

COLLIERS INTERNATIONAL VALUATION & ADVISORY SERVICES

WEEKLY MARKET RECAP



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K.C. Conway, MAI, CRE, CIVAS Market Analytics

The events and economic news of the past two weeks sent me back to the history annals searching for some perspective for the latest edition. Finding True North in this environment continues to be a challenge. The continuation of Occupy Wall Street protests, dysfunctional nature of the capital markets, additional financial service industry layoffs, Congress' inability to tackle our debt crisis and find \$1.2 trillion in spending cuts, revelations that our elected national leaders are exempt from insider trading laws, and the largest municipal bankruptcy in U.S. history (Jefferson County, AL – outpacing the \$1.7 billion bankruptcy of Orange County, CA in 1994 by nearly three-fold) have American and foreign investors questioning their faith in our fiat currency, as well as our governmental (Congress) and business (Wall Street) institutions. Fortunately, the perspective was found in former U.S. Presidents Adams and Washington – and three pinnacle events in our history:

- **Founding of the Marine Corps 213 years ago this month;**
- **Construction of the Washington Monument** – completed 137 years ago in 1884; and
- **Genesis of how we came to celebrate Thanksgiving.**

Let's start with the latter, Thanksgiving.

Thanksgiving

The tradition of celebrating Thanksgiving on Thursdays dates back to the early history of the Plymouth and Massachusetts Bay colonies, when post-harvest holidays were celebrated on the weekday regularly set aside as "Lecture Day" – a mid-week church meeting where topical sermons were presented. The legacy of a meal with the native Indians extends from one of these observances in the autumn of 1621, when Plymouth governor William Bradford invited

local Indians to join the Pilgrims in a three-day festival held in gratitude for the bounty of the season. Thanksgiving became an annual custom throughout New England in the 17th century, and in 1777 the Continental Congress declared the first national American Thanksgiving. **In 1789, President George Washington became the first president to proclaim a Thanksgiving holiday,** when, at the request of Congress, he proclaimed November 26, a Tuesday, as: **a day of national thanksgiving for the U.S. Constitution.**

However, it was not until 1863, when President Abraham Lincoln declared Thanksgiving to fall on the last Thursday of November, that the modern holiday was celebrated nationally.

At this time, when our Congress is so dysfunctional and retailers are battling over who can open the earliest on Black Friday – or even Thanksgiving evening, maybe it's time for us to reflect on the genesis of the Thanksgiving holiday and focus once again upon:

- Gratitude for the great bounty in this country. With all that is dysfunctional and problematic, we nevertheless have a great bounty not found elsewhere in the world. Whether it is the right to speak freely, assemble peacefully, change governments every four years without upheaval, or enjoy the lowest food and energy prices in the world because of our rich agricultural and mineral resources, we have a lot to give thanks for.
- The value of the U.S. Constitution. As Congress postures itself for 2012 national elections and tries to justify its exemption from insider trading, and Wall Street struggles with understanding the perils of widening economic disparity that has nearly destroyed the middle class in America (we now talk in ratios of 99% and 1%), Occupy Wall Street protestors and the Tea-Party movement

remind us that it is our Constitution that gives us the power to affect change and rebalance what is out of balance. Maybe this Thanksgiving we should all take a break between grazing trips to the kitchen table, outings to the mall, and football games to read a section of the U.S. Constitution. After all, George Washington proclaimed Thanksgiving to be the day we celebrated our Constitution – not the day we kicked off the Christmas shopping and College Bowl seasons.

Construction of the Washington Monument

On December 6, 1884 construction on the Washington Monument was completed. The site where it stands today was originally designated as the place where a statue in honor of our first President – George Washington – was to be erected. It wasn't until 1832, 33 years after Washington's death, that anyone really did anything about the monument and tribute to our first President. That year, a private Washington National Monument Society was formed. After holding a design competition and choosing the Greek temple-like design we see today, the society began a fundraising drive to raise money for the statue's construction. Sixteen years later, in 1848, the foundation stone for the monument was laid after nearly 25% of the monument's \$1.0 million cost was raised by school children (\$230,000). After a number of delays and disruptions, mainly the Civil War, President Ulysses Grant authorized the completion of the monument in recognition of the nation's centennial in 1876.



The monument has stood the test of time, wars, earthquakes and national crises. It has always pointed upward and represented a symbol of True North for our elected leaders. Perhaps it is the solid nature of the 24,500 pound marble cornerstone, or the intricate design in which 36,000 blocks of marble and granite are laid together, that have given the monument its

strength. When the monument was completed it was the tallest structure in the world at 555 feet. A city law passed in 1910 restricted the height of new buildings to ensure that the monument would remain the tallest structure in Washington, D.C. as a tribute to the man known as the father of our country.

As the Washington Monument remains closed for structural repairs after this fall's earthquake, and our Congress remains incapable of action, maybe this year's 127th anniversary of the completion of the Washington Monument on December 6th should serve as an opportunity for Congress to honor the history of the monument by restoring fiscal responsibility to the U.S. Over the Thanksgiving recess Congress should reflect on the role that children had in funding the monument, and then ask how continued deficit spending honors any kind of legacy to our children and future generations.

Founding of the Marine Corps

This month, the Marine Corps celebrated its 213th birthday. During the American Revolution, the Continental Congress passed a resolution on November 10th 1775 stating that "two battalions of Marines be raised" for service as landing forces for the recently formed Continental Navy. The resolution, drafted by future U.S. president John Adams and adopted in Philadelphia, created the Continental Marines.



Today, there are more than 200,000 active-duty and reserve Marines, divided into three divisions stationed at Camp Lejeune, North Carolina; Camp Pendleton, California; and Okinawa, Japan. Each division has one or more expeditionary units, ready to launch major operations anywhere in the world on two weeks notice. The motto of the service is Semper Fidelis, meaning "always faithful" in Latin. This Thanksgiving all Americans should honor the service of the Marines - and all men and women in our armed services - by adopting their "Semper Fi" motto and asking how we too can be faithful. Whether it is Americans paying their agreed upon debt obligations, Congress adhering to the same conflicts of interest laws that they impose upon everyone but themselves, regulators balancing their regulatory mandates with common sense and industry input, Wall Street incorporating a middle-class and domestic jobs into its business models, or American businesses extending employment opportunities to our returning veterans, a commitment to the Marine Corps motto by each of us can reverse much of what is wrong.

*THE MOTTO OF
THE SERVICE
(MARINES) IS
SEMPER FIDELIS,
MEANING
"ALWAYS
FAITHFUL" IN
LATIN.*

STATISTIC(S), QUOTE(S) & HEADLINE(S) FOR THE WEEK

The Statistic(s) of the Week

Several statistics were standouts these past two weeks that warrant elevation to Statistic of the Week status. The respective statistics are:

0.24% - FHA's Current Capital Ratio

In its annual report to Congress this past week, the Department of Housing and Urban Development and an independent auditor reported the FHA has a 0.24% capital reserve, well below its statutory 2% minimum for the third year running.

If a capital ratio of just 0.24% isn't enough to get your attention, how about a leverage ratio of 422:1? Take \$1.1 trillion of outstanding loan guarantees divided by \$2.6 billion in capital reserves and you get a 422-to-1 leverage ratio. Where is the regulatory oversight? This 422:1 leverage ratio is up from 33:1 in 2009. Meanwhile, banks are being made into villains over a leverage ratio of 12.5:1. These numbers are no surprise to those in the housing finance and mortgage industry, given FHA's inherently risky business model. The FHA provides 100%, explicitly taxpayer-backed mortgage loans to first-time, moderate to low-income borrowers. Down payments can be as low as 3.5%, at a time when most private lenders are prudently insisting on 20% after the housing bust. In fiscal 2011, 85% of FHA loans had a down payment of less than 5%. FHA has become the substitute for private subprime lending. As subprime lending vanished after 2007, FHA became the major lender for marginal borrowers. The share of new mortgages that FHA insures has risen to 24% - compared to just 6% in 2007.

\$263.3 Billion

Ginnie Mae has displaced Freddie Mac as the nation's second biggest mortgage funder - and that may not be such a bad thing. Ginnie Mae, unlike government-sponsored enterprises Fannie and Freddie, is a corporation entirely owned by the federal government. It packages mortgages insured by the Federal Housing Administration, the U.S. Department of Agriculture, the Office of Public and Indian Housing and the U.S. Department of Veterans Affairs. These agencies are the first line of defense when a loan defaults and assume almost all the risk whereas Ginnie is a catastrophic backstop and steps in only when a servicer fails. As a result, Ginnie will actually return a profit to the Treasury in 2011 because its business model is far more insulated from risk. Conversely, Fannie and Freddie, which have taken \$150 billion in taxpayer aid since being put

under government conservatorship, continue to require taxpayer funding. According to a recent Bloomberg article in which Paul Leonard, vice president of the Housing Policy Council was interviewed, "Ginnie Mae is being eyed as a model that would allow the federal government to keep its hand in the mortgage market without the kind of risk Fannie and Freddie pose." Compared to FHA, Ginnie Mae has \$600 million in loan-loss reserves and \$16 billion in capital reserves.

40% Default Rate In 2010 Vintage Student Loans

Historically, investors have assumed 25% of student loans will default (a staggering statistic by itself compared to all other types of credit). However, in 2011, investors in student loan debt are factoring 40% default rates among the current crop of college graduates, according to a recent Barclays Capital analysis by Chris Haid, a director in asset backed trading at Barclays Capital.

It's important to put these default rates into perspective. The total amount of outstanding student loan debt and state debt for all 50 states is approximately the same - \$1.0 trillion. However, if the states had an anticipated default ratio of 40% compared to its historical fraction of 1.0%, the \$3.7 trillion state and municipal bond market would be in utter turmoil.

A 40% anticipated default rate in the \$1.0 trillion student loan debt market translates to half the Federal Reserve's balance sheet prior to 2007, and more than half of the entire TARP program for the banks. Where is the outcry for this credit abomination?

The Quote(s) of the Week

"Efforts to develop the final Dodd-Frank rules have been progressing well. The Federal Reserve will soon release for comment its proposed rule on enhanced prudential standards that would apply to large bank holding companies and systemically important nonbank financial firms. Let me note that in all its rulemaking responsibilities, the Federal Reserve is attentive to aligning the rules required by the Dodd-Frank Act with international agreements, such as higher capital standards and new liquidity standards for large banks and capital surcharges for the largest global SIFs."

-Vice Chair Janet Yellen of the Federal Reserve - 14th Annual International Banking Conference

**AS SUBPRIME
LENDING
VANISHED AFTER
2007, FHA
BECAME THE
MAJOR LENDER
FOR MARGINAL
BORROWERS.**

THE FEDERAL RESERVE'S INTERESTS ARE NOT ALIGNED WITH A VITAL U.S. BANKING INDUSTRY RATHER, THEY ARE WITH INTERNATIONAL AGREEMENTS ON GLOBAL CAPITAL.

This quote is a final notice to prepare for the dreaded rules for Section 165 of the Dodd-Frank legislation dealing with who will be deemed "Systemically Important Financial Institutions." As noted in prior editions, these rules would likely be released in mid-November just prior to the Thanksgiving recess to give the banking and financial services industry not regulated by the FED minimal time to react and organize opposition to these far reaching rules that will forever alter the U.S. financial services and real estate industries.

Once published in the Federal Register for the required 30-day comment period, these rules are slated for implementation January 1, 2012 in accordance with the Dodd-Frank legislation. The FED is notorious for slipping these type comments and notices into speeches not on the radar screen of impacted entities. The rules for just this one section of Dodd-Frank are reported by inside FED resources to exceed 1,500 pages. They are intended to give the FED its broadest reach into the non-banking world to regulate life companies, large retailers - such as Wal-Mart, mortgage servicers - and even industry trade groups that the FED believes are systemically important in terms of financial information, education and certification of professional credentials. This section of Dodd-Frank was intended to disarm the argument by the FED that it could not rescue Lehman Brothers as it lacked the authority.

Through the Financial Stability Oversight Council (FSOC), the Federal Reserve will now have the ability to name any entity systemically important "just because." The findings by the GAO in its first-ever audit of the FED earlier this year regarding the Federal Reserve's abuse of "exigent circumstances" in using its 13-3 emergency lending authority should serve as the wake-up call to all as to the importance of these pending Section 165 rules. Banks, life companies, mortgage servicers, hedge-funds, real estate and banking industry organizations heavily engaged in the education and certification of real estate and finance professional credentials need to all prepare to mobilize, dissect, digest and respond to these rules upon their release - most likely during Thanksgiving week. Don't make the same mistake as the healthcare industry regarding the healthcare reform legislation and allow these rules to go into effect without ample vetting and modification. Undoing the harmful effects of policy and rule making is much more onerous and costly than battling it head on prior to implementation. Finally, note the comment in Janet Yellen's quote:

"The Federal Reserve is attentive to aligning the rules required by the Dodd-Frank Act with international agreements..."

In other words, the Federal Reserve's interests are not aligned with a vital U.S. banking industry; rather, they are with international agreements on global capital. This statement is tantamount to the Chief of U.S. Armed Forces stating that the U.S. military is attentive to aligning our military objectives with those of the United Nations and not our own security interests. These statements by Federal Reserve officials - and the Dodd-Frank rule writing process - have huge implications for the U.S. banking, capital markets and real estate industries. At stake are the availability of capital for real estate and the viability of U.S. capital markets. The "Semper Fi" (Always Faithful) ingredient is missing in FED policy and Dodd-Frank rule writing. More than anything else, including spillover from the E.U. debt crisis, these Section 165 Dodd-Frank rules have the potential to inflict the most harm on the U.S. economy in 2012.

The Headline(s) of the Week

Jefferson County, AL Files for Bankruptcy After Talks With Creditors Break Down.

ENR - Cindy Campbell - Nov 10, 2011

On November 9th the county encompassing the city of Birmingham, Alabama filed for Chapter 9 bankruptcy protection. With \$4.1 billion in sewer, school and general obligation debt, this municipal bankruptcy filing becomes the nation's largest - surpassing \$1.7 billion bankruptcy by Orange County, CA, in 1994.

What went wrong; and what are the market implications?

The genesis of this bankruptcy goes back almost 15 years to a consent decree with the EPA and Jefferson County to overhaul an inadequate and decaying sewer system and to eliminate sewer system overflows. What followed was a story of waste and fraud by politicians and bankers because there was never a plan or budget developed to address the underlying sewer problem. Hundreds of millions of dollars were paid for complex and unwarranted interest rate swaps, as well as bribery fees that left the 650,000 residents on the hook for approximately \$2.0 billion dollars in sewer bond debt - and a sewer system that is still a work-in-process. That figure equates to \$3,077 per resident, \$8,000 per household - or twice the cost of a functioning septic system per Jefferson County residence. Fast forward 14 years through years of investigations,



prosecutions, and negotiations to refinance the sewer debt that totaled half of the county's total indebtedness, and it all boiled down to material sewer rate increases that the affected parties couldn't come to agreement upon. Now Alabama's most populated county and MSA deal with the realities of bankruptcy, and an imposed resolution that will likely be worse than all proposals that were on the table preceding the bankruptcy filing.

In other words, a financial mess that resulted from elected officials engaging in a major capital project without a plan, budget or any expertise will now be compounded by elected officials' inability to act. This scenario is playing out in municipalities across the U.S. The Harrisburg, PA recent bankruptcy was primarily the result of a waste incineration project fraught with cost overruns and "pie-in-the-sky" financial projections that never materialized and was consuming a disproportionate share of the town's revenue in order to operate general services.

Each of these municipal bankruptcies provides insight into key lessons for our elected leaders in Congress as we observe the consequences unfolding in Europe from unrestrained fiscal policy. Those lessons are:

- Elected leaders lack the expertise to develop, implement, and oversee large scale capital projects. **If industry can't find financial feasibility in a capital project, how can politicians create this feasibility out of thin air?**
- **Waste and fraud are the bi-products of undisciplined spending** on projects that lack a plan/budget or independent oversight.
- **Overly optimistic revenue forecasts are typically accompanied by unrealistic cost projections** that are followed by change orders and cost overruns that decimate project feasibility. That is typically why industry tells government that their capital projects are not feasible.
- **Unfunded liabilities always come home to roost.** Pay as you go is a fiscal plan that we need to return to at all levels of government

This latest – and now nation's largest – municipal bankruptcy went almost unnoticed by the markets. Don't let this lack of immediate market response lull you into a false sense of security. The market is distracted by Europe, Q3 earnings and the debate over \$1.2 trillion in budget cuts needed at the federal level. Trust that this bankruptcy did not go unnoticed by JP Morgan (one of the major bond holders), regional banks headquartered in Alabama, or the investors in \$4.0 billion of Jefferson County issued bonds. Recall the dissection of our national debt in the left column and ask yourself:

What lies ahead for the \$4.0 trillion in outstanding state and municipal debt if these waste incineration and sewer project debacles are systemic?

TOTAL U.S. DEBT: All Sources (Federal, State, Municipal, & Consumer)		
DEBT CATEGORY	U.S. TOTAL	PER CAPITA \$ AMT
Mid-2011 Incurred U.S Debt	14,300,000,000,000	\$46,567
GAO Committed/Unfunded Debt	64,000,000,000,000	\$208,410
Subtotal:	78,300,000,000,000	\$254,977
All 50 States Incurred Debt	1,004,000,000,000	\$3,269
All 50 States Unfunded Pension Debt	3,137,000,000,000	\$10,215
Subtotal:	4,141,000,000,000	\$13,485
Total Outstanding Municipal Bond Debt	3,000,000,000,000	\$9,769
Total Consumer Debt (auto and credit cards)	2,400,000,000,000	\$7,815
Total Home Mortgage Debt (source: BEA)	10,300,000,000,000	\$33,541
Subtotal:	12,700,000,000,000	\$41,356
Estimated Student Loan Debt (OWS)	1,000,000,000,000	\$3,256
Total U.S. Debt (Gov. & Consumer)	99,141,000,000,000	\$322,843

Assembled by KC Conway (Sources: Colliers, GAO, Pew Center, FED, Moody's)

THE SCORE BOARD			
WEEK ENDING	BULLS	BEARS	BEWILDERED
November 16	6	4	8 ★
October 28	4	4	3 ★
October 14	4	5 ★	4
October 7	4	5 ★	4
4-Week Avg.	4.5	4.5	4.8 ★



THE MARKET APPEARS MORE BEWILDERED THAN AT ANY POINT IN 2011. THE FIRST GLANCE READ OF LEADING ECONOMIC INDICATORS SUGGESTS THE U.S. HAS ESCAPED A DOUBLE-DIP RECESSION AND ANY IMPACT FROM EUROPE'S DEBT CRISIS, BUT CLOSER EXAMINATION OF THE UNDERLYING DATA SUGGESTS SOMETHING ELSE.

THE IMPACT OF AUSTERITY MEASURES IN DEBT-LADEN EUROPEAN COUNTRIES HAS YET TO FILTER INTO THE U.S. ECONOMY.

The latest readings for the U.S. pertaining to Leading Economic Indicators (LEI), employment, manufacturing, inflation, housing starts, NFIB small business optimism index and CMBS delinquencies seem to suggest that the economy has turned Bullish and dodged a double-dip recession. However, a closer examination of these same metrics reveals that there is more to be Bewildered or Bearish about beneath the surface of these measures. How Europe's debt crisis plays out, and whether the U.S. Congress can step up and meet its commitment to cut spending, will dictate the direction of the market in Q1 2012. Announced financial industry job cuts have yet to factor into the employment measures, and more state and municipal budget cuts are ahead as a result of overly optimistic revenue forecasts for FY 2011. The impact of austerity measures in debt-laden European countries has yet to filter into the U.S. economy. As these measures are implemented, economic activity with our largest trading partner outside OPEC will be adversely impacted. How economists still anticipate

2.5% to 3.5% U.S. GDP in 2012 - when even the Federal Reserve is reducing GDP estimates in its November FOMC meeting - is curious. Blackrock's CEO (Laurence Fink) said it best this past week on CNBC when he described the market as "so risk adverse that it is only trading on signs of hope." Until debt burdened Europe and the U.S. get their fiscal houses in order, and some clarity results in capital rules for banks and systemically important financial institutions, the market is stuck in a volatile trading range of 200-300 point per day swings fueled by shorting strategies. The beneficiaries are commodities and commercial real estate. It's an unusual period in which all that ails bonds, currency and equities is good for commercial real estate. Income-producing real estate is the one haven that offers an attractive yield (5% - 7.5% cash-on-cash returns) at a material discount to replacement cost - along with a limited threat of new supply due to constrained capital and punitive regulatory policy.

The commercial real estate trade is on!

The Bulls, The Bears & The Bewildering



THE BULLS On the surface, the economic news and data of the past two weeks appeared quite Bullish. Last week, the Conference Board's index of Leading Economic Indicators (LEI) climbed more than forecast in October to +0.9% - supposedly signaling that the U.S. economy will keep growing in Q1 2012. This reading was the biggest jump in the LEI since February - and it followed a modest +0.1% reading in September.

What was behind the LEI increase?

Nine of the 10 components of the leading index contributed to the increase in October, led by a jump in building permits, the spread between short and long-term interest rates, a longer factory workweek and a drop in claims for jobless benefits. Keep these metrics in mind when we get to the Bewildered, as the underlying detail behind the building permits and weekly claims data may alter your outlook

and confidence in the LEI - which is only a survey of economists based on their interpretation of 10 select economic measures. One should place the LEI Index in the same category as the FED's Beige Book - interesting but you shouldn't make investment decisions upon either without deeper analysis. In addition to the uptick in the LEI, the following economic measures were also Bullish over the past two weeks:

- The government's U-3 unemployment rate fell to 9.0% from 9.1% for October. (<http://www.bls.gov/news.release/empsit.t12.htm>)
- The 4-week moving average for weekly jobless claims declined below 400,000 to 396,750 for the first time since April.
- Inflation at both the producer and consumer levels appeared to have abated despite oil prices rising back to near \$100 per barrel. (<http://www.bls.gov/news.release/pdf/cpi.pdf>) (<http://www.bls.gov/news.release/pdf/ppi.pdf>)
- The NFIB Small Business Index ticked up a tad bit in October to 90.2. The index is now 9.1 points above the March 2009 low of 81.0, but is still below the 91.1 YTD average (<http://www.nfib.com/research-foundation/surveys/small-business-economic-trends>)

UNEMPLOYMENT INSURANCE DATA FOR REGULAR STATE PROGRAMS

WEEK ENDING	ADVANCE NOV 12	NOV 5	CHANGE	OCT 29	PRIOR YEAR
Initial Claims (SA)	388,000	393,000	-5,000	400,000	441,000
Initial Claims (NSA)	360,139	402,494	-42,355	369,647	409,548
4 WK Moving Avg. (SA)	396,750	400,750	-4,000	405,250	441,400

On the surface, there was a fair amount of Bullish news the past couple of weeks. However, in the Bewildered section to follow, some additional perspectives will be added to this economic data that may alter your Q1 2012 outlook.

The recommendation from prior editions to dig deep into the data and connect the dots to understand the 'Why' is still the best advice during this period of market volatility.

THE BEARS The Bearish news of the past couple of weeks was overshadowed by the European debt crisis, Q3 earnings releases, and the plethora of economic data releases that all surprised to the upside as just discussed in the Bulls section. However, the Bears were still roaming the landscape and have not gone into winter hibernation. The four lead Bearish stories were:



- **Municipal Bankruptcies and a growing state debt crisis.**

The Headline of the Week discussed the Jefferson County/Birmingham, Alabama bankruptcy, but the other story of the week was the potential downgrade of NJ and FL credit ratings due to revenue shortfalls.

Increasingly, state revenue forecasts are coming up short of budget and the respective rating agencies are scrutinizing the fiscal conditions for potential downgrades. The \$4 trillion of outstanding state and municipal bond debt is approaching unsustainable levels.

- **More bank failures and financial service sector layoffs.**

Five more banks have failed thus far in November 2011. While the usual suspects, GA and IL, contributed to the tally of 415 bank failures thus far in 2011, bank failures are occurring in states that, until now, have had no bank failures in 2011 – states such as Iowa and Louisiana. (www.fdic.gov/bank/individual/failed/banklist.html)

In addition to the continued flow of bank failures, more layoffs are being announced by the nation's largest financial institutions. Citi is the latest Wall Street bank to announce layoffs. Citigroup is drawing up plans to eliminate about 3,000 jobs, or 1% of its global work force, and on Wednesday, BNP Paribas announced plans to cut about 1,400 jobs, or less than 1% of its staff. While Citigroup has not settled on a final number, the staff reductions could exceed 3,000, with roughly a third coming from its securities and banking units.

- **FOMC meeting and FED's lowering of GDP forecast.**

Despite the Bullish economic news from the Conference Board's Index of Leading Economic Indicators, the BLS on unemployment and weekly jobless claims and solid Q3 2011 earnings by U.S. corporations, the FED is reducing its estimates for GDP in Q4 2011 and Q1 2012. On Wednesday November 2nd, the FED revealed at its post FOMC press conference that it was cutting its forecast for growth to a 2.5% range, and that it was mulling the possibility of buying more mortgage debt to spur a struggling recovery. With the FED outlook turning more dower

- **Continuation of the E.U. and U.S. debt crises** in which neither entity appears capable of threading the needle through the eye of fiscal responsibility and austerity/spending cuts. In summary, the perennial Bears undermining the market since mid-summer remain with us. Until there is resolution to the U.S. and European debt crises, it's hard to see how GDP growth can approach or exceed 2.0% levels. The FED probably has it right in tempering its GDP forecasts.

THE BEWILDERING Let's set Europe and the



U.S. debt crises aside for this edition, as the failure by the U.S. Congress to meet the \$1.2 trillion in targeted spending cuts will likely bring the rating agencies and credit rating of the U.S. back into focus again. The focus this week is on why the Bullish indicators previously discussed are really more Bewildering. Let's start with the employment data.

Employment

On Friday, November 4th the BLS reported that the U.S. created 80,000 jobs in October and that the U-3 unemployment rate dropped from 9.1% to 9.0%. What's Bewildering is:

- The U.S. needs to create in the range of 125,000 to 150,000 jobs per month to just absorb the new entrants to the workforce each month.
- If we produced jobs at a level 40% below this break-even level, how can the unemployment rate decline?

The answer resides in how the Department of Labor calculates U-3 unemployment and who they count as unemployed. In other words, creative math and reducing the number of persons counted as unemployed makes it all plausible.

IN ADDITION TO THE CONTINUED FLOW OF BANK FAILURES, MORE LAYOFFS ARE BEING ANNOUNCED BY THE NATION'S LARGEST FINANCIAL INSTITUTIONS.

THE OCTOBER READINGS FOR CONSUMER AND PRODUCER LEVEL INFLATION SUGGEST INFLATIONARY PRESSURES ARE ABATING.

The antidote to this creative math is the U-6 Total Unemployment rate which captures what the BLS calls the “marginally attached” unemployed – students, long-term unemployed, the under-employed, etc. The real unemployment rate in the U.S. is the U-6 rate – or 16.2% . The U-6 rate has been elevated above 16% throughout 2011 and rose to 16.5% over the summer following the U.S. debt downgrade and Congressional debt debacle. (www.bls.gov/news.release/empsit.t15.htm)

Weekly Jobless Claims

This metric is one of the most abused economic measures that the market over-reacts to each Thursday morning. Until this past week, the weekly claims have been bouncing around the 400,000 level with an occasional dip below into the 390,000 to 399,000 range. However, this past week the 4-week moving average declined below 400,000. Normally, that would be considered a material enough trend to take notice. What is Bewildering about the data, is that:

- The state level detail for the past four weeks has consistently showed that the number of states reporting increasing claims has outnumbered those reporting a decrease by a ratio of 5:1 to 15:1.

revised for weeks after initially released. In other words, the data is like wine. It is not worth partaking until it ages.

This past week’s release of weekly jobless claims - and the accompanying state detail - is a good case in point that has been highlighted in prior editions this fall.

Fifteen states reported increases in weekly jobless claims totaling approximately 25,000, compared to one state reporting a decrease of just under 2,000 claims. This same pattern has been evident the past 8 weeks. It is definitely Bewildering how weekly jobless claims are decreasing given this state-level detail. Draw your own conclusion now that you have a more complete picture of the data.

Inflation

The October readings for consumer and producer level inflation suggest inflationary pressures are abating. This finding is at a time when oil prices have risen nearly \$20 per barrel since Labor Day, and the guidance from nearly every major U.S. manufacturer and retailer in Q3 earnings was that input costs are rising faster. Is this latest reading of inflation a lagged measure of prices 90 days ago when oil was back in the \$80 per barrel range that will reverse in Q4 and Q1 2012 with \$100 per barrel oil prices again? Is this latest reading also an indication of weakening demand for goods and commodities in Europe as the reality of austerity measures and elevated costs to access credit suppress demand? Outside Germany, the European nations of Greece, Italy, Spain, Portugal and Ireland have all seen the rates for government issued debt rise to or surpass 7.0%. Look at this past week’s Chart of the Day displaying the spread on France and Italy’s 10-year government bond debt compared to Germany. Could this same pattern confront the U.S. as a result of Congress’s failure to address our own fiscal problems?

STATES WITH A DECREASE & INCREASE OF MORE THAN 1,000		
STATE	CHANGE	STATE SUPPLIED COMMENT
STATES WITH A DECREASE OF MORE THAN 1,000		
FL	-1,696	Fewer layoffs in agriculture, construction, trade, retail etc.
STATES WITH AN INCREASE OF MORE THAN 1,000		
MI	+3,106	Layoffs in the construction and service industries.
IL	+2,516	Layoffs in the construction, service, and trade industries.
TX	+2,335	Layoffs in the manufacturing, service, and finance industries.
WA	+2,278	No comment.
PA	+2,261	Layoffs in service, entertainment and construction.
CT	+1,808	No comment.
NJ	+1,754	Layoffs in service, manufacturing and healthcare.
MA	+1,563	Layoffs in the transportation industries.
CA	+1,449	No comment.
NY	+1,334	Layoffs in construction, manufacturing, arts and entertainment.
NV	+1,236	Increase due to state holiday in the previous week.
MN	+1,209	No comment.
NC	+1,090	Layoffs in service, furniture, metal, and petroleum refining.
MD	+1,065	No comment.
KY	+1,014	No comment.

- The common sense question follows: if more states are reporting an increase in weekly claims by such a wide margin to those reporting a decrease, how can weekly claims be declining? The answer resides in understanding that the weekly claims data are “advance estimates” that are routinely



This same Bewildering pattern exists in most all of the economic measures spanning September and October. Retail sales were up 1.1% in October fueled by the infusion of insurance checks from recent storms and tornadoes in Alabama, Missouri and the Northeast (addressed on page 5 of the October 10-14 edition). Consumers are not telling us one thing in consumer sentiment surveys and then spending. Housing starts are up primarily due to an uptick in multifamily construction - not demand for new single family homes.

Existing Home Sales are up for homes priced under \$100,000 - but are flat to down for all price points above \$250,000. Pending home sales rose this Summer due to the back-log of mortgage applications that were taking in excess of 6 months to process, and now we see cancellation rates spike to their highest levels since 2009 as homebuyers develop buyer's remorse due to labor uncertainty and anxiety over a government that can't function. Blackrock CEO's comment earlier this week as a guest host on CNBC explaining the market behavior as being "so risk averse that it is acting on signs of hope" is a good assessment of this environment.

The market so wants to see recovery after four years of one foot in recession and one foot in anemic recovery. It is important to resist the inclination to partake of prematurely aged wine because we are thirsty. Market conditions like these distinguish the veterans from the rookies through analysis, patience and experience. Knowing how to dissect the plethora of weekly data releases and identify data links - not data points - is the hallmark trait of market leaders like a Berkshire Hathaway, Blackrock, JP Morgan, TREPP, and Colliers.

Disciplined analysis leads to the creation of knowledge that can then be transferred into market behavior.

ECONOMIC CALENDAR

NOVEMBER 21 – DECEMBER 2

Although we have a shortened work week ahead with the Thanksgiving holiday, there will not be much of a breather from market-moving news. At the top of the list will be the market response to a failure by Congress to find \$1.2 trillion in spending cuts as agreed in the August deficit compromise.

Later in the week we will get a revised reading of Q3 GDP, and Friday the mostly unnoticed FED data on the size of its balance sheet and U.S. money supply are likely to garner a lot of attention. The 2-year and 5-year treasury

note auctions on Monday and Tuesday could be especially newsworthy, given the events unfolding around both the European and U.S. debt crises. The week of November 28th shifts back to housing and employment data. Home price appreciation data and ADP, Challenger and BLS employment reports all get refreshed Wednesday, November 30th thru Friday, December 2nd.

The key events to monitor through the end of November as there will not be a Weekly Market Recap next week due to the Thanksgiving holiday include:

Monday: November 21st is D-Day for the Super Committee to reach agreement on \$1.2 trillion in budget cuts. As it does not appear an agreement is in the cards, Monday's 2-year treasury note auction should be interesting. On Monday, the market will also get a fresh reading from the Chicago FED on its National Activity Index, and NAR will try to put the best spin on Existing Home Sales data.

Tuesday: A revised estimate of Q3 GDP is released.

Wednesday: In addition to October Durable Goods and Personal Income data, the BLS will release Weekly jobless Claims a day early due to the Thanksgiving Holiday. Remember to look at the State level detail and revisions to see if the 4-week moving average gets revised back above 400,000 claims.

Thursday: Thanksgiving - The markets are closed. Catch up on all your family vital statistics and their LFI - Leading Family Indicators.

Friday: Black Friday and the beginning of the 2011 Christmas shopping season. After your tour of duty to the malls, check out the FED's balance sheet to see what Chairman Ben is putting under our national debt tree.

DISCUSSION ITEM

Happy Thanksgiving and spend some time connecting with family!



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KEY ECONOMIC FINANCE RATES

GROSS DOMESTIC PRODUCT

United States

Q3 2011 +2.5% (Advanced)
 Prior Qtr. +1.3% (Final)
 CY 2010 +2.9%

Hong Kong

Q2 2011 +0.5%
 Prior Qtr. +2.8%
 Recent High +6.3% Q3 2003
 Recent Low -3.6% Q1 2009
 Historic Avg. +1.0% 1990-2011

Germany

Q2 2011 +0.1%
 Prior Qtr. +1.3%
 Recent High +2.1% Q3 2010
 Recent Low -3.7% Q1 2009
 Historic Avg. +0.3% 1991-2011

CHICAGO FED NATIONAL ACTIVITY INDEX (CFNAI)

Current Period -0.13% Oct 2011
 Year Ago -0.35% Oct 2010
 Prior Month -0.20% Sep 2011
 May 2011 -0.37%
 April 2011 -0.85%
 March 2011 +0.41%
 February 2011 -0.26%

NATIONAL RESTAURANT PERFORMANCE INDEX

Current Period 100.1 Sep 2011
 Prior Period 99.4 Aug 2011
 Trend Volatile
 Key Note < 100 = contraction

PRODUCER \$ (PPI-FIN GOODS)

Oct. 2011 -0.3%
 Sep. 2011 +0.8%
 August 2011 +0.0%
 July 2011 0.2%

CONSUMER PRICE INDEX

Oct. 2011 -0.1%
 Sep. 2011 +0.3%
 August 2011 +0.4%
 July 2011 +0.5%

U.S. UNEMPLOYMENT

U-3 (Official) 9.1%
 U-6 (Total) 16.1%

JOBLESS CLAIMS

Initial (10/1) 406,000
 Initial (Prior) 404,000
 4-Wk Average 406,500

TREASURY RATES

2-yr (-1bps) +0.25%
 10-yr (+4bps) +2.00%

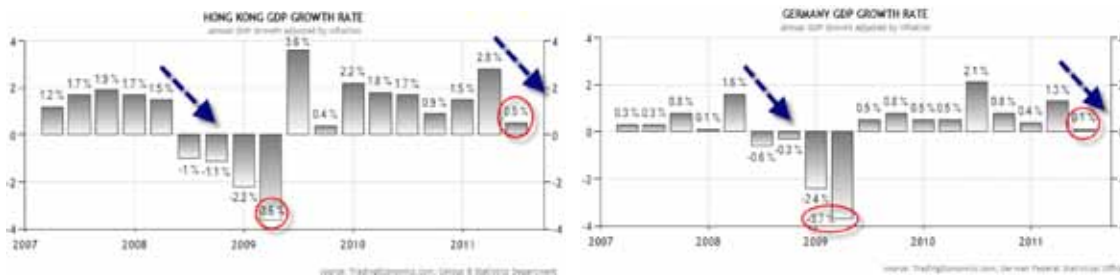


Chart 1. Monthly percent changes in the Producer Price Index for finished goods, seasonally adjusted: October 2010 – October 2011

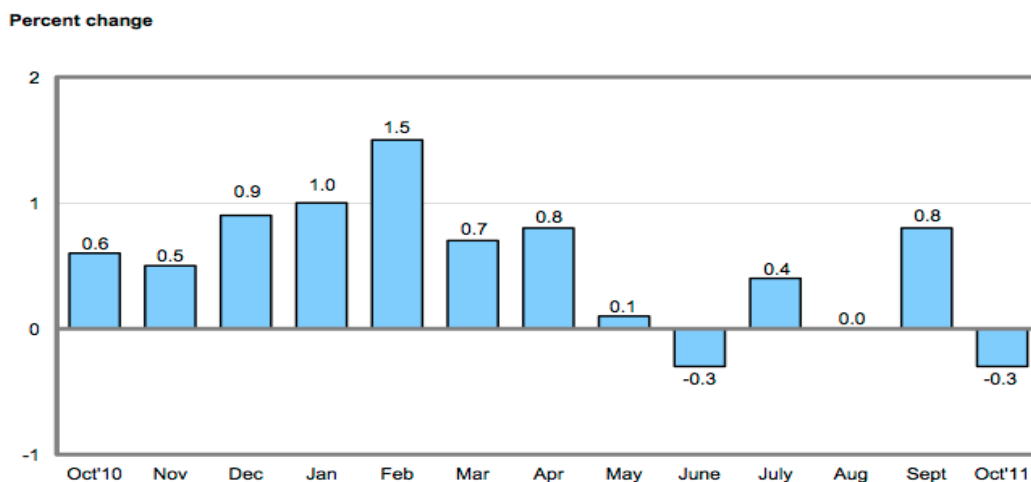
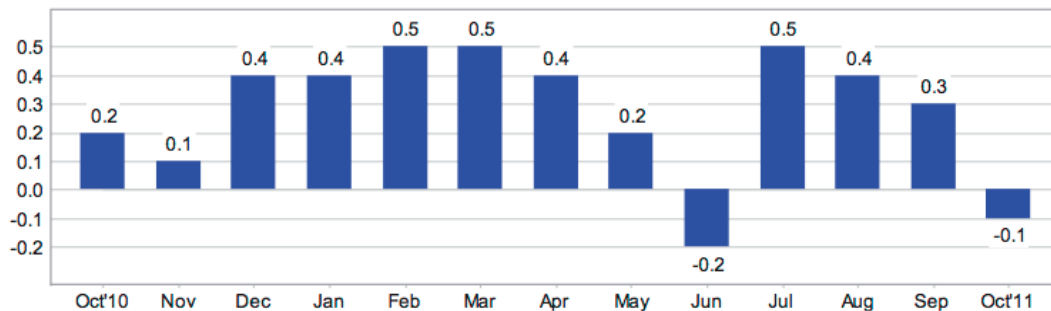


Chart 1. One-month percent change in CPI for All Urban Consumers (CPI-U), seasonally adjusted, Oct. 2010 - Oct. 2011



CMBS DELINQUENCY RATES

PROP. TYPES	OCT 10	SEP 10	AUG 10	3 MO.	6 MO.	1 YR.
Industrial	6.27	6.48	6.56	6.04	5.41	3.18
Lodging	14.92	19.33	18.92	18.41	17.16	8.67
Multifamily	14.63	14.43	14.53	14.00	13.06	7.66
Office	6.68	6.62	6.57	6.35	5.37	3.08
Retail	7.17	7.13	6.76	6.90	6.44	4.53
Overall	8.58	9.05	8.92	8.71	8.00	4.80



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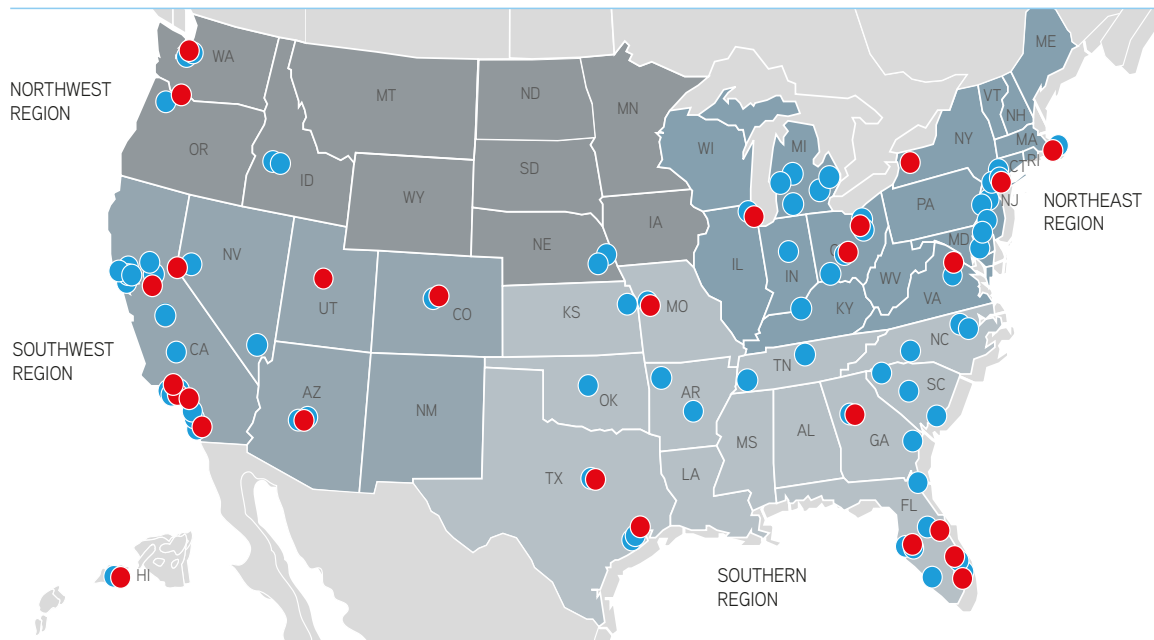
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