

Lowly Analyst Free Newsletter

Volume 9, Issue 3, March 2009

curtfey.com

In this Issue

The Market
Real Estate

The Market

The volatile market is in a correction. It will be many years before we will reach previous heights. According to University of Pennsylvania Prof Siegel S&P earnings were 2006 \$82, 2007 \$64, 2008 \$26, forecast 2009 \$32.

The US still has deflation due to energy and housing and the dollar is riding high. But inflation is lurking around the corner and with it a decrease in the value of the dollar. From 1929 to 1933 consumer prices fell by 25%.

Treasury prices are rising to unsustainable levels. It is a bubble waiting to burst.

Inflation is one way to get individuals, businesses and governments out of the current high debt to assets ratio. Inflation enables every one to pay back debts with cheap dollars.

During inflation assets, such as real estate, precious metals, and commodities, usually do well. Creditors are holding an empty bag.

Asset Classes. For the past month: Mid Cap Growth -4%, Large Cap Growth -8%, Small Growth -10%, Mid Value -12%, Large Value -13%, Micro -14%, Small Value -14%.

Sector ETFs. For the past month: Silver 3%, Managed Futures 2%, Gold 1%, Agribusiness -1%, Swiss Frank -1%, Euro -1%, Software -2%, Telecom -2%, Technology -4%, Natural Gas -4%, Covered Calls -5%, Commodities -6%, Oil -7%, Consumer Gds -9%, Basic Mtrls -4%, Natrl Rsrcs -11%, Biotech -11%, Healthcare -12%, Utilities -13%, Intrntl Real Estate -14%, Real Estate -24%.

Foreign Investments. For the month: Russia 7%, Taiwan 0%, China -3%, Australia -3%, BRIC -4%, Brazil -4%, Pac-J -5%, Emerging Mkts -5%, Latin Am -6%, So Africa -8%, World -US -10%, Canada -10%, United Kingdom -10%, India -10%, US -10%, Europe 350 -10%, Singapore -11% Japan -13%, Mexico -14%, So Korea -18%.

Fixed Income. For the past month: Insured Money Mrkt 3.5%, Ntl Munis 2.4%, Hi Yield Munis 1%, Global Bnds 0.4%, Intermed Credit Bnds 0.1%, Tax Free Weekly 0.1, GNMA 0.1%, 1-3 Mo Treas 0%, Total Bnd Mrkt 0%, Mortgage Backed 9%, 1-3 yr Treas -0.1%, 3-7 yr Treas -0.6%, Short Term Bnds -1%, TIPS -2.2%, Emrg Mrk Sovereign Debt -5%, Covered Calls -5%.

Real Estate

1. Introduction

It is time for an update on real estate funds that seem to exist only to provide material for the newsletter.

2. Characteristics of Real Estate Funds or ETFs

Typically, [Real Estate Investment Trusts \(REITs\)](#) have a higher pre-tax total return than US stocks and a slightly higher volatility. They lower volatility of portfolios. But currently their total return is lower and the volatility is higher. REITs also have unusually large dividends, up 3-4% from the past. REITs lag the economy.

The outlook for real estate funds is dismal. Because of the weak economy and bankruptcies leases get cancelled. Individual households are consolidating. Children move back home. It is estimated that 1.5 trillion dollars of commercial real estate mortgage will come due in the next three years and need refinancing. The only way to raise cash today is to sell assets at bargain prices.

3. Taxation of Real Estate

REITs used to pay cash dividends since they need to pay out 90% of their income. A revenue ruling lets REITs skip cash payments for a year and pay up to 90% of the income in stock. The total dividend is still taxable as income. Thus, it is possible that the tax is larger than the cash income for 2009.

Real estate funds can be tax inefficient for both taxable and tax deferred (IRA) investments. The return can consist of ordinary income or of non-qualified dividends; hence you should generally hold US REITs in a tax-deferred account.

Taxation of real estate funds is complex. The prospectus may indicate the tax status of distributions.

Foreign REITs may be treated as [Passive Foreign Investment Companies \(PFICs\)](#) by the IRS. You have to mark PFICs to market yearly. Thus unrealized capital gain must be realized each year for tax purposes. Withholding taxes may be assessed on foreign REITs. Therefore, unless you are in the lowest tax bracket, you should not hold foreign REITs in a tax deferred account.

4. Leverage

REITs are leveraged 60% or more. Leverage of less than 60% is considered safe. REITs go up and down more with leverage. Leverage increases volatility, and volatility is not desirable in the current environment.

5. Your Home

Your home is not a portfolio asset. While it is real estate, its value depends primarily on a local economy and is often more related to the fortunes of your town's particular industry rather than the national real estate market. Your residence is clearly not a diversified real estate investment.

6. Selected Real Estate Funds and ETFs

The tables below show the standard deviation (SD), the RiskGrade (Risk), the yield (Yld), the return divided by risk (Rt/Rsk), and returns for various time periods. The graphs show the price over time, adjusted for dividends.

AIM Select Real Estate Income, ASRAX

SD	Risk	Yld	Rt/Rsk		
30%	272	8%	-152%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-13%	-10%	-46%	-46%	-76%	-76%

iShares Cohen & Steers Realty Majors, ICF

SD	Risk	Yld	Rt/Rsk		
25%	497	8%	-253%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-24%	-30%	-64%	-61%	-63%	-44%

iShares Dow Jones US Real Estate, IYR

SD	Risk	Yld	Rt/Rsk		
22%	443	10%	-266%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-20%	-24%	-59%	-56%	-61%	-45%

SPDR DJ Wilshire REIT, RWR

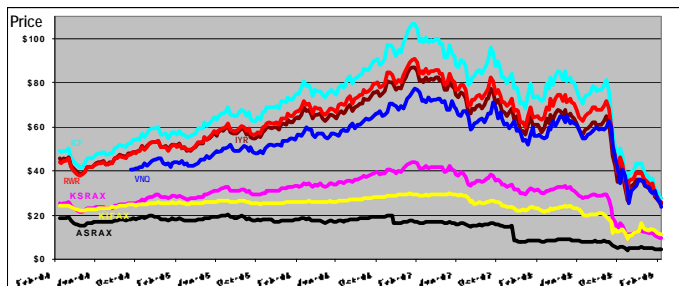
SD	Risk	Yld	Rt/Rsk		
24%	486	9%	-258%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-22%	-28%	-62%	-59%	-61%	-41%

Kensington Select Income, KIFAX

SD	Risk	Yld	Rt/Rsk		
17%	177	18%	-274%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-16%	3%	-46%	-49%	-57%	-53%

Kensington Strategic Realty, KSRAX

SD	Risk	Yld	Rt/Rsk		
24%	396	16%	-286%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-18%	-18%	-67%	-68%	-71%	-63%



7. Newer Funds

Following are the tables and price graph for newer funds (i.e. created in the last 5 years).

Vanguard REIT Index, VNG

SD	Risk	Yld	Rt/Rsk		
20%	466	10%	-290%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-21%	-26%	-59%	-56%	-57%	NA

iShares FTSE NAREIT Residential, REZ

SD	Risk	Yld	Rt/Rsk		
19%	414	10%	-294%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-24%	-34%	-57%	-54%	NA	NA

DFA Global Real Estate Securities, DFGEX

SD	Risk	Yld	Rt/Rsk		
29%	NA	NA	-186%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-17%	-20%	-55%	NA	NA	NA

Wisdom Tree International Real Estate, DRW

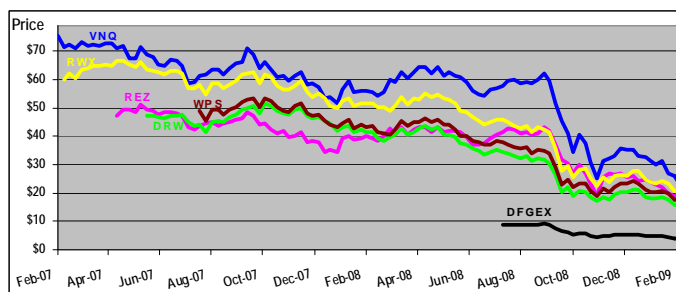
SD	Risk	Yld	Rt/Rsk		
30%	239	3%	-166%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-14%	-13%	-50%	-60%	NA	NA

S&P Developed ex-US Property Index, WPS

SD	Risk	Yld	Rt/Rsk		
29%	243	5%	-168%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-14%	-14%	-49%	-58%	NA	NA

SPDR DJ Wilshire Intl Real Estate, RWX

SD	Risk	Yld	Rt/Rsk		
28%	237	6%	-183%		
1 Mo	3 Mo	6 Mo	12 Mo	3 Yr	5 Yr
-13%	-14%	-51%	-59%	NA	NA



8. Bottom Line

- In 2009 REIT's can make taxable distributions in shares not in cash. Income tax may exceed cash distributions.
- Traditionally REITs have lowered the risk of a portfolio.
- Currently that is no longer the case since REITs have higher volatility and lower returns than US stocks.
- REITs are tax inefficient in both taxable and tax deferred accounts. We do not recommend REITs at the present.