

FINANCIAL FOCUS

Robert Smith says economic conditions reveal that investments in stocks and in commercial real estate are preferable nowadays. **Page 5**



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Signs show where money should go

These days, stocks and commercial real estate investments are much more attractive than bonds

Previously, I stated why you shouldn't be buying bonds now – historically low yields, when interest rates go up, bond prices go down, etc. Well, ready or not, here comes the next wave: municipal securities default.

Following the expected Republican tidal wave in November, states will go back to D.C. with a tin cup in hand and ask for more money. However, instead of a compliant Pelosi/Reid Inc., they will encounter a slew of fiscally conservative newcomers likely to send them packing.

Forced back upon their own devices and intransigent public employees unions, investors will shun their municipal securities and yields will skyrocket. Call it the "California Experience," where investors recently demanded 124 basis points in extra yield above AAA rated municipal bonds to be compensated for their risk. That was a 14 percent increase in yield in one week. Let's just call this little blip a "bond yield on steroids" – fitting for a state whose governor first gained notoriety as a body-builder. Did I mention that Cali-



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fornia already has the lowest credit rating among the 50 states?

Just about the time when all of this begins to unravel, stocks will rally. Corporate profits are at all-time highs and bond rates in the Treasury market are near record lows. Furthermore, more U.S. stocks are paying dividends now that exceed bond yields than at any time in the last 15 years. I repeat: stock dividends now exceed bond yields. And corporate profits are rising at the fastest pace in the last two decades.

Make no mistake: Businesses, at least those owned publicly, are in very good shape. U.S. firms scored a record \$1.2 trillion in profits during the second quarter and are sitting on roughly \$2 trillion in cash. This is more than enough money to buy anything they want and hire as many people as they like. And this process will start once Pelosi/Reid Inc.

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are out of business. A regime change will be good for stocks.

Along with stock dividends, U.S. commercial real estate yields are near the highest level relative to Treasury bonds on record. As with stocks, this should be a signal to investors that it's time to buy property. Remember what Bernard Baruch said: "I made money in real estate buying my straw hats in winter." Loosely translated, this means to buy when everyone else sells. I know this is counterintuitive, but you must get out of the box.

Capitalization rates, which measure real estate yields, averaged 7.22 percent in the second quarter. That was 429 basis points, or 4.29 percentage points higher than the yield on 10-year government bonds as of June 30. It's even higher today. This means that bond prices are too high and real estate prices are too low. Risk-averse investors

should seek the highest-quality office buildings, retail centers and apartments available. All this data indicates that real estate is poised for a rebound.

At the peak of commercial real estate valuations in 2007, the spread between property yields and Treasuries shrank to less than 80 basis points, or .80 percentage points. It's more than five times that now. This means that property is priced attractively versus the fixed-income market.

To capitalize on this value in real estate, you've got to be picky. You must look for the best properties with the best tenants with high occupancy. However, you also must avoid paying up for these leases. You make money in real estate when you buy, and not when you sell. If you pay too much, it is very hard to manage your way out of that situation.

Size matters in real estate. Therefore, you must align your-

self with a large and preferably old company that can bring real leverage to bear in terms of pricing. When this is combined with a strong management track record, it is a hard combination to beat.

Our preferred vendor out of the Midwest is a privately held company with more than 40 years experience offering high quality real estate investment programs. They have completed more than 416 investment programs since their inception and in each case no investor has received less than his or her contributed capital. This is a record very few can boast.

To summarize, stocks and real estate are cheap relative to bonds. You should own stocks and commercial real estate rather than bonds. There is more potential upside. If you are looking for current income, look to stocks and real estate. Both stock dividends and real estate yields exceed bond yields by a significant margin.

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