



Newsletter October 2010



Welcome

Dear readers,

Another quarter passed and gone by and it seems that things are at a stand still, at least economically. The perception of mainstream America is justifiable but we also need to realize that it takes only a minute to break something and several hours to put all the pieces back together.

In this issue we will look at what has been done and what we may expect for the remainder of the year.

As always, we at GPP or SiRuDo Realty, never look at our world through rose tinted glasses. We see truth and write our opinion based on data, objectivity and truth.

Happy reading.

Nick Doms

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Global Property Portfolio Expands

Global Property Portfolio has not been dormant and continues to expand its business ventures.

Besides assisting US and foreign investors in finding large commercial real estate around the globe focusing on growth potential and capital preservation, GPP also provides its clients with articles, newsletters and publications that provide an insight in global socio-economic and geo-political trends that influence the CMBS market directly or indirectly.

Besides our quarterly newsletters, which are made available through a joint venture with our sister company, SiRuDo Realty LLC, and our publications, Global Property Portfolio LLC also makes available daily published articles focusing on economic developments around the globe.

Our clients and interested parties can follow our analytical assessment and subscribe to our daily articles by using the below link and click “subscribe”.

<http://www.examiner.com/international-trade-in-national/dominique-doms>

The free daily news feed allows our clients to keep abreast of up-to-date news about the financial markets, currency trades, economic issues and geo-political changes, and serves as an additional tool to position their investments safely.

The Company has also expanded its role as a management and financial consulting firm through its international network of economists, financial analysts and real estate experts.

Letters of intent and non-disclosure agreements have been signed with China, Taiwan, Singapore, Vietnam and The Netherlands to ensure the anonymity of our clients and our investors.

For more details, please feel free to contact us at ndoms@gppllc.us and we will gladly answer your questions.

Nick Doms-9/2010

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The US Economy

It is now official, the Government experts have declared that the recession ended in June 2009 and is now over. That also means that all the talk about a “double-dip” scenario was really a waste of time.

If the dip is over, then how could we possibly end up with a double-dip? A new dip might sound more plausible.

Don't ask the average American whether they feel any better now that they know the recession is over. The recent town hall meeting with President Obama clearly showed how America feels; uncertain and struggling.

Washington should sell their rose-tinted glasses on eBay and borrow mine for just a few minutes.

This is what I see as reality:

- Official unemployment rate: 9.6%
- Unofficial unemployment rate: 17.2%
- Outstanding debt: \$14 trillion
- Budget deficit 2010: \$1.5 trillion
- Debt/GDP ratio 2010: 98%

Very sobering statistics indeed, but very truthful, and I will add another one. The 570,000 jobs that were created with stimulus money consist of 90% new government jobs and only 10% private sector jobs. During the same period, we lost 2.3 million private sector jobs, so the mathematics don't really paint a beautiful picture, with or without rose-tinted glasses.

I am not trying to put all of you in a depressive mood. If you are still reading it probably is because you want to know what we can and should do about this.

We should start by admitting that the Keynesian theory of large government stimuli to attract private capital and revamp an entire economy no longer works within a globally integrated marketplace. Therefore, we should stop any bailouts and stimulus plans. No more cash for clunkers, home buyer credits, cash for caulkers etc.



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Secondly, we have to balance the budget not by increasing taxes but by reducing spending. We are being fiscally irresponsible if we continue the trend where before the fiscal year even starts and we have written the first check that we are already calculating how much we are going to borrow from someone else to cover the other checks we are so eager to write.

Our outstanding debt will grow to 101% of GDP by next year if we continue to shop like it was Christmas Eve. To place this percentage into perspective, Greece, the Club Med country and one of the PIGS countries who is again on the verge of technical bankruptcy, has a ratio of 130% and we are slowly but steadily getting there in the US.

Our economy grows at a very slow pace of 2.4% annually. That is an unprecedented low number after any economic downturn we have seen in the past and should be our warning sign that the drugs we use to revive the patient don't work anymore.

Instead, we should use the new and improved medicine: cut corporate and personal taxes for a period of 5 years, to be adjusted or repealed once our engines run again at full speed.

A reduction of our current corporate tax rate from 35% to 25% would entice our private companies to inject capital by hiring available workers, producing more manufactured goods, increase our exports and balance our trade balance sheets with other countries.

A temporary extension of the Bush tax cuts for at least five years, combined with a decrease of capital gains and dividend taxes, would make a big difference in net spendable income for the US consumer who is the current driving force within our existing economic model.

It is clear that the US, as many other countries, will have to adapt to the new chapter of global economic growth. Each local or regional economy will have to balance itself between manufacturing/export and consumer spending.

Failure to do so will only strengthen my opinion that China will be the largest economy in the world by the end of the decade.

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The Global Picture

It is becoming more clear as time goes by that the economic powers continue to shift towards the east but also to other economies that seem to develop very steadily even in the light of the global financial crisis.

The BRIC countries are a perfect example of rapid GDP growth with a reasonable level of inflation and stand in sharp contrast to developments in the US and Europe.

The global economy is being supported by a handful of countries and such does not create a very stable environment for the immediate future.

The role that China plays is now obvious to everybody. Being able to consistently grow at 10% should leave no doubt. But unless the net importers of the world, i.e. the US, fire up their economic engines, China will face a problem finding offset markets for their large manufacturing and production facilities.

The only solution for China is to steadily steer their export-driven economy towards more domestic consumption.

India's economy faces the exact opposite problem. They consume 80% of their manufactured products and do not export enough to be self-sustainable in the long term.

Russia is battling high inflation but has been able to reduce such pressures from 13% at the beginning of 2010 to 8% by mid year. A very drastic move and intervention but still a lingering problem that needs to be watched closely.

Then there is Brazil. It seems sometimes that their economy has everything going for them. The country is mostly oil independent thanks to their massive production of ethanol, derived from large sugar cane plantations and the recent find of rich oil and gas reserves off the Atlantic coast led to one of the largest IPOs in history. Petrobras successfully priced its new preferred shares on September 24 for a total of \$67 billion, bringing its market cap to the same level as ExxonMobil, \$160 billion.

The only thorn in Brazil's side is their currency, the Brazilian real, which keeps appreciating against the dollar and hurts their exports.



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In addition let's keep a close eye on so-called "emerging" economies: Vietnam, Thailand, Taiwan and Singapore. All of them are located in the east, which begs the question, what in the world happened to the western economies? Did they just disappear from the radar screen and have nothing to contribute?

Maybe or maybe not. The fact is that by 2020, China will be the largest economy in the world, dethroning the US from what once seemed to be an invincible position.

So what went wrong? For starters, the west has lost its production capacity over the last 30 years by their own doing. Western companies used cheap eastern labor to increase the profit margins, referred to as "Global Labor Arbitrage" by Stephen S. Roach, PhD, and labeled as unsustainable and mutually not beneficial.

This arbitrage led to an increase in manufacturing activity in the east and obviously cheap consumer products in the west. Today, and since the beginning of the financial crisis, the west would like to bring back this lost manufacturing capacity but it may be too late to tip back the scale.

China is a perfect example of how the outsourcing of cheap labor leads to the creation of high-paying R&D, design and innovation jobs. China does not plan to continue to make cheap goods for US companies. They are now developing their own luxury brands, under their own name, that will find a prominent shelf space in stores near you.

Chinese garment and high-tech manufacturers are opening their own flagship stores in China's metropolitan areas and instead of producing components for Wal-Mart, Dell, Intel and AT&T; they produce their own finalized products.

If the above still has not convinced you, take this into consideration: Deng Xiaoping stated in 1979: "The Middle East has oil, but China dominates the rare earth elements."

Who knew that this phrase would resonate in the 21st century? Probably nobody but learning Mandarin starts to look more enticing every day. Mgoi gwei.

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The Housing Market Is Lagging

The housing market does not seem to be able to restore itself and continues to suffer from slow sales, high foreclosures and a continued drop in home values.

Despite the Government's quantitative easing, resulting in low mortgage interest rates and the first-time home buyer's tax credit, the housing market continues to be in a slump.

In 2008, we warned that a direct and artificial Government intervention through whichever stimulus bill would result in a prolonged unstable housing market that would further impede a reasonable economic recovery.

That is the case today and it seems that this trend will continue well into 2012 and probably beyond before we find solid ground to recover and rebuild a shattered industry.

What exactly stood in the way of a natural market recovery and what measures currently prohibit it from healing?

We'll answer that question by looking at the prevailing problem year by year.

2008: The real estate market closed its eyes and never really understood the dynamics of the economic recession. The NAR and similar professional associations just simply turned a blind eye hoping that tomorrow everything just seemed like a bad dream.

2009: The trend continued but home prices started to fall off the cliff and many real estate agents or brokers saw their income dwindle and left the industry, at least temporarily. That in itself is not a bad side effect of a crisis because the market was so overcrowded with unqualified representatives that the "Ken and Barbie" agents outnumbered the educated ones and sales didn't just occur anymore because of good looks and a nice smile, buyers and investors demanded knowledge and skill from their buying and selling agents.

2010: Regional, communal and local banks were forced by the FDIC to either raise their Tier I capital ratio or remove their toxic assets from their balance sheet through REOs, short-sales or outright foreclosures.

This has resulted in a delayed reduction of home values and an increase in inventory.



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We are now 3 years later and we still continue to face the same problems: high inventory, low existing home sales, low home values and shadow inventory that is now hidden on the books of GNMA, FHLMC, FHA or VA.

In essence, we have transferred the financial exposure and leverage from financial institutions to government owned entities, thereby multiplying the risk for American taxpayers.

If there is one lesson to be learned from this real estate crisis it is that the American Dream is exactly what it promises to be: a dream.

It is not possible for every American to own a home, just as it is not possible for every child to get a PhD. Lowering the lending standards just to ensure that everybody could get a loan without proper documentation about income, credit scores, assets and liabilities has only exacerbated the situation.

Even our “new and improved” lending standards fade in comparison with European and Asian standards. New loans with 0 or 3.5 % down payment are as prevailing as new ARM loans with more fine print than ever before, which we now know from experience, no applicant ever reads or understands.

In the meantime, the NAR published the new August existing home sales figures, which apparently held steady at 288,000 but were below the 291,000 expectancy level. The difference here to note is that the new NAR figures are no longer based on actual closings but merely calculated based on agreed upon contracts instead.

Using the readily available MLS figures that indicate that 10 to 15% of agreed upon contracts never materialize in an actual closing, means that the true August figure is 260,000 and well below the expectation level.

Combine this rose-tinted figure with a decline of another 1.2% in FMV versus July and we know that we have a long way to go before we see any bottom in the real estate market.

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What About China?

It seems that China has dominated the news during the past three months and yet a lot of it has gone by unnoticed or maybe people have a hard time connecting the dots and what it all means.

Here is what I noticed in the last three months and pay close attention to:

- China pegged its currency to the Malaysian ringgit. Result: more convertibility for China's currency.
- China allowed its trading partners and importers to invest directly in the inter-bond market for the first time. Result: more convertibility.
- China and Taiwan signed a free-trade agreement with possible peg between the renminbi and the Taiwan dollar. Result: more convertibility.
- China buys large amounts of Japanese Government Bonds, driving the yen to a 15-year high versus the dollar. Result: high deflation and stagnating economy in Japan.
- China bans the export of rare earth metals to Japan over the fishing boat accident. Result: the US will have to buy alloys from China instead of Japan.

Add to the above that Thailand, Hong Kong, Vietnam, Singapore and Latvia, just to name a few, have all recently invested in Chinese bonds to diversify their reserve accounts. Hong Kong has become "the" off-shore trading haven for the renminbi and banks now allow their clients to open renminbi accounts in addition to the traditional HKD checking and savings accounts. Before year-end, private clients will be able to buy A-shares which so far have always been reserved for investors that reside in mainland China.

It is clear what the red line is between the dots, a more convertible and international renminbi that will ultimately challenge the dollar as the most widely held reserve currency.

We are several years away from this occurrence but China is certainly paving the road fast and furious, both economically and financially.

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Precious Metals Market

Ever wonder what in the world is going on with gold prices lately? Precious metals move faster than the energy bunny and it seems the market does not run out of steam just quite yet. However, there are some things to take into consideration if you plan to make precious metals part of your investment portfolio.

There is a big difference between “paper” gold and physical gold. The former can be described as shares held in an Electronic Traded Fund (ETF) that either tracks the gold index or only partially invests in physical gold bullion. Some of the funds are so highly leveraged and rather than protect the investor against any deflation; it actually increases the risk of exposure.

The physical gold purchases represent another problem for individual investors and that is accurate purchase pricing. Recently the FTC and SEC have launched an investigation of some companies that sell gold coins directly to their customers. You have probably seen their ads on TV networks.

I’ll just mention one example. A five dollar golden eagle, 1/10 oz, sells for \$139 to \$250 per coin. Both prices indicate a 10% to 100% premium versus the gold spot price of \$1,298/troy ounce.

If gold is your favorite investment as an anti-deflationary technique, then look at buying physical gold on the spot market for delivery and avoid “paper” gold and overpriced coins.

But is gold really the only shiny metal of interest to investors? I don’t believe so. Silver, for example, is at a 30-year high and has plenty of upside room left to grow. The steady technical support level of \$20/troy ounce is a good indication that silver prices will continue to rise.

A lesser known fact is the importance of what is called “white metals” such as silver, palladium, platinum and titanium. Unlike gold that finds its application primarily in bank reserves and jewelry, white metals have a large industrial application, hence a continued rise in demand from various industries.



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Rare earth metals are another option. In contrast to their name, rare earth metals are abundant in our soil and ore mines. The problem is the cost of the separation process to extract the metals from other ore.

That was the main reason why American mining companies halted the production of rare earth metals altogether twenty years ago and China now controls 93% of the world supply chain.

These metals or their alloys are in high demand in the automotive industry as well as the military defense manufacturing industries.

Not everything that shines has to be gold and the rarity of a metal does not always justify the intrinsic value of the commodity in question.

The industrial demand for lesser known metals will drive the spot markets and may be a very good alternative if you seek protection and diversification of an investment portfolio.

Nick Doms-9/2010

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