Investing in a Tough Economy
By Chris Miller

"When is the economy going to get better?" This is question that I am hearing often these days. The bad news is that a quick turnaround is not very likely. So, rather than waiting for something to happen, many investors are looking for opportunities today. The good news is, there **are** deals out there – and now is a good time to buy them up.

But surely, all this money the government is pouring into these companies will fix things, right?

Unfortunately, this will likely make things worse. Let me use an analogy to illustrate. A recent college graduate has not yet seen his income rise to the level of his standard of living. He funds much of his lifestyle with credit cards, and has skyrocketing balances as a result. Whenever his credit card debt reaches $7,000 or so, the grad's parents will send him a "bail out package" that gives him a fresh start. This doesn't help anyone, because the grad doesn't learn how to manage his finances, and mom and dad are $7,000 poorer.

Similarly, the Big Three automakers won't learn how to run their business effectively. They won't need to address their high costs of production, quality concerns, or their questionable business practices. (Remember when high oil prices almost drove Chrysler out of business in the '70's? It happened again – what a surprise!) Uncle Sam will give them the money to pay for those problems.

When I was in business school, finishing my MBA, much class time was devoted to why Japan's economy was in such bad shape. One major reason was the existence of what we called "ghost companies." (This name means something else in Japan – this was our word for it.)

Now – stop me if this sounds familiar – because the Japanese government fears job losses created by a company's failure, they will subsidize a poorly run company in the name of "saving the economy." Everyone loses in these situations – the government spends a lot of money, the companies continue to falter – harming their investors, and these mediocre companies continue to be a drain on the nation's economy.

So, when will things get better? Well, I think it will take some time – perhaps measured in years. But – there are some great opportunities for investment now – assets that can be bought at lower prices for profits when the economy recovers.

What is a Good Investment Now?
Let us take a look at what the economy is doing now for our answer. The new Presidential Administration is touting a plan to pump an additional trillion dollars into the economy. No matter where this money is coming from, (and I'm curious to see myself), this greater supply of cash will likely lead to inflation. And inflation is bad for bonds and the stock market, but good for hard assets like real estate. Since oil and natural gas are priced in dollars, it is also good for energy. Since commercial real estate is valued based on the cash flow it produces, higher prices lead to higher rents, which leads to higher values. If the dollar that buys oil is worth less, than the owner of that oil gets more dollars.

What about CDs?
A search, (dated January 23, 2009), for the highest CD rates showed that one would be lucky to get 4% annually. Remember that CDs are taxable, though. Let's say that a California resident puts $100,000 in such a CD. This investor will earn $4,000 in interest in year one. If he is in the 28% Federal tax bracket (and 9.3% state), he pays $1,492 in taxes – leaving him with $2,508. If inflation is running at 5%, though – he's losing $2,492 ($2,508 - $5,000) every year.

What about Bonds?
Bonds are another tough asset class today. The near-historical low interest rates are scary enough for the bond market. Likely, higher inflation makes things even spookier. Since bond values are a reflection of current interest rates, if you were to buy $100,000 of 10-year treasury bonds today at 3.75% (Jan. 23, 2009), and interest rates double, then your bonds are now worth much less (about $75,000.) Or you can hold them until maturity to get your $100,000 back but, if inflation averages 5% per year, you'll get the equivalent of $59,873 (adjusted for inflation) back. During that time, you'll have earned $37,500 in interest, cutting your losses to "only" $2,627. Investing for 10 years to lose money sounds like a tough job to me.

So, bonds and CDs today can only be considered "safe" because you know for a fact that you will lose money.

So Why are Hard Assets the Way to Go?
Because they offer current income with tax benefits, hard assets such as real estate and energy are a great place to invest during this economic downturn.

Great buying opportunities in commercial real estate exist due to the combination of lower prices and low interest rates. For example, a warehouse in the best submarket of Orange County recently came across my desk. This property was 100% leased under a triple net lease (tenant pays ALL expenses) until 2018, with annual rent increases. Two years ago, this property would be priced too high for consideration – a higher price would mean lower cash flow – too low to interest my clients. Current market conditions allowed for a 6.6% year one cash on cash return – with income partially sheltered by depreciation. Better yet, this property has appreciation potential. 6.6% partially-sheltered cash flow with appreciation potential beats a 4% investment that is fully taxable and has declining principal any day in my book.

What About Energy?
Much as $140 oil was a peak on the high side, experts believe that $35 oil is a spike on the low side. Oil is still something that we use everyday – to build roads (asphalt), to make plastics, to power and lubricate machinery. Today's low prices offer a great buying opportunity. Since the goal of investing is to buy low and sell higher, with low prices today; what is it a good time for?

How Could I Go About These Investments?
Since a $100,000 equity investment would not buy much commercial property, or diversity at that, I prefer partial interests in properties. In this way, an investor can buy a part of the Federal Express – tenanted property above, and share in the cash flow and tax benefits. It is a much easier way than coming up with the $14 million down payment needed for such a building. The partial interests that I offer are in individual properties, or in baskets of many assets. We have

stabilized properties producing cash flow, and growth-oriented programs as well. Seek programs that offer between 6% and 10% cash flow, with additional appreciation potential. You should be sure to choose the investments that are right for your financial goals and risk tolerances.

If you are seeking attractive investments in today's uncertain economic environment, hard assets are worth a look. With inflation and interest rates poised to rise, these buying opportunities may not be around for long.

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