Newsletter April 2010

Welcome

Another year and time for a new approach and jacket for our newsletters and publications.
Global Property Portfolio will issue the newsletters that you have been accustomed to since their inception in 2007.
We have also created a new website for you to visit:

www.gppllc.us

The newsletters will still be available in PDF format on both websites in addition to hardcopies which are available at our office.
We look forward to hear your comments and suggestions.
Please contact us at ndoms@gppllc.us for more information.

Nick Doms
President & CEO

Content

Economic Outlook

We are at the end of the first quarter and things are not looking bright just quite yet. That was predicted last year and 2010 will prove to become another trying year for most.
The problems we are facing are multiple in nature and can be broken down in different segments.
First we need to realize that our GDP growth is well below a natural and healthy level. This is primarily due to the composition of our economy, which is very consumer spending driven. Until we start manufacturing more, and therefore export more goods, that GDP will remain weak for several years.
We are plagued by an ever increasing debt and annual budget deficits. This will weigh heavily on our shoulders for many decades to come.
What we should also take into consideration is the less than stellar performance of our UST auctions. The last 5 and 7 year UST-Notes did not go over well, hence the sudden jump in the yield curve, primarily the 10 year note and the 30 year bond. Both have a direct impact on mortgage rates.
Our unemployment rate remains high and independent of whether you wish to use the published rate of 9.7% or the unpublished realistic rate of 17.5%, the fact remains that we are not in a job creation cycle yet. A sentimental optimist may point out that by losing less jobs on a monthly basis that such is good news. A realist like me will point out that it will take several years to put more than 15 million Americans back to work.
As I pointed out in previous newsletters, this recession leaves a very different after taste behind in the sense that the pace of recovery is about half of what we have witnessed after previous economic crises.
Why is this occurrence so different?
Because the circumstances and conditions that control and guide the recovery are global and not purely contained within one economy. There are factors that play and influence our local economy such as Europe and Japan over which we have no control.
In 2010 and through 2012 we should expect a slow growth of around 2.5 to maybe 3% annually.
We should also watch the deflationary factor very carefully within this time period while we should prepare ourselves for a tidal wave of inflationary pressure starting late 2013 or beginning 2014.

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The Global Economy

When we look at a picture of global growth and compare the performance of the major players such as the US, UK, Europe, Brazil, India, China and Japan, we notice that globally we are at a stand still.
Where there is growth in one corner of the globe, it is offset by a decline on the other side. One interesting side note is that while economically we are flat that at the same time this does not stop our population from growing. Our people can only survive if and when economies grow at the same or at a higher speed than the population.
The big story this year has certainly been Europe but I will write about the Euro specifically in another article.
Economically Europe is now performing worse than the US and so is the UK. I don’t think that anybody really predicted this scenario; I certainly didn’t see this storm coming.
At the beginning of the crisis, Europe seemed to be holding its own ground very well but lately they have been sliding due to the struggles of the PIGS countries (Portugal, Italy, Greece and Spain) but also joining the ranks are now Ireland and Belgium.
So I have now dubbed them the PIGSBI countries (pronounce as pigs-bye).
The BRIC countries are holding their reign although they too are seeing a little bit of a slowdown.
China and India are still growing at a steady pace even though some of the Chinese subsidies have elapsed.
Australia and New Zealand are two countries we shouldn’t worry about right now. The first one certainly has the natural resources to strengthen their exports and their GDP.
Japan remains a question mark and a mystery. They are hard to read and one never knows how their deficit funding is going to work out. They are peddling along in a canoe upstream and don’t seem to get anywhere.
The resurrection of the global economy will completely depend on how all players work together and interact. If all the pieces fit back together than we can use the puzzle or the sandbox to the advantage of all.
I see no recovery in the immediate future and certainly not this year.

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The Inter-Currency Market

If there ever was one market worth watching these last three months then it had to be the currency markets.
Let's just focus on one currency in this article because it is worth the time and certainly fascinating to read.
Once upon a time there were 16 parents who decided in 2002 to get pregnant and give birth to a joint currency: the Euro. Prior to birth, a treaty was issued to determine who could be a parent and what they should adhere to. This was called the Treaty of Maastricht.
During the 8th birthday party, January 2010, one parent (Greece) admitted having lied to and cheated on all the other ones. They admitted that they had borrowed too much money to raise and support the child and were now on the verge of bankruptcy.
Without any help from the others, they would face serious financial distress because a parent (country) cannot technically file for bankruptcy.
The Greek outstanding debt was downgraded by the major rating agencies and the bond market reflected such in a dramatic increase in spreads on Greek bonds because of the risk associated with the bonds.
Spreads went as high as 350 Bp above normal levels. If you wish to make a comparison, that is the same as a Treasury note compared with a junk bond.
But the consequences of this were far larger. The confidence in the Euro tumbled and the exchange rate versus the USD dropped from 1.45 to 1.34.
The risk of a further weakening of the Euro is high because Spain, Portugal, Italy and Belgium are also candidates for a downgrade because of high debt ratios.
In the meantime, the euro-zone has received partial help from the IMF to alleviate the situation, but that also brings a stigmatism to the table.
In my opinion, the Euro should trade at around 1.25 versus the USD and we may very well see this level by year-end or early 2011.
The problems in the currency markets are not over yet and will continue to exist unless we find another system to calculate the exchange rates or find another standard.

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The Housing Market

Since the beginning of 2008. I have been pointing out the existence of shadow inventories residing on the balance sheets of local, communal and regional banks. Because there were no hard data available, it was impossible to analyze what potential impact a release of such assets would have on the market.
Well, then came 2010 and now the markets are being inundated with REOs, short sales and foreclosures.
According to the NAR, 1/3 of all recorded sales in the first quarter of 2010 fall within these three categories.
As predicted, this has a dual negative effect on the residential real estate market:
-It increases the inventory of available homes and the duration a home remains for sale on the market.
While at the end of last year we saw a decline in inventory from 11 months to 9.6 months, this year we see a rise back to 10.5 months on average.
-It decreases the home value of similar homes.
Homes that are in foreclosure or even short sales have a negative impact on existing homes in general. That is the secondary fallout and something no one can change or stop.
This is the double whammy I mentioned in a previous newsletter.

Why did this happen at the beginning of this year?

Banks and mortgage companies alike did not want to disclose their bad assets. When the FDIC issued new guidelines and forced the small banks to shore up their reserves for potential write offs and losses, the banks did not generate enough revenue to continue to do so while at the same time issuing a dividend to their shareholders.
The result was one of only one choice: dump the assets at the best price possible and eliminate them from our balance sheet.
This frees up available capital for the bank for future use and will hopefully spur increased lending to clients who wish to buy solid real estate with solid documentation and credit.
So, while this temporarily disrupts the market and may decrease the real estate value by another 5 %, it is the bitter pill we need to swallow in order to cure our disease.

But there is another little conflict that will hit us head on and will come to bite us back in the behind.

There is a very large discrepancy between the actual purchase price and the recorded tax value.
Recently, a house was purchased for 150K but the tax value, according to the BoA, was 350K. While the purchase price seems very attractive, the semi-annual tax bill does not and the new owner is forced to pay taxes on the value that his home will not have for many years to come.
That will become a major problem going forward and the BoA has no idea how to handle or resolve this issue.

Until this wave of foreclosures and short sales all find their way to the open market, I do not see a recovery. When the inventory is completely accounted for then I see a slow stabilization as we reduce the existing homes inventory.
A recovery at this point in time is not in the cards and do not expect one until well into 2011.

The commercial real estate market certainly avoided a major disaster but it still struggles on various fronts.
The good news here is that we did not fall into the abyss. We somehow found some stable ground, even though it is shaky.
Occupancy rates have fallen, primarily in small commercial space, i.e. mall stores, general store space, office space, restaurant space etc.
The leasing rate has certainly dropped to a new low and I do not expect this to change this year.
The large commercial real estate, i.e. distribution centers and warehouses have seen a similar fate but to a lesser extent. Rates are down and the occupancy rate has dropped but in a controlled manner.
International commercial real estate has found a stable bottom and will see a minor recovery once imports and exports pick up the pace again.
The real factor that will play in this latter market will prove to be the completion of the Panama Canal, expected to be finished in 2014.
Let's hope the river is deep enough by then.

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