GLOBAL Property Portfolio, LLC

Newsletter July 2010

Welcome

The second quarter cannot be called boring or disappointing. We saw more action in the last three months than in previous ones. The international markets were highly influenced by the turmoil in Europe and the weakness of the euro, but also by the global economic uncertainty and slow growth.
Another spoiler was the lagging housing market with high volumes in foreclosures that indicate we still have a long way to go in our road to recovery.
Read more about all these topics in our latest newsletter.

Happy reading,
Nick Doms

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The Inter-Currency Market

There has been a lot of turmoil in the currency markets these past three months due to the looming uncertainty in the EU and the Eurozone in general. While it may seem that these problems occurred unexpectedly, they have been in the making since the signing of the Lisbon Treaty in 1992.

The Treaty, as cornerstone for the creation of the Eurozone, stipulated that all members would have to adhere to a debt/GDP ratio of 3%. However, nowhere does it state what the repercussions would be if a member would not adhere to the stringent rule.

Since the inception of the euro, there has not been one single country in the Eurozone that has even remotely been in line with the imposed 3% rule.

It was not until Greece was on the verge of default and their government debt was downgraded that the real picture started to emerge and received worldwide attention. Portugal, Spain, Italy and Ireland soon followed suit and the debt disease could no longer be contained.

Besides the large amount of debt, two other problems came to light. The large annual budget deficits and the slow economic growth in the above mentioned countries also posed a serious long term risk.

As soon as the debt issues started to unravel, the inter-currency markets reacted immediately and the euro began to slide against the dollar and the yen simultaneously.
The euro found its low at 1.19 versus the dollar and has since stabilized somewhat around 1.23. That is not necessarily a sign that the problems are over but merely a precarious balance that may tip further in negative territory.

The ECB in conjunction with the IMF agreed on a rescue package for Greece that now totals around 1 trillion dollars equivalent. Jean-Claude Trichet, Chairman of the ECB announced a few weeks ago that the central bank would buy depleted Greek debt as collateral for the loan needed.

Greece was on the verge of bankruptcy in May and needed emergency funding just to fulfill its interest obligations. The financial turmoil in Greece quickly became an epidemic and spilled over to the other Club med countries, Portugal, Spain and Italy but even Ireland was not spared.

Europe now has a long road ahead of them and will have to implement stringent austerity packages to reduce their annual budget deficits and to diminish their total outstanding debt to an acceptable 3% debt/GDP ratio as per the Treaty of Lisbon.

That is not an easy task and may take many years. It will also place an extra toll on the driving economic engines in the Eurozone, i.e. Germany and France who will have to pay for the majority of the 1 trillion dollar rescue package.

One way out would be to let the euro slide further to 1.10 versus the dollar or even to parity. This will help stimulate GDP growth due to an increase in exports and a higher level of manufacturing and production, which in turn will bring down the unemployment rates.

If you are thinking about a European vacation, this may the year to take advantage of the conversion rate and Club Med is cheap and up for sale.

Greece is selling large pieces of land on some of their islands to raise cash. So, if your dream has always been to own a piece of Mykonos or Crete, put in your bids now.

ND – 06/26/2010

The Global Economy

During the past quarter a shift in the global economy has very quietly occurred and went by almost unnoticed. Even today not many economists are focusing on the importance of it, but we will point it out and why all of a sudden our approach should be adjusted.

Prior to the debt crisis in Europe, the US was so intensely focused on China and its monetary policy of government subsidies and the yuan-renminbi being pegged to the dollar thereby undervaluing the currency artificially, that nobody thought about the possibility of yet another economic disruption.

Now that we have explained the European problems, it will be easy to understand that globally there are three major forces at work and neither one of them is complementary to the other. On the contrary, all of them are a contradiction in terminis in and by itself and that causes a major problem going forward.

Here is an explanation of those three forces and how they work against each other.

-The American approach:
The US policy makers believe that spending is the solution and uses job creation as a justification for exceeding the annual budget and for increasing the national debt. They also believe that printing money without limits will ultimately increase the solvency of the country. The only result of this policy is a temporary increase in liquidity with a long-term negative effect on the solvency.
Secondly, the unlimited spending does not have a positive impact on manufacturing or production and therefore does not add value to the economic process or GDP growth.
This is what we refer to as the Keynesian school of thought, or The New Deal, that dates back to 1936.

-The European approach:
The EU believes in high savings rates and a strict monetary policy and is also willing to let their currency slide for the next few years. They believe in budget cuts, in a drastic reduction of government sponsored programs and in carefully planned investments that add value to their production and export lines. They cut the pork out of the budget and invest primarily in their own future and more specifically their advanced energy plan. This does not come as a surprise because they understand their dependency on Russian

natural gas all too well and have experienced first hand what it means when the Kremlin shuts down the valves.
We refer to this approach as the Friedman approach or Monetarism dating back to 1960.

-The Chinese Approach:
The approach here is based on government control and subsidies that keep prices of Chinese manufactured goods low and competitive versus other manufacturers. In addition, the Chinese pegged their currency to the dollar in 2008 to protect them from the global crisis and to keep their economic engine running at a 10% growth rate annually.
China will make certain limited concessions but only if it fits within their model.
This is commonly known as protectionism.

Combine all three strategies within one global economic arena to resolve the financial crisis and one immediately notices that one approach is counterproductive for the other and vice versa. It has to be understood that no continental economy operates as a closed circuit. The current status of our global economy requires continued integration and a streamlining of economic approaches. Keynesianism, Friedmanism and protectionism are outdated and no longer applicable in its purest form.

How do we resolve this sensitive issue?

The easy and probably sarcastic answer would be to get rid of all the politicians and let economists handle the problem from here, but it is not that simple nor is it realistic.
As much as the US caused the financial tsunami and buried every continent and country in 2007, the European turmoil is now causing shock waves on both sides of the world and a slowdown in China will cause commodity prices to go up.

The only solution is the integration and streamlining of our solutions into a global economic and monetary approach to ensure further growth. I will refer again to my favorite example, which I have used several times in my newsletters and articles.
We need to learn how to play together in the sandbox. Instead of one child delivering the sand and the second one building sand sculptures while the third one claims possession, we build together and all claim global economic victory in the end.

ND – 06/27/2010

The Housing Market

The housing market saw its ups and downs during the second quarter and figures are hard to analyze for accuracy since so many different methodologies are being used on a comparison basis and adjusted on an annual basis.
We will try to make sense out of all of them to keep things realistic because that is what we really need.

Existing home sales went up in comparison to the same period in 2009 but such need to be taken with a grain of salt. About one third of the sales were short sales and foreclosures that found their way to the market earlier in the year and can therefore not be interpreted as a positive sign of a rebound in the real estate market.

Much of 2010 will see the same trend of foreclosed properties being transferred from the regional, communal and local banks balance sheet and onto the FNMA, FHLMC, FHA and VA balance sheets awaiting sales at a very reduced price.

In and of itself that is not a bad thing and should not be interpreted as a negative sign, on the contrary, this is the only way to reduce the shadow inventory that weighs heavily on the financial health of our banks and financial institutions.

The only negative outcome, which is unavoidable, is that it will continue to put downward pressure on existing home values and may create a widening between the recorded tax value and the fair market value of homes affected in certain neighborhoods by a high volume of foreclosures.

Knowing in advance that this is what lies in our immediate future, we should find a flexible way to let this occurrence happen and pass with the least amount of interruption and resistance.

The Board of Assessors should be prepared to temporarily relax the valuation criteria used to determine the tax value of residential property. This will allow homeowners to absorb the lesser value caused by the amount of short sales and foreclosures.
The result in 2011 will be a firm and steady bottom ground upon which the real estate market can find its natural annual growth.

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The numbers for new home sales fluctuate so widely from month to month that it is hard to keep track or even make sense out of them, except for one thing.

In a time of high inventory of existing homes, does it really make sense to build new homes just in the name of job creation? Manufacturing companies that struggle with high inventory levels because of reduced consumer spending do not increase their monthly production, they lower the fire underneath the engine and wait until the demand is back.

Home builders should do the same and wait for the opportunity that will certainly come once the dust settles and we all walk on firm ground again. That may not happen until well into 2012. That doesn't sound like good news but this is a reality check for all of us.

The hiding of shadow inventories during the 2008-2009 period on the balance sheets of financial institutions has now come to haunt us back and we need to deal with it as best as we can and hopefully very fast so we can put this financial crisis behind us.

The remainder of the year will continue to follow the current trend and no dramatic change in the housing market should be expected until early 2011 when real estate prices and sales activity will stabilize. From then on we can slowly build up equity again but we should do so at a sustainable rate to match the prevailing inflationary rate or slightly above.

Any fast and furious hike in real estate prices to make up for lost time will be a sign that we have not learned much from this deep recession and creates the risk of another bubble bursting somewhere else.

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The BP Oil Crisis

The BP oil spill in the Gulf of Mexico is one of the largest environmental disasters in human history. The collapse of the Deepwater Horizon oil platform on April 22, 2010, has allowed 2.5 million gallons of crude oil to spill into one of the most precious and sensitive maritime environments in the world.

To put things into perspective, 85% of the world's dolphin population lives and multiplies in and around the Gulf of Mexico. Mature whales return to the Gulf after feeding in the waters off the North Eastern US seaboard to calf and bring their young back up north after the winter.

The impact is not just limited to the natural food chain that sustains maritime life, it has impacted thousands of local residents and small businesses in already difficult economic times.

While it is pertinent that the massive oil spill be cleaned up as soon as possible and hoping that the top cap will hold before a bottom-down solution and relief drilling begins in August, we also need to look at the long-term and unavoidable damage that has been caused.

The Louisiana State University has conducted lab tests to simulate the effect of oil and Corexit9500, the chemical used widely by BP, on simple maritime life. One of the conclusions is that the simplest life forms, worms that live at the bottom of the ocean and are a daily food source for bottom feeders such as shrimp, crab and lobster, do not survive in this environment and permanently disappear. This is not due to the oil that sinks in small quantities to the bottom of the Gulf of Mexico, but is caused by the existence of the toxic and non-biodegradable chemical Corexit9500 and Corexit9527.

The long-term effect on local fishermen, shrimpers, restaurant owners and local residents cannot be measured accurately and it will take years to even remotely calculate the economic impact of such a large scale ecological disaster.

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