Berkeley Investment Advisors

Real Estate Brokerage/Retirement Planning

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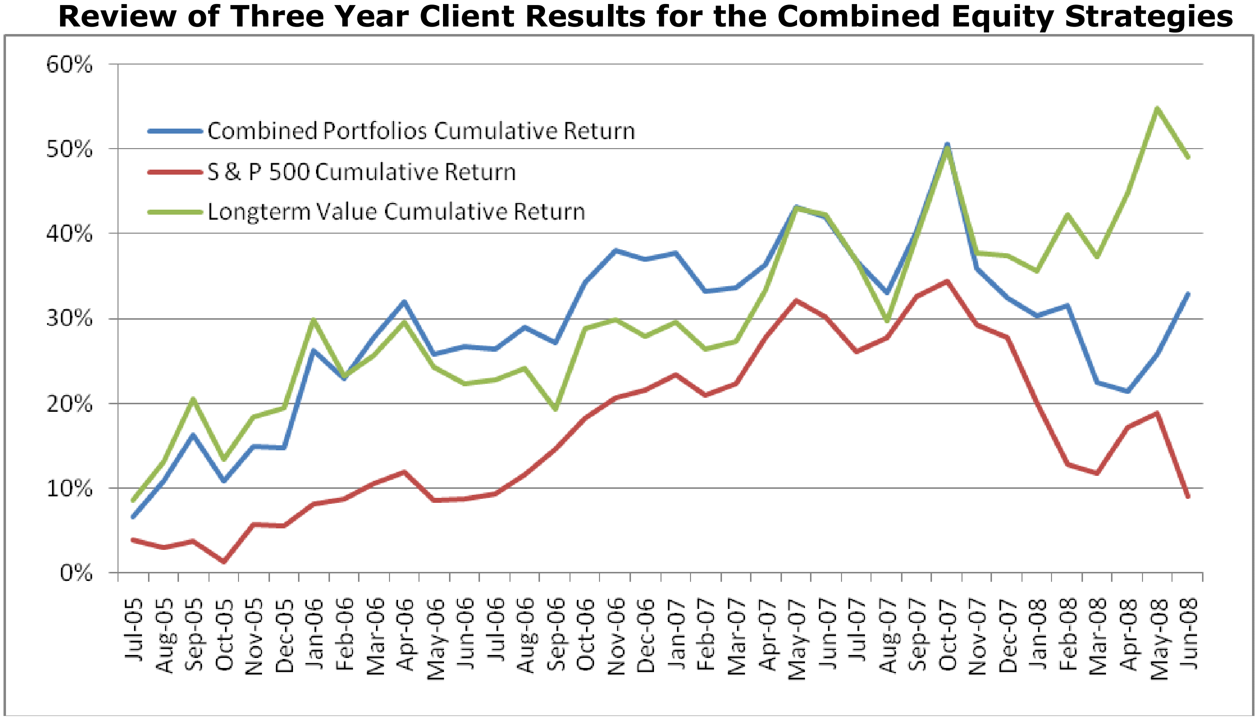
Investment Newsletter – June 2008

Referral Incentives and Future Client Fees

Starting today I am offering financial incentives to refer your friends and family for money management services. My objective is to significantly increase client accounts in the short term so that I can focus more time on helping people reach their financial goals for retirement. For those who have yet to open an account, I will raise fees for new accounts opened after July 31st. They will still be a bargain at 1.75% annually but you lock in my business launch fee level of 1.25% if you fund an account before August. In addition, anyone who refers a new client who invests with us will receive a **$500** discount towards their management fees over the next year.

Besides these incentives, the performance of our equity strategies for the last three years shows the substantial benefits of using Berkeley Investment Advisors to manage investment funds: a 33% cumulative return on an overall basis. After we review performance, I will provide some insight into my investing strategy in the current environment to show why it is still a good time to be investing with us.

Review of Three Year Client Results for the Combined Equity Strategies



For those of you unfamiliar with Berkeley Investment Advisors, we have implemented our investment strategies in a number of different risk portfolios which we allocate client money to according to their risk tolerance. Our primary equity portfolios are called Long Term Value (which hit its 3 year anniversary in March) and the Special Situations portfolio which came just a bit later. In January 2008 we initiated what we call the Hedge portfolio which we use to reduce the risks of the first two strategies under the current adverse market conditions. At that time we also moved a portion of client funds into some income oriented portfolios so that this money would be available to reinvest in the two main equity strategies once the risk of market wide losses is reduced to an acceptable level.

As shown in the March newsletter, the Long Term Value portfolio had outstanding performance over its first 3 years through March 17th. Since then it has been nothing less than amazing these last 3 months as our energy theme generated fantastic returns. In contrast, the Special Situations portfolio has had disappointing results since last July. Prior to that, the portfolio had a record even better than the Long Term Value portfolio. As I had warned, this strategy sometimes brings us short term losses if we invest in a declining sector before it hits bottom. I misjudged the extent of disruptions in credit markets and this portfolio took a beating – especially in March. These risks are precisely why I recommend only a small portion of client money be invested in this strategy. In retrospect my normal 20% target allocation was far too high for such a concentrated industry wide investment. It should have been more like 12% so as to give room to allocate more in response to lower prices and thereby reduce our cost basis. In any event, the following data shows that we have still performed well overall despite the setbacks in this portion of the portfolio.

For the 3 years ended June 30, 2008 clients following my most common allocation recommendations earned an overall cumulative return of 33% compared to just 8.9% for the S&P 500. The Longterm Value portfolio returned 49.2% over this three years and so was an even better investment than our blended allocation recommendation. Given inflation of about 3.4% over the last three years, our annual return goal was 13.4%. Although, we achieved a 14.3% annual return in Long Term Value, we fell a bit short on a combined overall basis – eaning a 10% annual return. The severe disruption in the credit market is responsible for this underperformance and I expect to reach our target returns over longer periods. The chart on the prior page plots the cumulative returns for the Long Term Value Portfolio and the overall blended portfolio recommendation over the last 3 years as compared to the S&P 500 index. As can be seen, we were meeting our return goals until October 2007 when the market peaked. In January 2008 we became defensive to preserve capital but were still hit hard by turmoil in financial holdings in March. The value of our financial holdings hit such a low level in March that our exposure to this risk factor is now relatively minor.

Investing in a Stagflation Environment

Back in the 1970's the U.S. experienced a devastating combination of inflation and anemic economic growth which led to the term stagflation. It also led to two recessions and large losses in the stock market. Today we are in a similar circumstance in that prices are rising at an accelerating pace even while real national income growth stalls. The economics of what has happened are clear. The financial system went off the rails in providing easy money to house purchasers which created a bubble in housing. This illusion of increased wealth drove consumer (and government) spending higher than it otherwise would have been – financed by housing debt. Now that the illusion of free money is being deflated, spending must drop to levels more closely linked to the nation's productive capacity.

The government is trying to find ways to prolong the adjustment process and so they did the borrowing for us and sent rebate checks to temporarily prop up demand. The effects of this will soon fade. The damage to the financial system and the economy from dropping house prices is so huge that the Federal Reserve must engineer inflation to save us from a serious meltdown. This in turn depreciates the dollar, driving up import costs (such as oil) and effectively reducing the amount of real goods we must pay back to our overseas creditors (i.e. China and Japan).

The end result will be a contraction in consumer spending. As consumers tighten their belts and the monetary stimulus drives up production costs, we can expect to see lower profit margins for companies. This scenario may take quite a while to play out and, in my view, is not fully reflected in current stock prices. Hence I foresee the overall market declining.

So what does this mean for investors? Should we sit on cash and wait a few years for the dust to settle? The answer is clearly no as the upsurge in inflation will erode the purchasing power of cash. The smart strategy is to invest in assets that will help you ride out inflation or perhaps even benefit from the depreciation of the dollar. At Berkeley Investment Advisors, we are putting client money to work in energy, gold, real estate, and foreign stocks, while simultaneously hedging against the overall market decline (with new Exchange Traded Funds designed exactly for this purpose). The portfolio we've constructed pays dividends much higher than bond yields and these will rise with inflation. We don't lose money just because the overall market goes down. In fact we have been making good returns on down days for the wider market.

We have had some bad picks in financials that have hurt returns this year, but the rest of the portfolio has done well enough to keep us at break even for 2008. Since our losing stocks now represent such a much small part of the portfolio, I don't expect them to negatively impact us in the 2nd half of the year.

A Strategy for Long Run Investing

There are many who advocate buying index mutual funds and just holding through all market conditions. The reasoning for holding through a downturn is that most people cannot properly call the bottom or top of a market and their emotions cause them to sell low and buy high which is a recipe for poor returns relative to a buy and hold strategy. While I don't claim to be able to time the market, I believe that avoiding large losses is the key to strong returns over the long run. Therefore, when poor economic conditions increase the risks of losses, our strategy is to reduce our exposure to market wide risks while capturing returns from individual securities that are likely to meet our return targets in the long run.

Essentially what I advocate for investors is an absolute return goal, not just an attempt to beat an equity index. My fixed goal for myself and my clients is to earn a return that exceeds inflation by 10% over the long run – regardless of what the overall market does. By pursuing this absolute return strategy rather than trying to always beat the S&P 500, I'm saying that it is more important to earn a substantial steady return than always take full equity market risks. We may underperform when the market rises rapidly, but in the long run we achieve our goals (or at least close) with much less risk of damaging losses. As you saw in the performance review above, the results have been substantially better than a passive strategy even though the turbulence in financial stocks over the last year has caused us to fall just a bit short of the our long term goal. My expectation going forward is that we can indeed make up the difference and meet our target return by the fifth anniversary of client investing.

Conclusion

Although our investment strategies are not immune to the volatility of the market during difficult periods, we are proactive in addressing risks so as to preserve capital during prolonged downturns. Our attention to economic developments and their implications for asset allocation, combined with our discipline in buying undervalued stocks, should enable us to achieve our return goals over our long term investing time horizon. Even if we do not reach our lofty goals, this style of investing greatly increases your chances of earning returns well above the inflation rate over long periods. Compounding these kinds of returns over time can make a very real difference in your wealth at retirement. In my own case, my cumulative returns are now more than 10 times the cumulative returns on the S&P 500 after just 9 years.

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