FINANCIAL SOLUTIONS

A Registered Investment Advisor

Michael Boulton
Financial Advisor

Financial Planning
Retirement Planning
Portfolio Management

December 2006 Newsletter

www.bestfinancialsolutions.com

415 388 3975

The Stock Market Versus Real Estate

Our two best inflation-hedge investments are real estate and the stock market. Most of us have a clearer sense of why real estate is an inflation-hedge than the stock market. However, if you think about it, an average house in California cost under $50,000 until 1960. The Dow Jones Industrial Average was under 500 until 1960 and is now over 12,000. Much of this is due to inflation and the loss of purchasing power of our currency. When we own stocks, we own a "piece of a company". Each company raises its prices for goods or services on a regular basis to protect against inflation. As investors, we then get that same inflation protection. To the extent we are able to beat inflation in both real estate and the stock market, that's where our true financial benefits reside. So, when people ask me if they should own real estate or stocks, I say "both". The ownership of stocks has become even more important since the government has expanded the laws allowing for tax-deferred retirement accounts.

Despite being our two primary inflation-hedge investments, they both have very different traits. The first requirement for the purchase of real estate is "affordability". Due to the high costs, we usually want to use debt and leverage to make a real estate purchase. Because of this, we need to analyze cash flow and the ability to carry the debt service. If we are able to service the debt, then the leverage created by the debt allows us to reap even better returns. The overall pattern of fluctuations in real estate is totally different than that of the stock market. Real estate cycles are long-term in nature and somewhat less volatile.

In order to purchase stocks or stock mutual funds, we have the ability to deposit our money with a brokerage firm and start purchasing. Due to the higher level of volatility, I do not recommend that most people use debt or "margin" to make stock purchases. Therefore, without debt, there is no "cash flow" requirement as exists in real estate. However, because there is no debt, the benefits of "leverage" also do not accrue.

Starting at the beginning of 2000, the stock market peaked after a 6-year boom and started a major correction. This downturn encouraged more real estate investment as investors had to choose between the two. Over the last two years, interest rates have risen, real estate has softened and the stock market has become the preferred vehicle of the two. These vacillations back and forth are normal and will always be a factor. It is impossible to predict each cycle perfectly and real estate does not allow for quick trading in and out to play the cycles. While the stock market does allow for quick trading, it is very difficult if not impossible to successfully time the shorter-term cycles. However, if we own both an appropriate amount of real estate and stocks over the very long-term, we will be protecting ourselves from the erosion of our currency through inflation and hopefully beating inflation substantially during the up years in each cycle.

Quotes

"Time is the coin of life. It is the only coin you have, and only you can determine how it will be spent. Be careful, lest you let other people spend it for you."
– Carl Sandburg

"Money is only loaned to a man; he comes into the world with nothing and he leaves with nothing."
– William C. Durant

"If you don't know who you are, the stock market is an expensive place to find out."
– Adam Smith

Why December is not the Best Month to Buy Mutual Funds

Usually toward the end of December many mutual funds issue distributions to shareholders, especially when they have had a good year (like 2006) or when they are an income-producing fund like a Real Estate Investment Trust (REIT). When a distribution takes place, the Net Asset Value (NAV) of the mutual fund decreases commensurately with the distribution. So, if the mutual fund price is at $40.00 per share and they issue a $2.00 per share distribution, the fund price drops to $38.00 immediately. So, how does this affect us? Well, distributions are "taxable events" to us. So when we receive that $2.00 per share distribution, it may be taxed at our ordinary income tax rate, on top of our other income for the year. For those that are in very low tax brackets, it is not as big an issue as for those that are in higher tax brackets. However, the point to understand is that if we purchase a mutual fund on December 15th and then the distribution occurs on December 28th, we have only owned that fund for 13 days before being hit with a taxable event. If we had owned that fund since January, 2006, we would have benefited from the growth of the mutual fund throughout the entire year, which means we benefited from the growth and then got the distribution, which is a lot easier to swallow, at least for those in the higher tax brackets.

Four convenient newsletter options from which to choose: (1) Add a friend or relative to the mailing list; (2) Receive this newsletter by email instead; (3) Tell us about a change of address; or (4) Be removed from our mailing list. *Please call or email us today with your preference. If we do not hear from you, newsletters will continue by regular mail.*