



Real Returns

March 21, 2008

By Will Woodard, CFP®

Today's Topic: Buying Fear

**"Be fearful when others are greedy and greedy when others are fearful"--Warren Buffett**

Readers, I'll be honest: A couple of years ago I was becoming fearful about continuing to live on the Outer Banks. Low interest rates, easy credit and a three year bear market in stocks had combined to produce an historic boom in Outer Banks real estate, and with it came an unfortunate Wild West atmosphere. Greed was rampant--it was everywhere. You couldn't swing a dead cat, metaphorically speaking, without tripping over a giddy wannabe real estate tycoon of the construction, investing, or marketing persuasion. It was like late 1999 in the tech stock IPO market, with the attendant lack of market discernment. A rising tide of a market if there ever was one, lifting all boats.

But, thankfully for the quality of life on the Outer Banks, boats don't grow to the sky (couldn't resist). At least, not in one straight move. Spring 2008 finds a much more subdued, sober Outer Banks, a market where much reversion to the mean from the prices of a few years back has taken place and an almost palpable sense of fear has taken hold. Like the rest of America, the Outer Banks seems immersed in fear of recession, of a much-jawboned housing Depression, of \$1000 gold and \$110 oil, of terrorism, of wars that won't end, of historic Presidential elections, ...and, perhaps most insidiously of all, of the unknown. The same media that made house flipping a national hobby four years ago is now doing its sensationalist best to convince America that real estate is a dead asset class. Hmmmm....

Folks, I am by no means a paid cheerleader for real estate interests, but when I sense that kind of irrational fear in a marketplace, I smell opportunity. So let's step back from the (overstated?) abyss a moment and look at some pertinent data points. This past week the Fed lowered interest rates 75 basis points, making the Fed funds rate 2.25% and prime 5.25%. Though fixed rate mortgages are more tied to the 10 year Treasury note yield than to prime, on March 19<sup>th</sup> a conventional 30 year fixed rate mortgage could be gotten for 5.75% interest with ½ point. That's certainly not overpriced by any historic metric. So there's capital in the marketplace at reasonable rates to finance a real estate purchase, at least for folks with jobs and respectable credit. How do we know if it's a good time to invest in real estate?

Let's consider the impact of inflation on asset classes. If inflation is running 3% a year, the money that's in your money market account earning 2.5% is actually losing purchasing power over time. Economics wags coined the term "cash is trash" to describe a low interest rate environment with moderate inflation, and that's just what the Fed gave us last week with its most recent cut in the Fed funds rate.

What about owning Treasuries? All the fear of the unknown has caused a flight to quality in the Treasury bond market, with two year note yields at 1.59% a year as of 3/20/08 and the interest being fully taxed as ordinary income. Ouch! Oh and by the way, there's purchasing power risk, too. No thanks.

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The classic asset classes to own as hedges against inflation are stocks, real estate, and commodities. Stocks are down on the year and probably represent decent to good value at these levels. Commodities have been rallying like crazy and are probably overextended at current levels. Real estate has been in a multi-year bear market and under no scenario could be described as overextended at these levels. Hmmmm....

The final point that I'll make on the issue is that of market psychology. Like Mr. Buffett said, the time to buy is when the market is afraid. Sellers know that they have to price their properties well. Buyers know that they have some leverage in the negotiating process. But not forever. After all, for as much as we wish they would, they don't ring a bell at the bottom.

Good investing,

Will

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