Berkeley Investment Advisors
Real Estate Brokerage/Retirement Planning

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Investment Newsletter – September 2006

Updates

The New Mexico market update planned for this month is being delayed because the development we are looking at has not yet set the pricing for their units. We will issue our update on this market as soon as we are able to quantify our analysis of the opportunities there. Consequently, this month's newsletter is devoted to a general review of the U.S. real estate and stock markets, as well as an update on recent events in Thailand.

U.S. Real Estate Markets

For the first time since the early '90's the median house price in the U.S. declined. Regionally the West still showed an increase in the median price despite declines in several cities. There are certain places (e.g. New Mexico) where prices were not driven to unreasonable levels by speculators with cheap money. Strong fundamental demand versus supply in these areas may allow them to buck the wider trends and rise. In the markets that went up the most, prices are expected to fall as speculation dries up and higher rates reduce buyers' ability to pay ever higher prices. I have been expecting this adjustment to start for some time because I expect reductions both in mortgage capital and speculative equity in the most overpriced markets. The strength of the psychological component of demand surprised me, but now people seem to understand that real estate can indeed go down as well as up.

Unlike stock markets, real estate markets do not adjust quickly when participants realize prices are too high. Once a seller has in mind that the value of his house has reached a certain level, they will be reluctant to accept a lower price. In the face of a declining market, many sellers will simply not sell at the market price because they believe they can get the old higher price just by waiting a little while. Meanwhile most buyers refuse to pay prices from the market peak - so sales volumes drop drastically – as they now have. In a market like this, only the most motivated sellers and buyers will participate. Builders will be the first to cut prices. Thus cities with significant new supply will see the fastest and largest price cuts (though developers may disguise these as free upgrades and other such incentives).

In markets where new supply is relatively un-important like San Francisco, transactions that close will not show serious price declines until all the price insensitive buyers have been satisfied. When price sensitive buyers dominate the market, sellers who must sell will reduce prices to get rid of their property. This changes the psychology of the market and begins a long slow-moving cycle of price cuts that can drag out the price adjustment for years.

Economic Impact of Housing Decline

In markets where construction activity is significant, the drop in new orders and pricing will slow development and therefore reduce regional economic growth (think Phoenix). Dropping prices reduce consumers' equity in their homes. This will quickly reduce the amount of cash-out refinancing activity that has been adding vast spending power to the U.S. economy. Price drops will hit speculators even harder as many expected appreciation to bail them out of negative cash flow investments. When this rescue is not forthcoming, many will have no choice but to allow the bank to foreclose on the property. We are already seeing a big increase in foreclosures and these should continue rising over the next couple of years. Investors with cash, and the inclination to go after these deals, will find more and more opportunities in 2007 and 2008. The resulting drop in general demand and the destruction of spending power will put a brake on the economy. I believe there is at least a 50% chance of a recession in the U.S. in 2007.

Stock Market Notes

The bond market is forecasting a recession. Currently long term rates are below short term rates. This means that traders backed by big money expect the Federal Reserve to cut rates in the future to pull the country out of a recession. Certainly the inflation data are not tame enough to suggest the Fed can afford to cut rates without a recession. The expected slowdown has contributed to a dramatic pull back in oil prices. Energy stocks declined significantly along with oil prices. Our Long Term Value portfolio has suffered a big drop since peaking in May and is now up just 2% year to date.

When I look at our positions, I see oil stocks whose prices reflect a prolonged and much larger decline in the oil price than we've seen so far. The portfolio also contains several stocks in businesses that will be virtually unaffected by recession. We also have a significant investment in foreign equities that could increase in value due to a decline in the dollar exchange rate that would logically follow a recession and drop in interest rates. Thus I feel the Long Term Value Portfolio is well positioned in the current uncertain environment.

The Special Situations Portfolio has been nothing short of spectacular this year – soaring 51% year to date. We have sold positions and the existing positions are now much closer to their intrinsic value than at the beginning of the year. Therefore, I expect that returns will be lower until some new opportunities come along to allow us to redeploy capital.

Thailand Developments

If you haven't heard, there was a military coup in Thailand on September 19th. The consensus is that the coup will bring increased political stability. Previously the country found itself in a political stalemate. The prime minister had sold a large telecommunications company to a company from Singapore in a way that avoided all taxes. This angered a lot of people. The prime minister had also worked to systematically weaken other government institutions in the country by replacing top people with his own entourage. Finally the military and the revered King could stand by no longer. The move has re-united the country with more than 85% of Thais approving of the coup. Policies going forward are likely to be even more favorable for foreign investors than before.

Below is an excerpt of a newsletter written by Mr. Holt, one of my primary contacts in Thailand.

Sorayuth Chulanon, a former Army Chief, is about to be named as the new caretaker Prime Minister. He will be responsible for stabilizing the country, encouraging investment and growth, and preparing the way for new elections. He is very popular and the Thais I have spoken to approve of him. They say that he is a 'nice guy', so we are all very hopeful.

No matter what happens, the specter of further social unrest has disappeared and we are all getting on with our business. It's time to look forward to a better future.

Property sales have been very quiet for the last few months while all the political shenanigans were going on. Now that the corrupt politicians have been ousted Thailand has a good opportunity to start afresh.

Now that the Thaksin government is gone, the changes he initiated to control land ownership are not being applied as strictly. During my stay in Pattaya this week I talked to several people in the realty business and all of them mentioned that the Land Officers are letting it be known they are not checking companies set up with foreign investors to buy a house to live in.

So, if you have had reservations about bringing your money into Thailand, set your mind at ease. The Thais are actively seeking international trade and investment. They understand the issues, and they want to encourage more investment. This can only happen in an outward looking environment. The Thaksin government was xenophobic, to put it mildly. With them gone, many of the problems they brought with them are melting away.

The new airport, Suvarnabhumi (the 'i' is silent), opened this week and all the planes moved to the south east of Bangkok. Good news for Pattaya, as The Extreme City will be only about one hour away. But don't count on it right now. I drove down there last weekend and found that extensive road works are well underway. The entire motorway is being widened. The center dividing area that was green grass and trees will soon become another two lanes, giving us a four-lane highway to Pattaya and back.

How will all this new infrastructure affect the Eastern Seaboard?
It doesn't take a genius to see that the exploding growth we have seen in Pattaya over the last few years is only the tip of the iceberg. If you haven't got around to buying property there by now, don't wait too much longer. Savvy Thais I know have taken their properties off the market at the moment while they wait for the next growth period.

I could see construction going on everywhere as I drove around Pattaya and the surrounding areas. New condos and housing estates are springing up. Overseas companies are flocking in to build hotels and resorts. The remaining land along the coast between Jomtien and Bang Saray is being snapped up. Land up in Huay Yai near Phoenix Golf & Country Club and in the hills behind Bang Saray is selling fast, with new housing estates planned for the area. It's like a gold rush.

I get quite a few people sending inquiries telling me they plan to come here sometime next year to buy. They will be too late. Prices will have started rising by then and I believe it will cost at least one third more to buy your place in the sun. They say time waits for no man. You can say the same about the property market in Thailand right now too, especially in Pattaya.

My thanks go to Mr. Holt for his excellent on-the-ground analysis. This newsletter and articles appearing in the Wall Street Journal all read as great news for investors in Thailand. After having researched this market thoroughly over the past year, I have no doubts that my investors will earn much higher returns in the Thailand Development Fund than any other real estate investment that I know about in the U.S. Investments in Mexico and Costa Rica are all the rage right now because world demographics and capital flows favor resort areas. Thailand is far less risky than either of these and there is a lot room for upside moves. Thailand gets over 12 million tourists annually. It is hugely popular with Europeans and Asians and getting more popular fast.

Conclusion

The key to superior investment returns is research and keeping up with current developments so you can accurately assess risks and the likely returns *going forward*. That's what Berkeley Investment Advisors is all about. Let us show you the true opportunities out there

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