Memorandum

To: Clients, Associates & Friends of Pro@ctive Advisory
From: Mark L. Wyssbrod, CPA
Date: December 18, 2014
Re: Repeating Real Estate History

In this memorandum, you will receive information about the following:

- Repeating real estate history
- Market volatility, not economic volatility
- Oil follow up

We don't see how the patterns, habits per se, of the past haunt us; perhaps that is why history repeats itself.

Repeating real estate history
I have mentioned multiple times over the past six to seven years I believe real estate is in a 18 to 24 year down cycle (starting in 2006-2007), especially compared to inflation. This means, if I am correct, we are one-third to one-half of the way through the cycle.

Currently, the real estate environment doesn't feel too bad; it may even appear to be strong! Should we just enjoy the blessings of the valuation recovery and move on? Potential significant headwinds are rising interest rates and repeating old habit.

First, rising interest rates reduce the purchasing power of the borrower. Additionally, I have mentioned I believe interest rates will stay lower for longer than people expect. So this may not be a factor in 2015.

Second, we are repeating old habits. Multiple individuals above age 50 have informed me they have and will continue to purchase real estate rental properties. The reason is they did not save for retirement and are now trying to make up for lost time. These individuals are investing in a cash flow strategy, not a net worth strategy. These investors are hoping for a positive cash flow if: the properties can be rented to "good" renters who respect their property; and the net cash flow is positive.

What these individuals are not saying, but I am assuming are: no bank will lend them $100,000s to purchase stocks and investments to save for retirement; and cash flow may be positive, however the value of the property may stay the same (I believe when compared to inflation).

I believe these investors will face a different outcome than they are hoping for. First, the risk and leverage is too high compared to the reward. Second, "good" renters are hard to find. Third, the increase in net worth will not be significant and may only come from the reduction of debt, not the increase in property value (compared to inflation).

One of the reasons for the last real estate bubble was individuals purchasing multiple rental real estate properties. This seems similar to before. Another factor which led to the last real estate bubble was financial institutions easing their lending standards; which they will do once again on January 1, 2015 (when the Federal government lessens the restrictions). Are we setting ourselves up to repeat history?

A factor going for real estate investors might be ability to charge higher rents as a current, and appears to be a growing trend, is for younger generations not wanting to own real estate (but still requiring a place to live).

Market volatility, not economic volatility
It seems strange to me the volatility and quickness of market reactions.

- The market peak in September 28, 2008 to the bottom in March 9, 2009
    - 163 days, ~40+ market decline
- Oil's bear market in 2014
    - From $110 in July to $57 in December 2014
        - A $53 or 48% decline
- The market correct and recovery in October 2014
    - October 3 to October 16, 2014
        - Over 13 days the market fell 893 points or 5.2%
    - October 17 to October 28, 2014
        - Over 11 days the market rose 888 points or 5.5%
- Friday, December 6, 2014 17,958.17
    - Friday, December 16, 2014 17,068.87
        - Thursday, December 18, 2014 17,778.15
            - 900 point drop and 710 point recovery in 12 days

It seems markets move very quickly and are more volatile than individuals expect.

Today's Prediction 1: I do predict the markets to be more volatile over the next 12 months. The small business economy should remain stable. So keep on looking for opportunities!

The low interest rates has increased supplies, but has not solved demand issues. Therefore, expect contraction in prices. This does not mean to go ahead and lower your prices. This does mean to be very aware of what your competitors are doing as well as to have a plan in place if there is pricing pressure. Small business owners will need to be vigilant to reduce costs when sales prices fall in order to maintain their Gross Profit Margin.

Today's prediction 2: Do not be surprised if lower energy costs do not get passed on to the consumer. Several industries have had margin crunches due to high energy costs and the Great

Recession (Small Business Depression); now they will be pressured to keep the savings themselves and increase their margins instead of passing along to the consumer.

Oil follow up from last month

Prediction 1: I am predicting federal and state governments will increase their gasoline taxes to fund infrastructure projects (as long as gas prices remain low). Per local news, Georgia (Governor Deal) has already announced potentially raising the gasoline tax and will not lower the current amount per gallon

Prediction 2: I do predict low prices to remain low for a significant time. Why? I believe the US dollar will remain strong and the supply to remain high. Russia has announced they just found the "Saudi Arabia" of oil in the Arctic Ocean (September 2014 Rosneft oil company). This means there are 3 "Saudi Arabia's"; the original, the US and Russia.

Conclusion

You can take advantage of the current scenario. First, you can use the strong dollar to purchase more from foreign countries and commodities at lower prices. Second, you can use the savings from the gas pump to reduce debts and/or save. Third, you can use the current low interest rates to refinance current debts. Fourth, you can be patient and not feel like you have to rush into a real estate purchase decision.

Make the most of the current economic environment and plan for the future.