

FOCUS

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The transition

Yes, loyal readers, this issue is late. Three months late, to be exact, for which you have your editor's sincere apologies. The transition to new space, a new portfolio management system and new associates has taken longer and sapped more of our time and energy than we anticipated. However, we are now back on track, and Focus is back in production. Because we are now under the Osborne Partners banner, we've started a new volume number, so this issue is Volume 20, Number 1.

On that note, we continue to receive inquiries from clients and professional colleagues as to the progress of the integration of the former Woodside Asset Management into Osborne Partners. Here's a summary of what we've accomplished and what we're still working on.

The move from Sand Hill Road in Menlo Park to downtown Palo Alto was about as seamless as we could have hoped for. We managed to misplace only one item, a computer connecting cable (packed in the wrong box so it went to storage). The new partitions for the open-area workstations are installed, and the missing modesty panels and under-cabinet task lighting will be installed on October 7. The new phone system is working very well, although it has so many bells and whistles that we haven't figured them all out yet.

The migration from the FIN portfolio management system to the Advent APX system is about 99% complete, although we will need to do some fine tuning of the formats of some reports during the fourth quarter.

Finally, we now have the time to have regular conference calls with our colleagues in the San Francisco office on

topics ranging from investment philosophy to workflow to staffing issues. Osborne has a very definite plan for growth in place, including additional operations and portfolio management personnel and new investment opportunities. Both offices are also benefiting from a fairly steady stream of new client referrals.

Perhaps the biggest benefit to us (from your editor's perspective) is the wealth of dining opportunities in Palo Alto. We still love our friends at the Sundeck, where we ate lunch most days for 25 years when we were housed on Sand Hill Road. However, the availability of Greek, Turkish, Jordanian, Vietnamese, Thai, Chinese, Indian, Italian and the usual mix of Asian-fusion and California cuisines within a few minutes' walk is a real treat. Waistlines beware.

We've also received many inquiries about the three former Woodside employees who did not transition with us to Osborne. Mary Lettiere now works as the assistant to the compliance officer at Silicon Valley Bank who oversaw our compliance needs when we were part of the Bank. Denise Carlquist has a position at a friendly competitor's firm doing almost exactly what she did at Woodside. Lastly, Tom Sedgwick has decided to take a year off to be a stay-at-home dad and to evaluate his options as to a future career path. The word we get is that all three are very happy in their new positions.

And now on to the usual, more serious items...

Still the land of opportunity

One of our favorite economists is Ed Yardeni of Oak Associates. In a recent edition of his online newsletter, he summarized the Federal Reserve's 2004 Survey of Consumer Finance, which was released this spring. The Survey shows conclusively that Americans are better off today than they were in 1995. Yardeni adds, "Their assets are up much more than their debts, so their net worth has increased led by realized and unrealized gains in real estate and equity

in their own businesses. The income data aren't as upbeat mostly because they focus on cash income and ignore health care, and other noncash benefits and capital gains." Here are his main findings from the report:

- Median family income is up 14% since 1995. Mean family income is up 29% since 1995. The Personal Consumption Expenditures Deflator is up 18.5% from 1995-2004. The income data are based on cash income and exclude benefits and capital gains.
- Are the rich getting richer? Not really. The ratio of the mean to median family income has hovered between 1.45 and 1.70 since 1995. The same ratio for salaried workers has fluctuated between 1.31 and 1.42.
- Want to get rich? Quit your job and work for yourself. In 2004, the mean income of self-employed workers was \$141,500, twice that of salaried workers (\$70,100). The mean/median ratio for the self-employed was 2.12 in 2004. Only 11.8% of families were self-employed in 2004.
- The median net worth of all families rose 31% from 1995-2004 to \$93,100. The mean rose 72% to \$448,200.
- The median net worth of homeowners rose 44% from 1995-2004 to \$184,400. The comparable mean rose 67% to \$624,900. In 2004, 69.1% of families owned homes, up from 61.3% in 1995.
- American families tend to have roughly a 60-40 split between their non-financial and financial assets.
- On average, American families tend to have roughly one-third of their assets in residential real estate, including both primary residence and other residential property. On average, American families tend to have about 17% of their assets in their own businesses.

- About a third of financial assets are in retirement accounts. In 2004, the share of these was 32.0%, up from 28.1% in 1995.
- In 2004, American families had median unrealized capital gains of \$23,000, up 238% from 1995. The mean unrealized capital gain was \$161,700, up 94% from 1995.
- Are American families drowning in debt? Hardly. Their debt was only 15.0% of their total assets in 2004, not much different than in 1995.
- Most of Americans' debt is in mortgages, which accounted for 75.2% of their total debt in 2004, about the same as in 1995.
- The percentage of Americans who are debt-distressed was 18.0% in 2004, not much more than in 1995.

On the other hand . . .

...there may be some debt problems lurking out there, at least for some unsuspecting holders of adjustable rate mortgages (ARMs). For example, a homeowner with a 3-year fixed ARM issued in 2003 may be looking at a monthly payment that is 50% higher once the mortgage resets. The folks at the *Market Intelligence Report* did some calculations as to the potential magnitude of the problem (August report):

“[Let’s] use an average ARM value of \$250,000. . . If the total value of ARMs which will reset their interest rate level is \$2 trillion, then we end up with the ‘owners’ of 8 million homes having their mortgage payment increase by 50% in the next 12 months or so. Rather than go through foreclosure, we expect many of these home ‘owners’ will attempt to either refinance or sell their homes. Refinancing will be challenging, as any refinancing option will give them a higher interest rate than they currently have.

“According to the National Association of Realtors, there are currently 3.9 million homes on the market, which

amounts to 7.3 months of supply at current sales rates. The current annual sales rate for homes is 6.3 million. So in a supply demand equation, the 'owners' of an amount of homes equal to the next 1.3 years of supply of homes are looking at a huge, almost unpayable, adjustment in their mortgage payment.

"This additional supply will help the real estate market to be softer than expected for longer than expected. We also expect the fallout of mortgage foreclosures to tighten credit standards, reducing demand."

With inventories of unsold homes rising, and the shares of homebuilders falling (or more correctly, having plummeted and then plateaued), the unwinding of the housing mania may be more unpleasant than many expect.

***But education
does matter***

One exception to the claim that wealth and income disparities are widening has to do with education. We recently heard a report on the radio about research on how education differences account for income disparities.

With the American economy moving away from manufacturing jobs and increasingly towards service- and knowledge-based jobs, those with only a high school education (or less) are at a severe disadvantage relative to those with at least a college education. While we didn't write down the numbers (we were driving on the freeway), the data showed clearly that incomes of the less-educated workforce were growing significantly more slowly than those of the more educated workforce, and that gap appears to be widening.

The bottom line: keep the pressure on your children and grandchildren to pursue their education with a vengeance. ○

Links we like

In this era of international tension, deficits, polarized politics and generally heightened angst, we'd like to recommend two online publications that we have found to be unbiased and extremely informative. The first is Stratfor (www.stratfor.com). Stratfor is the largest intelligence operation in the world after the CIA. The difference is that it is run for profit. Therefore, they have to be right more often than not. You may have seen its founder, George Friedman, interviewed on Fox, CNN, MSNBC, etc. While not free, a subscription is not expensive in terms of the depth of analysis and the quality of the interpretation of trends and events that are offered. If you want an unbiased and expert interpretation of what you see and hear regarding world events, from Iraq to Thailand to Sri Lanka to Ecuador to the U.S., Strafor is unequalled, IOHP.

The second is John Mauldin's "Thoughts from the Frontline" (www.frontlinethoughts.com). By signing up, you actually get two newsletters, John's weekly missive, and another that he provides called "Outside the Box" in which he shares articles of interest written by others. It's a free subscription, but that alone cannot account for the fact that he has over 1 million subscribers. Like George Friedman, you may have seen him on television. We have found his market and economic insights to be thought-provoking, and he has a world-wide network of other thought leaders whose material he quotes extensively. This is a great way to get a wide variety of opinions on topics of interest to anyone involved with investment portfolios.

Note that Mauldin frequently includes Friedman's articles in his "Outside the Box" letter, and at such times he may also offer a reduced rate for a Stratfor subscription. Therefore, it may pay to subscribe to Mauldin's first and then wait for such an offer. ○

***Inquiring minds
want to know***

As we, and many of our readers, are Baby Boomers approaching “retirement” age (not that we plan to any time soon), we thought we would share the answers some retirees gave to a series of questions about retirement life. After all, forewarned is forearmed.

How many days in a week? 6 Saturdays, 1 Sunday.

When is a retiree’s bedtime? Three hours after he falls asleep on the couch.

How many retirees to change a light bulb? Only one, but it might take all day.

What’s the biggest gripe of retirees? There is not enough time to get everything done.

Why don’t retirees mind being called Seniors? The term comes with a 10% percent discount.

Among retirees what is considered formal attire? Tied shoes.

Why do retirees count pennies? They are the only ones who have the time.

What do retirees call a long lunch? Normal.

What’s the biggest advantage of going back to school as a retiree? If you cut classes, no one calls your parents.

Why does a retiree often say he doesn’t miss work, but misses the people he used to work with? He is too polite to tell the whole truth.

Why are retirees so slow to clean out the basement, attic or garage? They know that as soon as they do, one of their adult kids will want to store stuff there. ○

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About FOCUS

In quarterly publication for twenty years, *Focus* is intended for the edification and entertainment of our clients, professional colleagues, friends and families. It is not intended to be an investment or economics letter or tout sheet. Rather, it is akin to an annotated clipping service: we summarize and comment on articles and papers we've read, presentations we've attended or heard, and similar information provided by others that we think will be of interest to our readers.

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