs has fallen along with the drop in oil prices. We continue to recommend RIG because of its prospects for survival. Although down substantially in recent years, RIG still has a backlog of orders that is significantly higher than its peers totaling $12.2 billion, nearly all of which is for ultra-deep water floaters. Transocean currently has a fleet of 56 drilling rigs, most of which are deep-water floaters.

The company completed the construction of three new ultra-deep-water rigs in 2016 and will complete two more by early 2018. These additions mean that the company has one of the newest fleets in the industry with the ability to be most competitive. The long-term profit from RIG should be very good from here. Deep-water drilling is still a necessary source for the US and the world's oil needs.

Valero Energy (VLO) is the largest oil refiner in the US. It owns 15 refineries with a capacity for 2.9 million barrels per day. The company also has 7,400 retail outlets in the US, Canada, UK, and Ireland. Profitability in refining is a function of the so-called "crack spread", the difference in the amount a refiner pays for crude oil and the amount for which it sells the resulting refined products such as gasoline and jet fuel. Fluctuations in these prices compress and expand margins which can make refining stocks volatile at times. Valero is the most complex refiner in the US, which allows it to purchase lower quality crudes when they are priced at the most advantageous discounts. This flexibility allows VLO to capture the highest margins among its competitors. At the end of January, on a 10 percent revenue increase, VLO reported fourth quarter earnings of 81 cents per share, up from 62 cents a year ago.

ETFs for Rising Interest Rates

We have been recommending three ETFs designed to benefit from the normalization of interest rates and long-term bond yields. The economic sea-change initiated by Trump's aggressive pro-growth plans makes these ETFs particularly timely.

Although details are lacking, the combination of corporate tax cuts, infrastructure spending, deregulation, and repatriation of capital trapped overseas is bound to stimulate significant economic growth. Of course, this stimulation will also boost inflationary pressures.

The last time we saw similar proposals was from President Reagan. His tax cuts took the form of the Tax Reform Act of 1981. However, this came at a recessionary time, with unemployment close to 8 percent, relatively high interest rates, and plenty of slack in the economy.

After 7 years of economic expansion thanks to the medication of historically low interest rates, today's unemployment rate is below 5 percent which is considered full employment. Most economists agree (and worry) that stimulating a fully-employed economy will be inflationary.

Tariffs, border taxes, and forcing US companies to move plants and jobs into the more expensive US locations will raise costs and contribute to inflation.

In addition to the upcoming inflationary forces from Trumponomics, we have confirmation from the **Sound**Advice **Diffusion Index of LAGGING Indicators** (page 11) which is telling us that the US economy is already strong enough to prompt a rise in inflation and interest rates. For a multitude of reasons, the era of slow economic growth, nearly zero inflation rates, and historically low-interest rates is clearly over.

Our recommended ETFs differ in the amount of leverage used, and 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 bonds, as measured by benchmark 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 benchmarks will cause TMV to increase by 3.0 percent, TBT by 2.0 percent, and TBF by 1.0 percent. Conversely, an increase in their respective benchmarks will cause these ETFs to drop in the same fashion.

We can project the movements of these ETFs based on any given scenario. We have been using the Federal Reserve's prediction, which was as good as any. As part of the Federal Reserve's quarterly Federal Open Market Committee (FOMC) meetings, each of the 17 committee members makes a prediction regarding the future path of interest rates. Those predictions are plotted in the so-called "Dot Plot".

The most recent Dot Plot was taken at the December meeting. As usual, there was a wide difference in the predictions among this group of informed experts. The median prediction was that the Federal funds rate would be 1.375 percent at the end 2017, 2.125 percent at the end of 2018, and 2.875 percent at the end of 2019.

These are modest increases from the September meeting. The Federal Reserve is data dependent. Members base their opinions on the most recent data available, and use older data for context. Accordingly, monetary policy is generally a reaction to recent and past conditions. This is why the Federal Reserve is usually "behind the curve" when major economic shifts take place, and this time appears to be no exception. The market, not the Federal Reserve, is raising interest rates, as evidenced by the rise in bond yields of both long and short in maturities since election-day. With the Federal Reserve behind the curve, it is probable that the December Dot Plots will likely end up to be low.

In the spirit of being conservative, we can use the December Dot Plots as a basis of a forecast. Assuming long-term Treasury bond yields move in accordance with these target points (to preserve the same as today's real return), long-term Treasury bonds would be yielding 3.95% by the end of 2017, and 4.7% by the end of 2018, and 5.45% by the end of 2019.

Here is what would happen to each ETF:

TMV would rise from $23.26 to $36.43 by the end of 2017, to $51.73 by the end of 2018, and to $71.28 by the end of 2019.

TBT would rise from $40.11 to $54.10 by the end of 2017, to $68.35 by the end of 2018, and to $84.64 by the end of 2019.

TBF would rise from $23.73 to $27.56 by the end of 2017, and to $30.98 by the end of 2018, and to $34.47 by the end of 2019.

The Erosion Factor

As pointed 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, 0.04 percent (4 basis points) every day, and thus go nowhere through the end of 2017. Here is what would happen to each ETF:

TMV would decline to $21.72 by the end of 2017 (6.6%).

TBT would decline to $38.78 by the end of 2017 (3.3%).

TBF would decline to $23.47 by the end of 2017 (1.1%).

While not insignificant, this erosion factor is nominal in comparison to the price swings caused by a change in bond yields.

Real Estate Selections

It has been our posture for many months that the average real estate investment trust (REIT) does not present a particularly good value. As in the case of bond yields, low interest rates have pushed down real estate capitalization (cap) rates to historically low levels. (The cap rate is the cash yield before debt payments are considered.) As a result, commercial real estate prices are historically high. Accordingly, the *Sound Advice* portfolio only includes real estate stocks offering an extraordinary value now.

Two currently exist in the hospitality industry: Hersha (HT) and RLJ Lodging (RLJ). Both are selling at deep discounts to their net asset values and offer high dividend yields.

The table above shows the comparative values of other hospitality REITs. **Hospitality Properties (HPT)** has the second largest 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. **Apple Hospitality (APLE)** is trading at a slight premium.

Hersha Hospitality (HT is a real estate investment trust which owns and operates high quality upscale hotels in urban gateway markets. The Company's 55 hotels totaling 8,654 rooms are located in New York, Boston, Philadelphia, Washington DC, Miami, and select markets on the West Coast. HT is selling at a discount to its hotel assets. Many of HT's major properties have been undergoing renovations and not producing their full income potential. As renovations are completed and rooms are put back on line, revenue and FFO should climb substantially higher. New acquisitions will also contribute to growth, along with sales of less-attractive properties.

In January, a move to upgrade its overall portfolio, HT sold its 203-room Courtyard by Marriott in Alexandria, VA, and its 120-room Residence Inn in Greenbelt, MD for $62.0 million. The sale was based on a 7.4 percent cap rate. This sale follows purchase of the 77-room Ambrose Hotel in Santa Monica, CA, in December using proceeds from the sale of two suburban Boston hotels. Also in January, HT assumed ownership of the Mystic Marriott Hotel and Spa by closing out a joint venture owning lesser-quality hotels.

During the last several years, Hersha has reported several hotel transactions it made at cap rates ranging from 5.4 to 8 percent. To be on the conservative side,

Hospitality REITs Comparison Table

Company Name	Symbol	Recent Stock Price	Dividend Yield	Stock Market Cap Rate	Portfolio Value @ 7.5% Cap Rate ($Millions)	Stock Value	Discount (-) Premium (+)
RLJ Lodging	RLJ	23.21	5.7%	11.8%	6,472.5	40.80	-46.9%
Hospitality Properties	HPT	31.13	6.6%	10.2%	11,184.6	50.14	-37.9%
Hersha	HT	19.99	5.6%	10.0%	2,305.0	27.71	-32.3%
Host Hotels & Resorts	HST	18.07	4.4%	8.9%	19.2	22.05	-18.1%
Apple Hospitality	APLE	20.02	6.0%	6.8%	4,699.1	17.53	14.2%

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 7.5 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 7.5 percent cap rate valuation of each company's real estate portfolio.

we can establish a main street cap rate at the high end of this range, of 7.5 percent for valuation purposes.

Based on the latest trailing four quarters' financials, including the most recent 2016 third quarter, and using 7.5 percent cap rate to evaluate the company's portfolio, we value HT at $27.71 per share which is substantially higher than the current price. The dividend yield is attractive and lowers the risk profile.

RLJ Lodging Trust (RLJ has a large, geographically diversified portfolio of 125 hotels, branded by Marriott, Hilton, Hyatt, and Embassy Suites with over 20,000 rooms. Rather than traditional full service hotels, RLJ emphasizes "focused-service" or "compact full service" hotels, where only specially chosen services important for guests are offered. The most important amenity is an attractive, modern room offering quality features for the basic necessities – sleeping, bathing, and working. Minimized are amenities such as large restaurants, spas, and meeting rooms. Overall, the hotels are mid- to up-scale, but with reasonably-priced rooms. This concept translates into a larger portion of revenue from the rooms. The company is on a mission to upgrade its assets by purchasing properties in high growth markets with barriers to entry. The company is also seizing opportunities to sell at high prices. In December, RLJ sold two of its New York City hotels at a lofty 4.7 percent cap rate.

RLJ is currently selling at a steep discount to its hotel assets. Based on the latest trailing four quarters' financials reported, including the most recent 2016 third quarter, and using a 7.5 percent cap rate to evaluate the company's portfolio, we value RLJ at $40.80 per share which is considerably higher than the current price. The high dividend yield is attractive and lowers the risk profile.

Retail Opportunities Investment Corp (ROIC) is a real estate investment trust (REIT) that specializes in the acquisition, ownership and management of grocery-anchored shopping centers located in densely-populated, metropolitan markets across the West Coast. We originally recommended ROIC in 2011 at $11.11 when we thought it was a good value. After collecting nice dividends, we have a 100%+ gain. However, the current stock price is now paying slightly less than a 5 percent cap rate for the real estate portfolio. This is a historically low cap rate on this type of real estate. **Accordingly, we believe it is no longer a good value, and are selling ROIC.**

Third Avenue Real Estate Value Investor Fund (TVRVX) is loaded with good values substantially

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below 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. The managers expend great effort analyzing financial statements, visiting companies and their properties, and assessing management teams in order to come up with their estimates of intrinsic 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.

TVRVX has a number of distinguishing characteristics. This is a global real estate fund. 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.

Medically-Related Selections

Trump pledges to repeal the Affordable Care Act (Obamacare) and lead the effort to bring much-needed free market reforms to the healthcare industry. The sequence and timing of revamping the government health care provisions is not clear. These sweeping changes also need Congressional approval which adds further uncertainty. How this will all shake out is anyone's guess, which means it is too early to look for new investments in this area. We are comfortable with our current recommendations in this sector based on their own individual merits.

Boston Scientific (BSX) produces medical products well suited for an aging population. The company's mission is to transform lives through innovative medical solutions that improve the health of patients around the world. 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.

In January, BSX announced entry into the US treatment for Parkinson's and other movement disorders with its deep brain stimulation (DBS) devices as an established therapy for modifying brain circuitry. BSX already sells its DBS devices in Europe.

Stryker (SYK) provides a diverse array of innovative medical technologies, including reconstructive, medical and surgical, as well as neuro-technological and spine products, although SYK is best known for its orthopedic devices for artificial knees and hips. Continued growth is assured by accelerating demand for joint replacements on aging US 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 and strong cash flow give it avenues for continued diversified growth through acquisitions.

In January, SYK beat expectations with its fourth quarter earnings report of $1.78 per share. With that announcement, the company said it expects to earn from $6.35 to $6.45 per share in 2017.

Tekla Life Sciences Investors (HQL) is in our portfolio because the most explosive profits in the entire healthcare industry can be found in biotech companies. Over the last 10 years, biotechnology has become a major industry and the source of the world's top breakthrough drugs. Biotech companies tend to be high risk and high reward investments which makes diversification essential. This fund is an excellent way to invest in this sector.

Small Caps

Small caps tend to be domestic companies without substantial overseas exposure. They are typically not buffeted by the currency fluctuations that often haunt larger companies. The Trumponomics benefit is evident by the rise since election-say in the Russell 2000 Index, which is oriented toward small caps.

Numerous studies show that small caps perform better over the long run than the market as a whole. They 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. TVSVX management scours the investment universe for companies that combine the three main features: creditworthiness, a meaningful discount to a conservatively estimated net asset value (NAV), and the ability to consistently grow NAV, with an initial targeted holding period of three to five years.

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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.

Agrium (AGU) is a Canadian company offering a broad mix of agricultural products, from wholesale fertilizers to retail farm products, aimed at increasing the efficiency of food production. AGU products will be in growing demand as arable land continues to disappear around the world while population and per-capita income increases. This translates into a need for greater crop output per acre through the expanding use of AGU's products. Most of AGU's earnings come from its network of 1400 retail stores offering farm products along with 3,800 crop consultants who provide advice and products to customers to help increase yields and returns on hundreds of different crops. The balance of earnings comes from wholesale sales of fertilizers, mostly nitrogen-based with a minority from potash and phosphates. This diversification protects AGU from swings in the markets and brings steady sources of free cash flow for future growth.

AGU has been on the rise under the likely assumption that AGU will merge with PotashCorp (POT). Shareholders of both companies approved the merger and so have the Canadian authorities. The merger is expected to close in mid-2017 which is expected to benefit AGU.

Arconic (ARNC) is the spin-off of the downstream operations of value-added products from Alcoa (AA). Arconic retained a 20 percent interest in Alcoa Corporation which it plans to sell when market conditions improve. Arconic manufactures specialty metal products for aerospace and defense, building and construction, and automotive industries. Arconic is one of only a few companies with the expertise and assets to use uniquely advanced metallurgical techniques to produce metals that can withstand harsh environments, such as within a jet engine, as well as in other vital uses in products that must not fail.

Apple (AAPL) has a pristine balance sheet, with as much cash as long-term debt, with the highest A++ financial ratings. However, the stock market has been giving APPL a below-average price/earnings (P/E) ratio because of slow and even negative growth prospects. However, the demise of Samsung's latest Galaxy Note 7 phone has flung open the doors for a significant new growth path. Samsung has been Apple's fiercest competitor. Samsung has had 22.4 percent of the market share of smart phones – nearly double that of Apple's 11.8 percent share. Slightly more than one-half (57%) of Apple's revenue comes from its iPhones, so a gain of just one percent in market share translates to 14 million iPhones, which would add 7 percent to revenue. In addition, the new *iPhone 7* and *7 Plus* have been well received which is inaugurating a long-awaited upgrade cycle.

Trump's proposed border tax or tariffs would raise the cost of Apple's products brought into the US (along with its competitors). On the positive side, much of Apple's potential for growth is outside US borders. Additionally, lower corporate tax rates would be a large benefit to the company's massive tax burden. Apple has more than $200 billion stored offshore, and Trump's repatriation tax break gives Apple the opportunity to potentially repatriate 37 percent of its market capitalization.

Ford (F) is clouded with new uncertainties stemming from the Trump administration. New border taxes on cars and parts brought in are among the most negative propositions. The alternative of spending billions for plants to build cars, and paying substantially higher wages, in the US is also draconian. On the positive side are potential tariffs on foreign cars, primarily from Japan and lower US corporate taxes. How the cross-currents will end up remains to be seen and casts a pall of uncertainty over the industry and Ford. The stock has been a poor performer since election-day and the cloud of uncertainty is likely to continue to dampen its performance. **Accordingly, we are moving out of Ford to deploy capital to more promising areas.**

International Business Machines (IBM) was introduced in our January 24, 2017, email update called *Introducing Watson*. IBM is turning into a growth stock, thanks to the growth of its artificial intelligence division based on Watson, the Company's super computer that can think like a human. Watson cognitively scans a world of data and applies relevant information to what it learns about a company's business and systems to create new revenue streams, reduce expenses, and make existing operations more efficient. We have only begun to see and imagine the uses of artificial intelligence. IBM is the leader in that field and on a solid path to provide a growing abundance of opportunities in the months and years ahead.

We can simply look at IBM's current P/E of below 13 to see the profit potential. For example, if the P/E of IBM increases to the average of the overall market, which is close to 17, the price of IBM would reach $234 per share.

NCR Corp (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.

Management expects NCR's 2016 earnings to be close to $3.00 per share. We added NCR to the portfolio when it was close to 10 times earnings. NCR has climbed substantially recently, but it is still selling below the market average.

Symantec (SYMC) is the dominant supplier of software for computer security and protection against viruses and other nuisances. Nearly all of the Fortune 500 companies are Symantec customers. If there ever was a more certain growth industry, protection from cyber espionage is it.

In January, SYMC's product called Encryption Everywhere was introduced to the European markets as the first service to help secure websites and web applications.

Tetra Tech (TTEK) is a leading company in water technologies and environmental remediation with a healthy balance sheet for growth in strategic markets. Two recent acquisitions of Coffey and INDUS corporations have swelled TTEK's backlog of contracts and increased prospects for more Federal contracts in the IT sector. The company's backlog is now $2.3 billion, which reveals a robust pipeline with major government organizations like the US Department of State, US Army Corps of Engineers, and the US Air Force, which should continue to bolster growth.

Tetra Tech helped build the border wall near San Diego, and TTEK is among the companies to receive new contracts on building the wall and fences should the project become a reality. New contracts would come through the Army Corps of Engineers which has had a long history of contracting TTEK.

Wells Fargo (WFC) will be a beneficiary of rising interest rates, and the prospect of some deregulation will expand business opportunities. WFC has not participated in the bank rally due to the scandal a few months ago regarding unauthorized account-opening practices. While there may still be some fall-out, management has changed and the issue is basically history. The relatively low price of WFC makes it a strong value and a timely investment.

WFC is trading at less than 14 times earnings, which is substantially below the market average. Accordingly, WFC is presenting a good value and offers growth from rising interest rates, both in the stock price as well as the yield. WFC has a history of increasing dividends along with rising earnings.

Under conservative assumptions, 2017 earnings are expected to be $4.45 per share. This puts the current stock price less than 13 times 2017 earnings. Even with no expansion in the current price/earnings (P/E) ratio of 14, the stock would be $62 based on 2017 earnings. However, we expect more upside because the P/E ratio should expand due to brighter growth prospects. At a P/E ratio of, say 18 which is still below the overall market average, WFC would be $80 per share – 45 percent more than it is now.

Xerox (XRX) spun off its business services unit in early January to a separate new public company called **Conduent (CNDT)**. You received one share of CNDT for every five shares you owned of XRX on December 15, 2016. This is the event we had been waiting for, and we recommend keeping both for now.

SoundAdvice Investment Returns

Calculated Independently by the Hulbert Financial Digest

SoundAdvice in 2016 = **18.69%**
vs. S&P 500 = 9.54%

SoundAdvice from 2000-2016 = **10.30%** Annually
vs. S&P 500 = 2.37% Annually

XRX will now pay a 25 cent annual dividend for a 3.5 percent yield (based on today's closing price). As part of the spin-off, XRX received $1.8 billion in cash which will be used to pay off debt. XRX also has a new CEO, John Jacobson, who is bringing a new enthusiastic corporate culture and a three-year strategy for renewed growth.

Conduent is the consulting and outsourcing company formed by the 2010 acquisition of Affiliated Computer Services. CNDT offers no dividend presently but has been the growth side. The old Xerox had been moving its resources in this direction for several years for that reason. CNDT also has a new enthusiastic CEO, Ashok Vemuri, and over 93,000 employees in more than 40 countries with expertise in transaction-intensive processing, analytics, and automation. This side of the business has had an 86 percent contract renewal rate.

Both of these new companies should benefit from the split in their expenses, new separate leadership and goals, and the ability to focus and execute their respective plans for growth. Carl Icahn holds 9.77 percent of the stock of both companies.

Hedging the Portfolio

Our **SoundAdvice Diffusion Index of LAGGING Indicators** (page 11) is warning us to be cautious. Accordingly, we are also recommending a reverse ETF that essentially short-sells the market and will benefit from down-drafts in the S&P 500.

The **ProShares UltraShort S&P 500 (SDS)** 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 performs as it should, with daily premiums and discounts within 0.5 percent. It is also very liquid.

Energy/Natural Resources	Symbol	Price / NAV	Yield	Action	Limit
Chesapeake Energy Corp	CHK	$6.45	0.00%	BUY	$8.00
Chevron	CVX	$111.35	3.88%	BUY	$120.00
Fidelity Select Nat. Gas Fund	FSNGX	$29.25	0.42%	BUY	$32.00
Freeport-McMoRan	FCX	$16.65	0.00%	BUY	$18.00
ICON Energy Fund Class S	ICENX	$13.35	0.41%	BUY	$14.50
Transocean	RIG	$13.97	0.00%	BUY	$17.00
Valero	VLO	$65.76	3.65%	BUY	$72.00
Real Estate					
Hersha Hospitality Trust	HT	$19.99	5.60%	BUY	$23.00
Retail Opportunity Investment Corp	**ROIC**	**$21.20**	**3.40%**	**SELL**	**$20.00**
RLJ Lodging Trust	RLJ	$23.21	5.69%	BUY	$26.00
Third Avenue Real Estate Value Investor	TVRVX	$30.65	0.53%	BUY	$32.00
Medically Related					
Boston Scientific	BSX	$24.06	0.00%	BUY	$25.00
Stryker Corp.	SYK	$123.53	1.38%	BUY	$127.00
Tekla Life Sciences Fund	HQL	$17.87	0.00%	BUY	$19.00
Small Caps					
Third Avenue Small-Cap Value Investor Fund	TVSVX	$21.40	0.30%	BUY	$25.00
Special Situations					
Agrium	AGU	$102.91	3.40%	BUY	$114.00
Apple	AAPL	$121.35	1.88%	BUY	$124.00
Arconic	ARNC	$22.79	1.58%	BUY	$24.00
Conduent	CNDT	$14.96	0.00%	BUY	$16.00
Ford Motor Company	**F**	**$12.36**	**5.66%**	**SELL**	**$13.50**
In't Business Machines	IBM	$174.52	3.21%	BUY	$180.00
NCR Corp	NCR	$43.02	0.00%	BUY	$45.00
Symantec	SYMC	$27.55	1.16%	BUY	$28.00
Tetra Tech	TTEK	$43.70	0.82%	BUY	$45.00
Wells Fargo	WFC	$56.33	2.70%	BUY	$60.00
Xerox	XRX	$6.93	4.04%	BUY	$10.00
ETFs for Rising Interest Rates					
ETF - Direxion Daily 20+ Yr Bear 3X	TMV	$23.26	0.00%	BUY	$27.00
ETF - ProShares Short 20+ Year Trsry	TBF	$23.73	0.00%	BUY	$25.00
ETF - ProShares UltraShort 20+ Year Trsry	TBT	$40.11	0.00%	BUY	$44.00
Hedges					
S&P 500 ProShares Ultra Short ETF	SDS	$14.58	0.00%	BUY	$17.00

This table has live prices, charts & buy limits on our website: http://www.soundadvice-newsletter.com/members

Notes to the table: The right hand column is the highest recommended price limit for purchases. Prices are as of 1/31/2017. See our website for live pricing and buy limits:

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

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. The table above divides the portfolio into four sectors; Income with Growth, Diversified Growth, Energy and Natural Resources, and Aggressive Growth.

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 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 under performing 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.

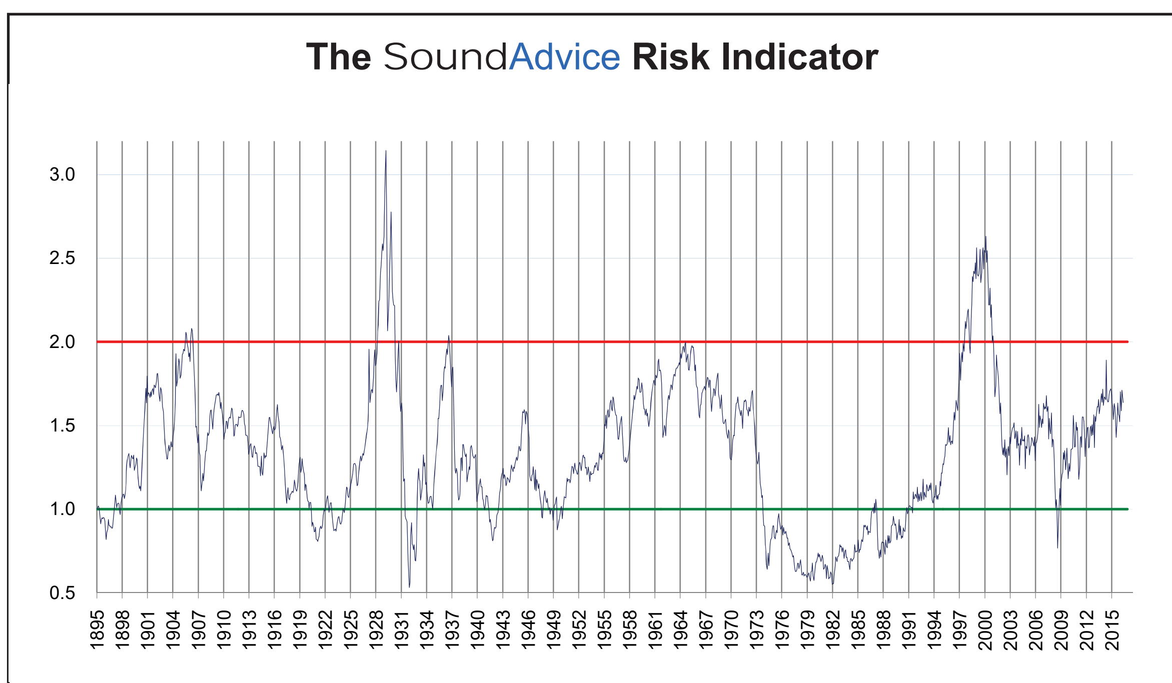
The figures show that over the entire century-plus, stock prices have outperformed housing prices. Just based on the price growth of each investment market and assuming no leverage was used, a $25,000 investment would have grown to $13.4 million in stocks and to $1.64 million in houses.

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 $533 million, 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 latest reading for the SoundAdvice Risk Indicator is 1.72. This reading reveals that stock prices are above 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 the Stock Market*** for a complete explanation of the SoundAdvice Risk Indicator and its track record.



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

We have been operating under a "Caution" signal since the June 2015 release of the May lagging economic indicators.

The SoundAdvice Diffusion Index of LAGGING Indicators was 83.3 percent in December (the most recent data). This is follows a consecutive string of five 100 percent readings.

Our next signal will come from the SoundAdvice **Diffusion Index of LEADING Indicators** when it drops to zero. **The latest reading for December was 100 Percent**.

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 32.1 percent. During "Caution" signals, the S&P 500 increased an average of 3.1 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
Ave +/-	32.1%		3.1%

See ***The Science of Making Money in the Stock Market*** for a complete explanation of the **SoundAdvice** Diffusion Indexes and their track records.

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