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“I’m Dreaming of a White Elephant”

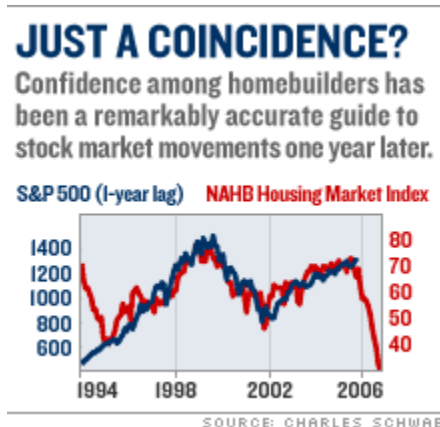
As the holidays approach, we are watching Wall Street program traders and hedge fund managers fill their Christmas stockings with Standard and Poor’s Index ETF’s and other synthetic instruments.

This means that they are blindly buying replicates of the index, not directly buying the underlying stocks. They are not buying individual stocks based on case by case merits. They are just speculating on the stock market as a whole.

This may or may not be a good choice, and it may or may not stick. We are proceeding cautiously because anytime the herd gets this excited, they might stampede as well. Since there does not seem to be a lot of commitment to the underlying fundamentals of the actual stocks, these investors are simply riding momentum. They are just gambling. One pop in the price of oil or a geopolitical event could quickly reverse this upturn.

And then there’s the white elephant under the Christmas tree. The real estate housing market is coming down from its multi-year bubble and we do not know what it will do to the economy.

All markets are uncertain, and the residential housing market is no different. We don’t know what will happen in the next year in the residential real estate market. All we have to guide us is what is happening now, which is a very uncertain indicator. We also have a choice about how we react to what is going on.



Here's what we know at the moment: we had a large multi-year manic increase in the residential housing market locally and globally up until earlier this year. Now the market seems to be in a decline. We don't know how deep this will go or how long this will last. Since October 2005, existing home sales are down 11.5% nationally.

This downturn is of course varied in local markets. The housing markets of some regions are doing reasonably well and others may suffer through 2007. One rule of thumb is that the more new housing gets built locally, the more volatile and damaging a downturn might be. Places like Bakersfield and Las Vegas, where land is cheap and zoning is easy, tend to experience wide swings in market value. Places like Pacific Grove or Santa Cruz, which have much less new supply, tend to be more resilient because there is a limited supply of housing available. Salinas is somewhere in the middle. It's a question of supply and demand.

It's also worth noting that historically, price downturns such as these last at most about 10 years. Since value increases in any market tend to happen in waves, holding a home longer than 10 years is likely to result in some sort of gain.

So where is the smart money now? With the buyers who are searching for a long-term family home. Long-term investors tend to kick the tires a lot. So what we are seeing more than anything else in real estate is a build-up of inventory as long-term buyers wait and watch. We don't know what will happen yet, but it will probably affect the stock market when it happens.

Other financial markets such as the stock and bond markets have a "love hate" relationship with residential real estate. One old and true saying goes, "When people are talking stocks, buy real estate. When people are talking real estate, buy stocks." This is good advice because the prudent investor will always avoid a hot, overpriced market. At the moment, people have not really accepted that real estate prices are down, and are likely to stay down for awhile. They also are not ready to admit that the stock market has recovered from 2001. I expect that at some point people will finally be down on real estate and bullish on stocks. That will be a great time to get out of overvalued stock positions and invest in real estate. We're not there yet. I'm staying in the stock market for now.



*I'm dreaming of a white elephant
Just like the ones I used to know.
When the tech stocks glistened,
And the tech geeks listened,
To see stock options on the go.*

*I'm dreaming of a white elephant
With every "For Sale" sign in sight.
May this real estate bubble
Stay out of trouble
And may all your escrows close up tight.*

*I'm dreaming of a bull market
With every e-trade that I write.
May your days be merry and light
And all your mutual fund picks be right.*