

U.S. Economy: Moving in the Right Direction

The U.S. economy seems to be showing signs of improvement. Leading indicators include, decreasing job cuts, increasing manufacturing spending, calming housing market, rebounding consumer confidence, and a rallying stock market. Detail on each indicator is as follows:

- Unemployment rate increased to 9.7% in August from July's 9.4%. The rate of job loss fell from 600K per month reported between December and March 2009 to 350K in May, 467K in June, 276K in July and 216K in August.
- Manufacturing purchasing sentiment in U.S. rose to 52.9 in August from 48.9 in July according to the Institute for Supply Management. New orders are rising across all sectors, most notably semiconductors, textile mills, paper products and apparel.
- Resale of existing homes rose in June 3.6% from the previous month to 4.89 million homes (seasonally adjusted annual sales) according to the National Association of Realtors. New home sales volume increased in June compared to May, resulting in 384,000 transactions (seasonally adjusted annual sales) according to National Association of Realtors.
- Car makers sold 1,261,977 cars/trucks industry-wide, an increase of about 1% from a year earlier and up from July's 997,824. It was the highest total sales since May 2008 and the first time the industry saw a year-over-year increase since October 2007.
- The Dow Jones Industrial Average is up 46% since March 9, when the world itself seemed to be hurdling into the deep abyss. In the entire 113-year history of the Dow, only six rebounds have been bigger and faster.

The global economy, however, remains far from a full recovery. Signs of weakness remain. Some economists believe that the recent rebound was a "false rally", or the "first leg up" on a W recovery. In the first few days of September, the S&P 500 slipped 3.29 points, or 0.3%, to 994.75. Its financial sector fell by 0.9% as regional banks like SunTrust Banks and Regions Financial dropped. Similarly, the Nasdaq Composite Index fell 1.82 points, or 0.1%, to 1967.07 in the first days of September. We are likely to slip backwards in the coming months before reaching the "real bottom".

Commercial Real Estate: Ticking Time Bomb in U.S. Banks & CMBS

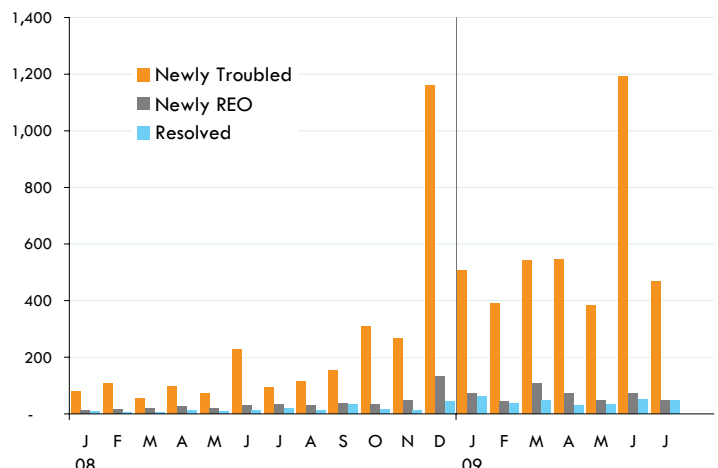
The storm clouds continue to gather above U.S. Banks and the commercial-mortgaged backed securities market (CMBS). The issue is the accelerating number of maturity defaults (See RCA charts below.) Declining asset values and scarcity of debt are forcing more and more owners into default. U.S. Banks hold \$1.0 trillion of mortgages backed by commercial property, while the CMBS market holds another \$0.7 trillion. Analysts estimate that the default rate on U.S. bank mortgages could reach as high as 15.3%, or \$150 billion, over the life of the loan portfolio. CMBS mortgages could reach similar height of default rate. As of July, the delinquency rate stood at approximately 4.3% for U.S. banks and 3.1% for CMBS loans. Despite the mounting pressure to address the new reality, U.S. banks have been reluctant to take losses on their commercial books. The following factors may force banks to take a more aggressive stand:

- Growing number of performing and non-performing loans coming due that are unable to payoff as scheduled.
- Increasing number of floating rate, un-stabilized properties maturing that fail to meet debt service or cash flow covenants.
- Depleting interest reserves of transitional assets, forcing owners into default.

Distressed Properties
(cumulative volume in \$Billions)



Distressed Properties
(number of troubled assets per month)



Investment Outlook: Sellers Becoming Increasingly Motivated

With limited options to recapitalize, distressed sellers are now becoming more motivated to work with buyers. The hopes of capital markets returning to normal anytime soon are fading, and these sellers are adjusting their price expectations to match the new reality. Similarly, lenders are fatiguing from "kicking the can down the road" and simply extending terms. We expect by early to mid 2010, lenders will choose more stringent courses of action with renewals and non-performing assets, including foreclosure. Buyers are now amassing funds and defining strategies, so that they can act quickly on the coming wave of assets.