Optivest First Quarter 2008 Newsletter

US Economy- What a wild ride the first three months of the year has been! The sub prime mortgage problem, compounded by highly leveraged investment vehicles (CDOs), caused a bona fide banking panic culminating in the mid March government sponsored bail out of Bear Stearns, steep drops in the stock markets and the floating of $200 billion of Federal Funds to help weak financial institutions meet minimum capital requirements. Investor sentiment touched a 17 year low, while the U.S. dollar dropped to all time lows amidst all time highs for oil, gold and food. The housing market continued to drop nationally as prices returned to 2004 levels. While it officially takes two back to back negative GNP quarters to qualify as a recession, most economists believe we started one in December.

Stock Market- All of this quickly drove the stock market down 13% in the first 13 days of the year; ultimately making what we believe was a multi-month bottom on March 17th in the S&P 500 at 1256 (down 14.4% for the year). We sent you an email on March 20th (enclosed) explaining the important dynamics of that week and why it was likely the bottom. Since that bottom, the market has recovered, reaching progressively higher highs and higher lows, forming a positively sloping channel upwards. The next major upward milestone will be to cross the 200 day moving average on the S&P 500 which is currently at about 1440 and dropping. The reason that the stock market has likely bottomed, despite being in the middle of a recession, is that historically, bottoms occur about 7 months before recessions end as investors anticipate a recovery. This would put the end of the recession in October 2008. Overall, the first quarter ended at a level making it the worst quarter in six years for the U.S. stock market while most foreign markets fared even worse with China and India dropping 23% and 34% respectively (now both are down almost 50% from their highs); up one side of the Eiffel Tower and down the other.

Fixed Income- Investments also went down over the first quarter as investors shunned corporate bonds and muni bonds in favor of treasury bonds, driving the yield of 10 year treasury bonds down to about 3.3% and 90 day notes to 50 year lows of 0.5%. Fortunately, as the banking panic subsides, this trend is reversing and most of our fixed income investments are now up for the year and further gains are expected as the economy recovers. Although it sounds counter intuitive, an increase in the 10 year treasury bond yield to above 4% (3.72% today) will signal that confidence is being restored to financial institutions and the worst is behind us.

Real Estate- While the U.S. housing market is dropping quickly, commercial property, in general, has only slipped a little. I have enclosed a good report on the housing market vs. the commercial real estate market to show this distinction. Self storage properties have advanced with a 20% raise in public self storage REITs over the first quarter (see enclosed). Today the greatest challenge to real estate is qualifying for loans with lenders offering attractive rates, but only to top credit borrowers. We believe home prices will level off by the end of the year, but climb very slowly over the next few years.

New Opportunities- We continue to review dozens of possible investments every month and we have one particular new investment we believe looks very attractive. We are working with one of the country's leading low tech equipment leasing companies (think leasing forklifts to Whirlpool) and are designing an investment pool that will be 50/50 co-invested with the company. Profits are likely to produce a 7% tax sheltered cash flow (depreciation) and return 150%+ of original capital over 5-7 years. We will keep you posted as this develops. We are also reviewing several new hedge funds, real estate projects and fixed income managers.

Major Trends and Investment Themes- Inflation, particularly in U.S. dollars, continues to be the most important long term investment theme to pay attention to. Panics will subside, recessions come and go but inflation has the biggest effect on trends on investment vehicles. We reached a long term low of 1% inflation in 2000, after dropping from a peak of 10% in 1983. Falling inflation helps the bond market as interest rates drop and prices of bonds go up. It also helps the stock market by raising P/E ratios. But at the same time, falling inflation hurts hard assets like oil, commodities and real estate. A simple portfolio of stocks and bonds worked well during this long 17 year period.

Unfortunately, we are now in a long term trend of rising inflation; currently back to our 100 year average of about 4%. This has caused a reduction in P/E ratios (lower stock market) and lower bond prices. Commodity prices have been a big beneficiary of this, along with the economies of the third world countries that produce them. We have seen this in the spiking of oil, gold, and food prices.

So where do we go from here? We believe that we are near the peak of a cyclical cycle, in a long term rising trend of secular inflation. Let me explain. Commodity prices are probably near a 6-12+ month peak and will likely drop back down in the quarters ahead. However, this is only the top of a 2-3 year cycle within a longer 10-15 year rise in inflation (like 1968-1983). This long term trend is the result of the quickly swelling middle class in second and third world countries and their rising consumption of oil, building supplies, food, consumer goods, etc. The U.S. consists of only 6% of the world's population but consumes 25% of its resources. The rest of the world is catching up and this will continue to put upward pressure on prices.

However, prices have risen too fast and have been pushed beyond actual demand by speculation and unfounded fear of shortages. Therefore, we believe commodity prices will back off for awhile. In addition, our weak dollar vs. other major currencies has exacerbated inflation in the U.S. The G7 nations have now formally announced their intention to support the dollar and this will further help ease local inflation. This, combined with a recovery in the U.S. banking system, the anticipated end of the U.S. recession in the fourth quarter and government interest rates starting to go back up, will produce a rosy background for the stock and bond markets to recover and finish 2008 well above where they started.

In short, we would be buyers of U.S. stocks, corporate bonds and selected commercial real estate. Aggressive investors might also look at China's and India's stock markets at today's levels. We would hold trust deeds, hedge funds, muni ARB funds, mortgage funds and hedge income funds. We would avoid or sell commodities, non dollar assets, U.S. government bonds and C.D.s.

Investment Summary- We continue to pursue well diversified portfolios designed to produce steady returns in the 8-10% range; our long term track record. This year will be more challenging than most, but we are feeling confident because our investment strategy of diversification apart from the general stock and bond markets is helping tremendously. We look forward to another positive year and opportunities to pick up good values during the current market weakness.

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