Is California a state to invest in or a state to avoid?

By Brian D. Holmes

The economic demise of California is greatly exaggerated. It has been portrayed by the media and investment community as economically and politically dysfunctional, taxing to business and facing debts that rival Greece’s. While much of this criticism is certainly warranted, it is important to not just focus on what could go wrong, but on what will probably go right.

Although California has been coined as unfriendly to business, it is home to Apple, Google, eBay, Intel, Cisco and Disney. It still has the world’s eighth largest economy, accounting for 13.4 percent of the U.S. GDP. It is the country’s largest agricultural producer and will continue to be a leader in technology and biotech innovations.

The state that “invented” movies and the Internet has always been an entrepreneurial boom-and-bust place, notably the technology boom in the late 1990s and the subprime mortgage/real estate debacle last decade.

California’s unparalleled success with innovation and new economic trends also leads to temporary times of economic hardship, making it the most volatile economy nationwide. Boom-and-bust economies drive temporary revenue gaps as governments spend what they have and fail to build reserves. California has past experience of double-digit gaps as a percentage of annual budgets, but its debt-to-GDP ratio is approximately 6 percent, lower than in Massachusetts, New Jersey, Michigan, New York and Florida.

The state’s fiscal mess is real, and tough cuts must take place, but if the past is any indication, the pendulum will swing back. The next California Gold Rush may be just around the corner. Its general obligation bonds are attractively priced and are relatively safe. The stable income is federal and state tax exempt for California residents and is not subject to the alternative minimum tax. These bonds are backed by the taxing power of the state, and attractive yields exist in the short and intermediate California Municipal Class 1 debt (i.e., an intermediate bond at 4.5 percent equals 7.65 percent taxable equivalent at the top bracket). Class 1 municipal debt includes state and local general obligation, school district, power, water, sewer and higher education. The default rate has been less than 1 percent over the past 25 years on this type of debt.

Opportunities will also exist with equities of publicly traded and new companies. Arguably, the world’s largest incubation center of technology lies in the Bay Area and Silicon Valley. San Diego’s biotech cluster is expanding rapidly, and Los Angeles continues exporting entertainment and is the gateway to Asia with the largest ports in the country.

The University of California system, which continually feeds these three epicenters of innovation, is the envy of the world. Six of the country’s top 15 public universities, as reported by U.S. News & World Report, are part of the UC system. Cal Berkeley and UCLA occupy the top two spots.

The comparisons between California and Greece should stop at their picturesque coastlines. Although Greece is only 2 percent of the European Union’s GDP, the contagion factor recently forced the EU to band together to temporarily protect Greek debt. California is more than one-eighth of the U.S. economy and is critically important to both the U.S. and world economies.

Ben Franklin said it best: “We must, indeed, all hang together or, most assuredly, we shall all hang separately.” I believe investment opportunities will continue to exist in the Golden State, and it will lead our country’s economy while producing the next generation of economic innovations.
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How to reach Brian D. Holmes
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About Brian D. Holmes
Brian D. Holmes, MS, CFP, CMFC, is the president and CEO of Signature Estate & Investment Advisors LLC. For four consecutive years (2007, 2008, 2009 and 2010), Mr. Holmes has ranked in the top 25 in Barron’s annual list of the top 100 independent financial advisors. He has been in the securities and insurance business since 1984 and is the managing partner of the Century City branch of the John Hancock Financial Network. Mr. Holmes is a past member of the Schwab Institutional Advisory Board and the UCLA Department of Economics Board of Visitors. He received his bachelor of science degree from the University of California, Los Angeles. A longtime resident of Malibu, Calif., he is involved with numerous charities throughout Southern California.

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