OPTIVEST

Turning Success into Peace of Mind.

Quarterly Newsletter

Third Quarter 2008

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Investment Summary- Thank goodness for broad diversification in our investment portfolios. While the portion of our accounts that are in unhedged stocks and bonds have been subject to the worst bear market since the Great Depression, our diversification into real estate, trust deeds and hedged stock and bond funds have held most accounts to losses in the low single digits. Stable, cash flowing assets never looked so good.

U.S. Economy- The current U.S. financial crisis has shaken investor confidence to the lowest level measured since they started keeping track in 1967. We are now at a low of 38.0 vs. the next lowest score, at the bottom of the worst post World War II recession in 1974, of 43.2 and with good reason: collapsing home prices, near insolvency of all major financial institutions – saved by an unprecedented rescue by the U.S. Government, a Congress so inept that they have an all time low approval rating of 17%, and a bitterly divided presidential election coming to a head. All of which has sent world stock and bond markets into 40-70% losses year-to-date (as of 10/28/08). It is about as bad is it can get. Which is the only good news: we are not likely going into a multi-year depression, rather a moderate to deep recession until next summer (according to the UCLA Anderson recent forecast among others). If this is true, the financial markets have already over-discounted this downturn and we are seeing security prices at very attractive valuations.

Stock Market- While the majority of our investments are outside of the stock market, we believe today's levels are near enough to the bottom of this bear market to warrant an over-weighting. Historically, the November–January time period has been kind to stocks and we are optimistic that we will see a near term bounce back to at least the 10,000 level on the Dow Jones. Our outside managed portfolios are positioned well for such an advance with late stage recession and early stage recovery stocks.

The cash on the sidelines is a historic high 40% of the total value of the U.S. Stock Market. The emotion that follows "fear and panic" is "greed" and much of this cash will enter the stock and bond markets over the coming years as we recover from our recession.

Fixed Income- The drop in publicly traded fixed income securities, specifically corporate and municipal bonds, has been every bit as big as the stock markets' drop, but much less widely followed. These price drops have pushed yields up to 6%+ on municipal bond funds and 15%+ on corporate bond funds. As we said in a recent market update, "if Goldman Sachs and G.E. need to pay 10% interest to attract capital, everybody else has to pay even higher interest rates." This has been a direct result of the frozen credit markets and will likely recover much sooner than the general economy.

Real Estate- Commercial real estate transactions have slowed to a crawl as lenders have withdrawn from making new loans except on the best projects, and even then at rates 1% to 2% higher than early this summer. Either prices will have to drop to meet the cost of this higher financing or loan rates will need to come back to pre-crisis levels. We think a little of both will happen over the next few months. In the meantime, our properties continue to cash flow well, especially the defensive categories of self storage and apartments.

The Future- The United States, while bruised and in shock, is still the largest and most productive country in the world. While we only have 4.5% of the global population, we account for 25% of Gross Domestic Product (GDP), more than the next four (Japan, China, Germany and the U.K.) combined. Further, according to the "World Economic Forum", we also have the most competitive economy on the planet, thanks to America's innovations, business development and top universities. That is why the world's major stock markets are down more than ours and our dollar is rapidly rising. As bad as it may seem here, it is worse overseas.

However, because of our recent banking and related financial crisis, governments around the world have added an unprecedented amount of cash into the banking system. This "supply" is an attempt to replace "velocity" (turnover of money in the economy) until financial institutions are stable and lending again. In addition, balance sheets, both corporate and private, are being de-leveraged and debt is being reduced at a historic pace. And you can bet that there will be more government oversight, regulation and taxes.

All of this will help the U.S. and other mature economies to avoid a serious recession, but at the cost of a weaker recovery and long term inflation.

Strategy- While today's stock and bond markets may present some of the best investment opportunities over the next 6-12 months, they will eventually resume their tepid post 2000 growth rate caused by inflation, regulation, high taxes and a swing towards more socialized public services. We believe that in this environment, real estate, asset backed lending, specialty niche businesses (healthcare, education, efficient energy, etc) and commodities will perform the best. In addition, fast growing "cowboy growth capitalism" economies like Brazil, China and India will grow faster than the mature economies of the U.S., Europe and Japan.

In the meantime, we remain widely diversified and cognizant of how valuable our clients' capital preservation goals are during times of uncertainty.