Berkeley Investment Advisors

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Investment Newsletter – March 2009

This month is the 4th anniversary for our money management services. I am happy to report that the cumulative average of returns for our clients who invested back in 2005 has exceeded the returns on the S&P 500 index by 34.2% since March 17, 2005. At the end of this newsletter I will provide further details on past returns, but first I want to start with my analysis and strategy for both the stock market and the real estate market. If you are familiar with my contrarian style, you should not be surprised that I see value in assets that many are dumping.

Real Estate Investment Looks Smart Again

Starting in 2005 it became increasingly difficult to purchase investment real estate at reasonable valuations given my expectations for a cyclical upswing in interest rates and capitalization rates – especially in California. Too many people were willing to bid at historically high levels – thus driving down future returns for all. The expected correction in values is now well under way and returns on real estate are returning to more normal levels that compensate for its illiquidity. Stocks still offer higher potential returns at this point, but on a risk adjusted basis, real estate is becoming rather attractive. In fact, for the first time since I have been watching the local markets, local houses are starting to make sense as investments. As I will explain, anyone with available cash to invest should start looking for investments now, while these opportunities are available. Over time, as inflation and interest rates rise, good deals will become harder to find again.

House prices in the remote suburbs of the East Bay are down by 40-60% since the peak. On March 10th a search for sales in El Sobrante Ca over the previous 4 months revealed that 11 of 12 sales were bank owned houses and the other one was a short sale. Some are selling as low as 10 times gross annual rental value. This translates into a 5.9% cap rate. Combine this with recent mortgage rates of 4.75% and you can achieve positive cash flow with 20% down. This means it's cheaper to buy than rent - even on a pre-tax basis. Amazing! Either interest rates will go up or prices will go up, or both. These houses are in a supply constrained market within easy commuting distance of San Francisco. If the government's efforts to boost inflation succeed, current buyers will have large gains over 5 years.

Multifamily properties are also listed at valuations not seen in California this decade. Appendix A shows a sampling of recent listings with advertised capitalization rates in the 7-12% range. Some of these are a bit exaggerated but still represent great value. In 2006 you would not find anything over 6% and that was when mortgage rates were higher than now. In this environment it may be possible to get cash on cash returns greater than 10%. Again, the likelihood of significant inflation provides large expected upside.

Despite my optimism about this market, there are caveats. First is financing. Although Fannie Mae and Freddie Mac are supporting the multifamily mortgage market, you will still need good credit, a large down payment, and strong property operating statements to secure a mortgage. Those of you with cash are being handed a gift from the government. I suggest you take it – despite my second caveat. Namely, the possibility of tax law changes aimed at "the rich". Given the runaway spending and deficits planned, it seems very likely that by 2011 the government will look for ways to take back some of the gifts they've given.

An Update on Our strategy for Equity Investment Funds

Our strategy is mostly unchanged from December. Although the Federal Reserve is in overdrive pushing all the right stimulus levers they can, the Obama administration and Congress are using the crisis as an opportunity to remake the economy in ways that are unlikely to promote economic growth. There seems to be a very substantial risk that the financial industry will be effectively destroyed by a lethal combination of bad investments and government interference. This will greatly reduce potential GDP growth and profitability for the whole economy. Consequently we are very defensive - despite the recent rally in the market. I continue to believe that we are better off late to a sustained bull market than to risk large potential losses that could easily materialize as more bad news comes out. That said, I would see a large (20%+) move down as an opportunity to reduce our hedging substantially.

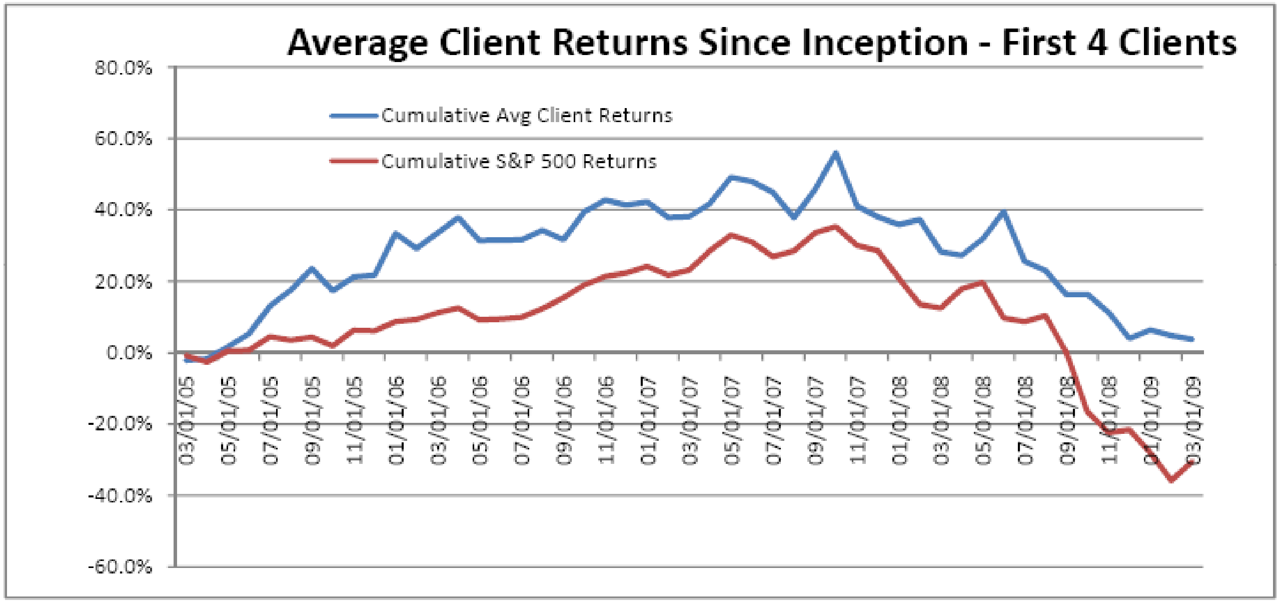
The Chinese have now publicly complained about the coming depreciation of the dollar because they see it is aimed at pushing some of our losses onto them. As I explained in the September 2008 newsletter, we as a country can shift our losses to our creditors by stimulating inflation and depreciating the value of the dollar. Given the short sighted nature of our political system and the incentives to shift losses away from voters to foreigners, it is now clear that our politicians will do their best to go this route. They know that this policy could destabilize the world if the dollar collapses abruptly - so they must never talk openly about it or acknowledge the truth of what the Chinese have now figured out. We hold substantial gold positions and foreign securities to profit from this policy. I expect to further increase our allocation to foreign markets going forward since I am predicting that risk adjusted returns will be better in higher growth economies.

Review of Client Investment Results 2005 – 2009

The table below shows the average returns for the clients who invested in separately managed accounts at Berkeley Investment Advisors in 2005. Although it is disappointing that we've lost almost all our gains since the start of this bear market, we can be proud of the fact that we've avoided the disastrous losses of the S&P 500.

Returns Comparison	From Mar 17				To Mar 31	Cumulative Since
Year	2005	2006	2007	2008	2009	Inception
Average of Client Returns	21.8%	16.1%	-2.4%	-24.6%	-0.3%	3.8%
S&P 500 Return	6.2%	15.2%	5.1%	-39.0%	-11.3%	-30.4%
Difference	15.6%	0.9%	-7.5%	14.4%	11.0%	34.2%

The graph on the following page shows the same returns on a cumulative basis.



In October 2007 our cumulative return peaked at 56%. In January 2008 we put on hedges against further expected market declines. Consequently we did not lose money for the first 6 months of 2008. After that, the rapid drop in oil prices and very high volatility rendered our hedging instruments less effective than expected. Now that the drop in oil prices is reducing supply and dampening the drop in demand, this risk factor has become relatively less important. Furthermore, we have shifted to more effective hedging instruments to reduce the losses attributable to volatility. As a result, we have managed to remain roughly flat so far in 2009.

In summary, our clients have managed to outperform the market in both up and down markets. Although cumulative returns to date are somewhat unimpressive on an absolute basis, by sticking with our strategy (but hedging more effectively) we are well positioned to withstand further declines and produce outstanding returns as the economy recovers.

Another Bit of Advice in the Current Market

It's wise not to sell just because an investment declined in value but you also should not leave money tied up in a particular stock or mutual fund **because** its price went down. This may sound contradictory but it's not. If you bought something and then new information reveals that its value is lower than its current price – sell it even if it means taking a loss. Your emotions will tell you to hang in there until it recovers. Unless you can't find any better investments, ignore your emotions; take the loss and move on to better investments. Of course if it's a mutual fund you have to decide if you believe that the strategy still might be right for the current market environment.

Conclusion

If you have lost too much investing in equity mutual funds, face up to your responsibility to find a strategy that makes sense today. We can implement a risk managed approach for your equity investments and help you take advantage of the current opportunities in the real estate market. Call us for a consultation. Do it soon – things are likely to change rapidly from here.

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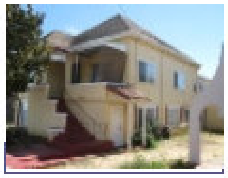
Appendix A

Sample California Multifamily Listings at March 31 2009



Vallejo Apartment Portfolio
Vallejo, CA
*****LENDER OWNED - REO - PARTIAL SELLER FINANCING!!!***** LOOK AT THE NUMBERS! 10% Cash on Cash! 6.5 GRM! Apartments make sense again! The...

Status: Active
Price: $795,000
Bldg. Size: 6,628 SF
Units: 11
Cap Rate: 7.70%
Property Type: Garden/Low-Rise

SF 5-Unit with good cashflow upside
San Francisco, CA
5-unit Edwardian building with a positive pre-tax cash flow. 4 1-bd units, plus large 1-bd live/work space, formerly an office in a building zoned...

Status: Active
Price: $999,000
Bldg. Size: 4,000 SF
Units: 5
Cap Rate: 7.38%
Property Type: Mid/High-Rise

Townhouse Garden
Sacramento, CA
Lender Approved Short Sale Price. The subject property consists of three separate buildings. All the units are two bedroom / one half bath...

Status: Active
Price: $825,000
Bldg. Size: 16,200 SF
Units: 18
Cap Rate: 11.93%
Property Type: Garden/Low-Rise

1039 45th Street
Emeryville, CA
This classic Edwardian building offers 8 units, a 6-car detached garage and parking for additional cars in the rear. This property is currently being...

Status: Active
Price: $995,000
Bldg. Size: 7,500 SF
Units: 8
Cap Rate: 11.00%
Property Type: Garden/Low-Rise

1100 Sevier Ave
Menlo Park, CA
5 unit building in Menlo Park, located near Highway 101 with easy access to Silicon Valley. Building was completelyr emodeled and reinforced in 2001...

Status: Active
Price: $900,000
Bldg. Size: 4,000 SF
Units: 5
Cap Rate: 8.00%
Property Type: Garden/Low-Rise

Double L Mobile Ranch
Fresno, CA
The common area consists of a laundry room and playground. The laundry facility provides excellent income due to lack of local competitive...

Status: Active
Price: $775,000
Bldg. Size: N/A
Spaces: 37
Cap Rate: 9.04%
Property Type: Mobile Home/RV Community

5258 YOUNG ST
Sacramento, CA
15 UNITS ONE 3 BEDROOMS 2 BATHS,6 TWO BEDROOMS 1 BATH,7 ONE BEDROOM 1 BATH & STUDIOS.PLEASE DO NOT ASK THE TENANTS

Status: Active
Price: $725,000
Bldg. Size: 11,000 SF
Units: 15
Cap Rate: 12.00%
Property Type: Garden/Low-Rise