

# THE STORMS REVIEW

WHAT'S IMPORTANT IN THE REAL ESTATE AND FINANCIAL MARKETS

According to

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**Is the Market Rally Over?** At the beginning of last year, we predicted that the Dow Jones Industrial Average would not exceed 9500 for the year. As of this writing, that index stands at 9697. Actually, the high as of this date was in excess of 9800. With just over a month left in 2003, we do not believe there is a lot of room left for an increase. Why aren't we more optimistic? It's not because of Iraq (it's gone better than I predicted); it is not because of the high unemployment rate (from a historical perspective, 6% is pretty good); and it is not because of the increased federal deficit (although that can't be good). Mainly it is because eager investors have pushed the price of stocks to the point that companies don't earn enough to justify the high prices. When I hear predictions of an 11000 Dow, I ask myself why. In my opinion, the only justification for higher prices is higher earnings. While that may happen next year, some of those higher earnings will go towards lowering PE ratios. When these reach a more realistic level, I may become bullish again. Our strategy of buying an income stream, in the form of dividends, has served us well. Eventually, the market may push these prices to unrealistic levels but, for now, we still think high dividend portfolios are the only game in town.

**Is There a Real Estate Bubble?** It appears that there is. Many investors are pulling capital from the marketplace to buy real estate. Unfortunately, weak tenant demand is increasing the risk of owning real estate. In over 20 years, we have never seen so many houses with for rent signs in the front yard. Some of these have been vacant for more than 3 months. In those cases, the owners may be trying to deny the reality of the marketplace and run their investment as if we had the same supply-demand balance we had three years ago. Remember, your prospective tenants have a lot more choices now than they did then. You used to be able to find good tenants willing to move into a property in less than pristine condition. Now they turn up their nose and call on another property. You used to be able to hold out for top rents. Now you have to advertise reduced rents just to get the phone to ring. Remember, the most expensive item on your income statement is vacancy. Well, maybe that's the second most expensive item. The most expensive mistake you can make is to lease your property to a tenant who is willing to live in filth and doesn't pay the rent either. By holding out for top dollar, you increase your risk of ending up with one of these characters. They can sour your view of human nature for years. Your best strategy is to put your property in top condition and lower your rents to the point that you attract tenants at the top end of the range. It may sound harsh but the amount of rent you need to cover your operating expense and mortgage payment is irrelevant. The only thing that matters is the supply and demand for properties and the only strategy that works is to set your rents sufficiently low to entice the better tenants to choose your property over that of the competition.

Despite a difficult investing environment, our clients did well last year. Hopefully, we met your expectations. Either way, we would enjoy hearing from you.