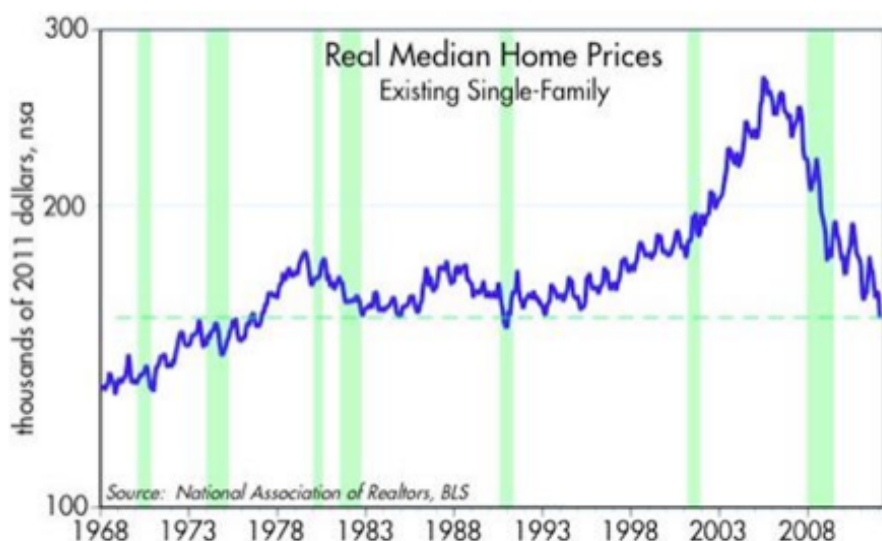


CHART OF THE MONTH

FEBRUARY 2012

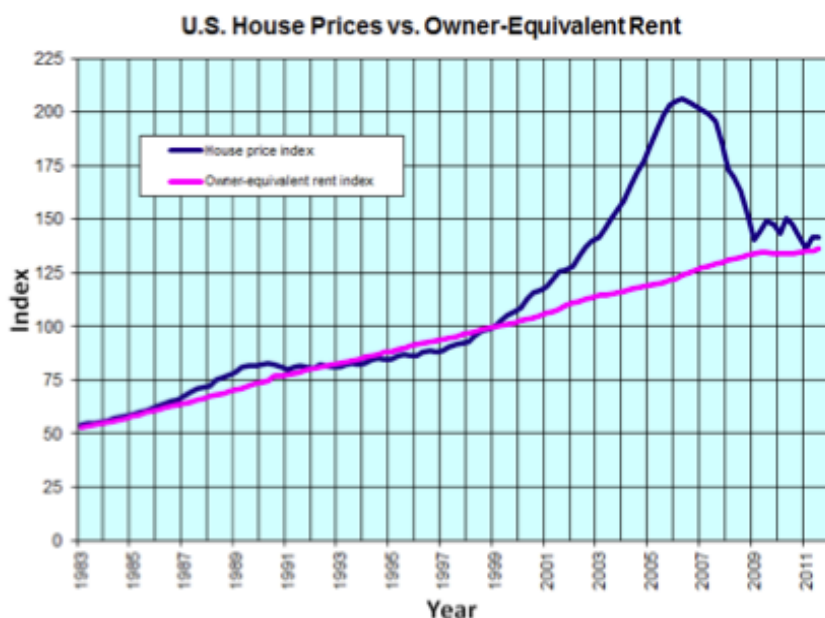
We called for the top of the real estate market at an investment conference in March 2006 and sent our presentation to clients with their statements the following month. We cited the overinflated market based on the long-term trend in housing prices, the lowest level of home affordability in 75 years, the rising inventory and new construction, and the record household real estate assets as a percentage of GDP as reasons why property values were likely to decline in the period ahead.



As it turned out, residential real estate peaked during the next 6 to 12 months, then fell an average of 33 percent in the 20 largest cities according to the Case-Schiller Home Price Index. The Los Angeles, San Diego, and San Francisco areas dropped 40 percent, meaning a home that was once valued at \$1 million was worth \$600,000.

As shown in the above graph, real median home prices (which are adjusted for inflation) are back to where they were in the early-1990s, 1980s, and 1970s. In other words, thanks to an unprecedented correction, record-low mortgage rates, and rising incomes, single-family homes are as affordable today as they were 20, 30, and 40 years ago. As a result, we are now reversing our prior position and believe that the market is bottoming and poised to move higher over the ensuing decade.

The next chart depicts the change in nominal house prices vs. rents since 1983. Home prices and rents, which should increase at the same rate over time, are back to equilibrium. The supply of existing homes for sale has declined 23 percent with inventory-to-sales the lowest since before the bubble burst. Meanwhile, employment and household finances are improving and housing-related stocks have appreciated, perhaps foreshadowing an upturn in property values.



Warren Buffett told CNBC viewers yesterday that "single-family homes are cheap now." He added, "I would load up on them" and "take mortgages out at very, very low rates." The CEO of Berkshire Hathaway said, "Five years ago they couldn't buy them fast enough because they thought they were going to go up, and now they don't buy them because they think they're going to go down." Amen.

