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the BRIEFING

THE NATIONAL ECONOMY AT A GLANCE

THE ECONOMY

The economy appears to be entering the New Year on a roll. However, just as signs appear to be pointing to an accelerating economy, clouds in China and emerging markets are creating uncertainty and threatening to derail growth in both the U.S. and abroad.

The Senate has approved a spending bill exceeding $1 trn that should keep the government running through September.

World growth is expected to increase from 1.98% in 2013 to 2.8% in 2014. Goldman Sach's economists are forecasting 2014 U.S. GDP growth of 3.3% with less fiscal drag from tax increases of 2013 and some improvement in domestic demand.

- 3Q GDP growth revised up to 4.1%
    - Only one-third was from inventory growth while consumer spending was only up 2% – but economy clearly firing on all cylinders
- December job growth a disappointing 74,000, following two months over 200,000
- ISM reported December at 57, up from first half of 2013 average of 51.5
- Durable goods sales up 3.5%
- 2013 was the best car and truck sales year since 2007, with 15.6 mm vehicles sold, a 7.6% increase over 2012
- Despite the positive momentum, weak earnings reported from Best Buy, Goldman, Citigroup, Sears, JCPenny, WalMart Kohls, Dollar Tree and Bed, Bath & Beyond
- Home prices have hit record highs in several U.S. cities, but the average prices overall are still at least 25% below their previous high
- Projections of 20% decline in oil prices as lower global demand can't keep pace with the U.S. shale oil boom

GLOBAL OUTLOOK

2014 is expected to be better for the Euro Zone with Deutsche Bank projecting 1.0% growth compared to 0.4% contraction in 2013

- European Central Bank rate cut in November should continue to provide stimulus
- European politicians have hammered out the underpinnings of a bank union
- Europe's recovery from the sovereign debt crisis led to a 57% rally in Greek bonds and a 12% surge in Ireland's bonds
- China's short-term liquidity squeeze eases as seven-day borrowing rate drops to 4.89% from 8.94% with central bank injection of $4.8 bn
- China's exports rose to just 4.3% compared to December 2012 while import growth was strong at 8.3%, narrowing the trade surplus to $25.6 bn from $33.8 bn in November
- China's Yuan has eclipsed the Euro and Yen as a trade currency, rising to 8.7% of trade financing agreements
- The dollar still accounts for 81%
- Everyone is carefully watching the emerging market currency meltdown with the hope we will avoid contagion to other markets and/or currency wars

CAPITAL MARKETS

There was surprisingly little reaction to the Fed's "taper-lite" announcement to cut monthly purchases from $85 bn to $75 bn in December. With the projected growth and "tapering-lite" there is likely to be upward pressure on interest rates. Therefore, 2014 is going to be a bumpy road for stocks and bonds, particularly Treasuries and high-grade corporate bonds.

- Dow Industrials up 27% in 2013
- Nasdaq composite up 38%
- S&P 500 reported 10 sectors up 32.4%, up 160% from March 2009 low
- 10-year Treasury rates up nearly 100 bps
- Bonds fell globally 0.4% in 2013
    - 3.4% loss in U.S. Treasuries was offset by a 1.2% gain in corporate debt and 7.0% return in high-yield

Technology on the Move

3.4 M
Number of vehicles with Ford Sync Applink to be added to the existing 1 million on the road

1.3 M
Laser shots per second in new LIDAR self-driving sensor technology, which accurately locates every object within 50 yards of a car

$75K
Cost of stand-alone LIDAR laser technology

1,000
Hours spent in a McLaren high-tech simulator to develop the 12C sports car

    - Long-term junk bond sales are down as investors favor shorter-term securities less vulnerable to rising rates
- Inflation has virtually disappeared at 1.2%, well below the target rate of 2.0%
- At year-end, the global capital markets had $85 trn in debt and $62 trn of equities
- Companies spent $500 bn, or 2.0% of the S&P 500's market capitalization, buying back their own shares in 2013 – that's 50% of what the Fed spent in 4Q14

COMMERCIAL REAL ESTATE

The economic growth should enhance commercial real estate fundamentals, improving cash flow and returns. On a relative basis, CRE should remain very attractive to both debt and equity investors.

Despite nearly 100 bps rise in 10-year Treasuries, commercial real estate sales ended the year with increased volumes and flat or lower cap rates.

The Ban Report (1/9/14) stated that the bid/ask spread has compressed considerably in the past year. "Since 2009, the biggest impediment to more sales of troubled assets has been the expected loss banks were taking on the disposal of assets.

"Today, pricing on performing, sub-performing and non-performing assets has improved dramatically, and the vast majority of banks have the capital and reserves to move assets. In some cases, banks are finding sales of undesired assets to be capital accretive. There have even been whispers from buyers that appraisals on assets are too low. Banks that dismissed loan sales two to three years ago should consider taking a second look."

- Much of the recovery over the last few years has been based on cap rate compression, due to lower interest rates and better financing – now, improving property cash flows will be critical
- After a six-year period of low interest rates, they are expected to rise modestly in 2014 and beyond
- Raising equity and debt will become even easier
- More than $350 bn is scheduled to mature over the next three years
- $125 mm in CMBS loans expected in 2014
- Bentall Kennedy has introduced a new investment fund targeted toward Canada's defined contribution and group retirement markets in partnership with Sun Life
    - They have created a vehicle that invests in units of a fund, as well as carrying cash units in publicly traded REITs, that provides enhanced liquidity
- Core assets providing annualized returns in excess of 5.0% look very attractive against a 10-year Treasury of 2.6%, leading to queues at many established funds:
    - J.P.Morgan's Strategic Property Fund: AUM = $19 bn; queue = $2.1 bn
    - UBS' Trumbull Property Fund: AUM = N/A; queue = $2.5 bn
    - Prudential's PRISA: AUM = $12 bn; queue = $450 mm
- Many funds now target 80%-plus in core assets with some freedom to do new construction or opportunistic on the remaining part of the allocation, giving the ability to generate beta or excess return to beat benchmarks
- These funds are considering build-to-core strategies in both multifamily and industrial development

the BRIEFING is an aggregation by Tom McNearney, Transwestern chief investment officer, of other articles and reports. Tom leads Transwestern's capital market efforts for development and investment nationwide. Tom also serves on the firm's investment committee and board of directors, and he directs the execution and expansion of the firm's principal investment activities across the country.