

Stanley Iezman
President & CEO

Walter Page
Managing Director,
Research & Strategy

Possible Indicators of a Market Recovery Part II

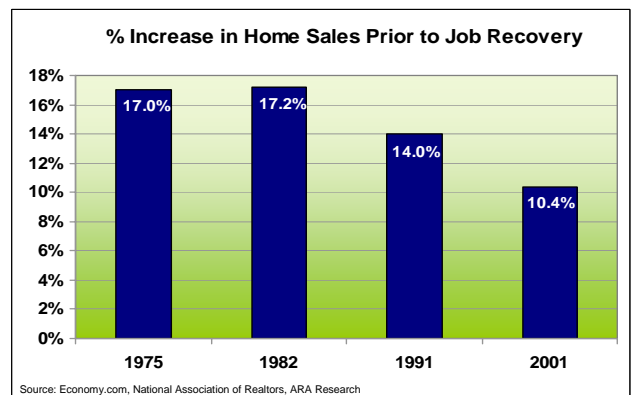
March 2009

With the economy now deep in a recession, what should we be looking for as indications that the economy may be turning the corner for the better?

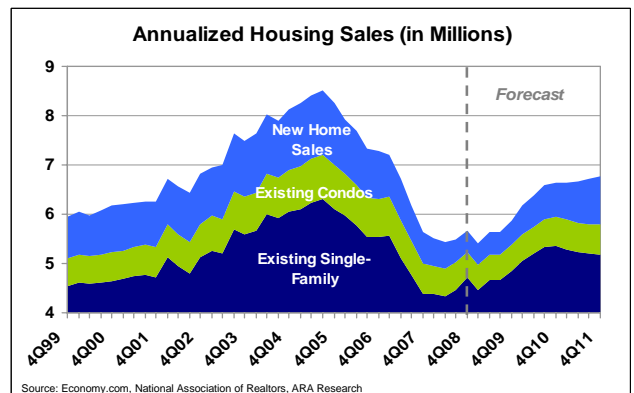
As we first discussed last September, in answering this challenge, we have compiled six of the leading economic indicators, including home sales volumes and interest rate spreads, that should be an early sign of when the ultimate predictor of real estate demand—total employment growth—is likely to turn positive. Additionally, we will discuss why these metrics are important and look at other factors that correspond to an eventual recovery.

Number 1: Rising Single-Family Home Sales

In the four previous recessions, U.S. single-family home sales rose by 10% to 20% in the six- to twelve-month period prior to increasing employment. While U.S. home sales are currently at recessionary lows (see graph), home sales in some of the harder hit markets are showing signs of revival. For example, in California, home sales are near their 2005 level with an annual pace of 600,000 units, marking a more than 80% gain from a year ago. However, this sales gain has been driven by a 40% decline in property values, as foreclosed home sales now represent an estimated 60% of total home property sales.



While a few data points do not necessarily form a trend, this increased sales activity indicates that some clearing of the inventory of foreclosed homes is occurring. It is hoped that this rise in sales volume will spread to other states and help diminish the inventory of for sale homes, a key component of price stability. Additionally, an increase in home sales volumes should spur the demand for complementary real estate

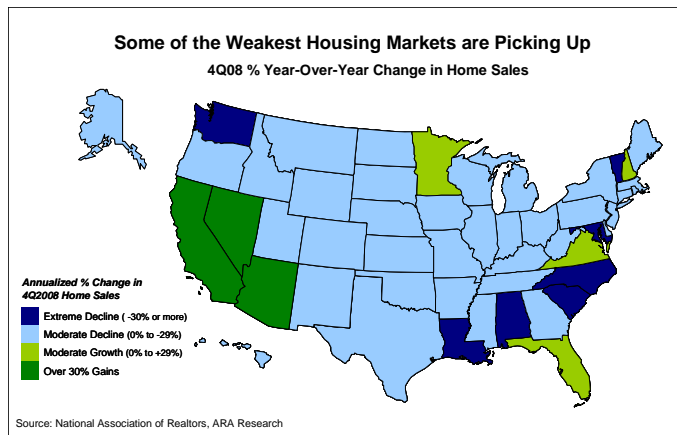


AMERICAN
REALTY ADVISORS

Corporate Headquarters
801 North Brand Blvd.
Suite 800
Glendale, CA 91203
818.545.1152

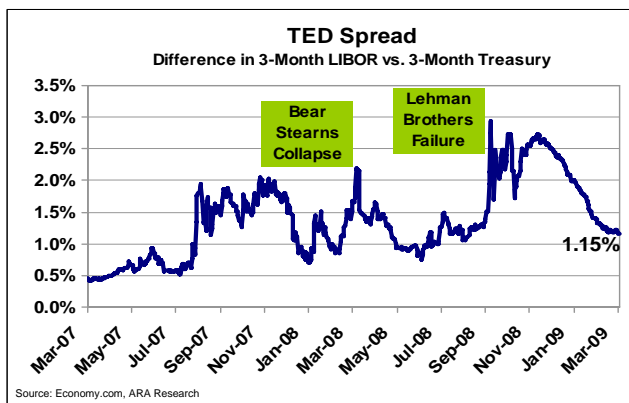
www.americanreal.com

products. This would include purchases from furniture and home improvement stores, which should benefit the retail sector.



Unfreezing of Credit Markets

When lenders provide credit to investors, it has a powerful multiplier impact upon the economy that fuels additional investment and economic growth. In contrast, when less new credit is extended rather than loan repayments, contraction of the money supply occurs and economic growth often stops. While it is too early to say that the credit markets have unfrozen, the following two factors represent positive signs that liquidity in the short-term credit markets may be improving, while, by all indications, long-term credit remains highly restrictive.



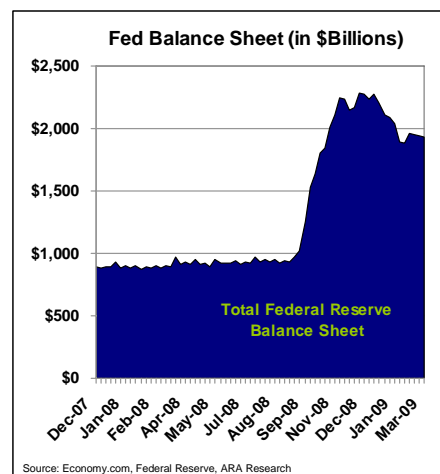
Number 2: The TED Spread Falls to 0.5%

The spread between the 3-month Treasury Bill and the 3-month LIBOR rate—the TED spread—is a strong indicator of liquidity in the credit markets, and is considered to be a metric of “trust” between banks. At the lowest point in this recession, the spread peaked at over 3% after the collapse of Lehman Brothers. Indicating

some return to normality in the credit markets, the TED spread has since fallen by more than 60% to just above 1%. This reduction in the TED spread from peak levels supports the view that the Federal Reserve policy of infusing money into the credit markets is positively impacting the availability of short-term money. Additionally, given that many real estate loans carry interest rates pegged to LIBOR, the reduction in this spread has had a direct positive impact upon the cost of capital for real estate investors. In order to be a true positive indicator of unfrozen capital markets, however, the TED spread should fall to the 0.5% level.

Number 3: Federal Reserve Balance Sheet Returns to \$1 Trillion

Every week, the Federal Reserve publishes data on its balance sheet. Under normal market conditions this metric is fairly stagnant staying at about a trillion dollars of assets. However, due to the unprecedented market changes, the Fed more than doubled its balance



sheet to over two trillion dollars this past fall. The Fed truly became the lender of last resort by expanding its base to include not only banks but brokerage firms and other credit providers not typically involved with the Federal Reserve. While in recent weeks we have seen some decline in the Fed’s support of the credit markets, further reductions to more “normal” levels near one trillion dollars would be a significant indicator of improving credit market conditions, as this would imply that traditional lenders have returned to providing debt capital.

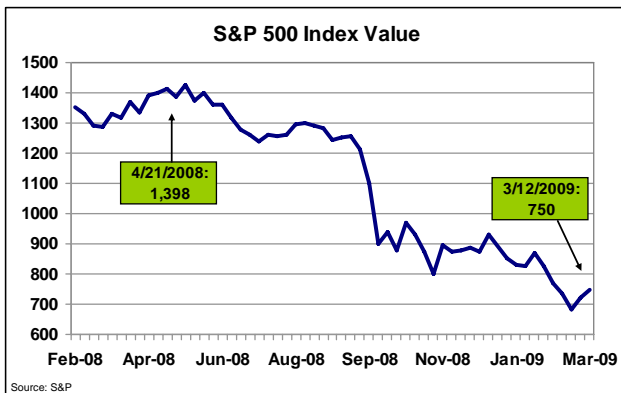
Other Factors to Follow

In addition to home sales and credit market trends, we have identified three additional market indicators that should help fill in the mosaic of early market indicators. While many of these factors, such as the stock market, are near historic lows, these indicators are traditionally good signs of a market recovery.



Number 4: Rising Manufacturing Supply Index

The manufacturing supply index, represented by the Institute of Supply Management (ISM) Manufacturing Purchasing Managers' Index, is a national survey of manufacturers on business conditions. An index value less than 50 indicates contraction while an index value over 50 signifies expansion. This benchmark has indicated a recession for 12 months, although in January we saw a slight uptick for the first time since the summer of 2008, followed by a flat index value in February. Manufacturing is a key driver of primary employment and an increase in the index value to over 50 should be a signal that total employment growth is likely to return within the next six months.



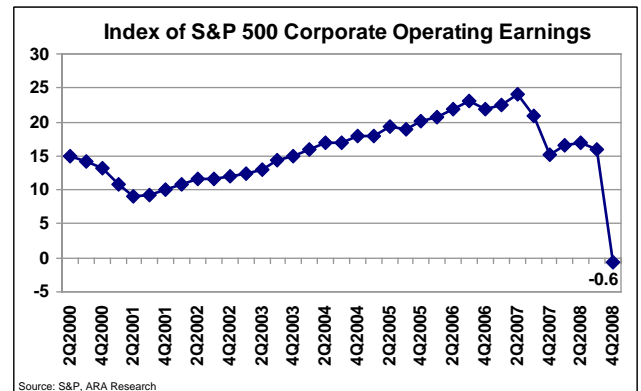
Number 5: Stock Market Values Rise by 25%

In reviewing the three prior recessions, we found that the stock market typically stages a 25% value increase prior to the start of positive employment growth. While there is low correlation of the current job market to the stock market, we have found that the stock market provides a good six- to nine-month indicator of future employment trends. Taken together, once we witness a strong (25% or

greater) increase in stock values, positive job growth should resume within the next six to nine months, with real estate demand generally corresponding to the total employment trends. Given that the capital markets for stocks and real estate are interlinked, the greater the increase in stock values, the better this will be for real estate too.

Number 6: Rising Corporate Earnings

Since corporate earnings influence expansion and contraction plans, the trend in earnings tends to provide a six-month lead in forecasting future total employment levels. For the fourth quarter of 2008, corporate earnings fell to near zero for the S&P 500 as shown in the graph below. Once this trend in corporate earnings reverses, we expect to see increases in businesses expansion plans, including adding new employees to the payroll.

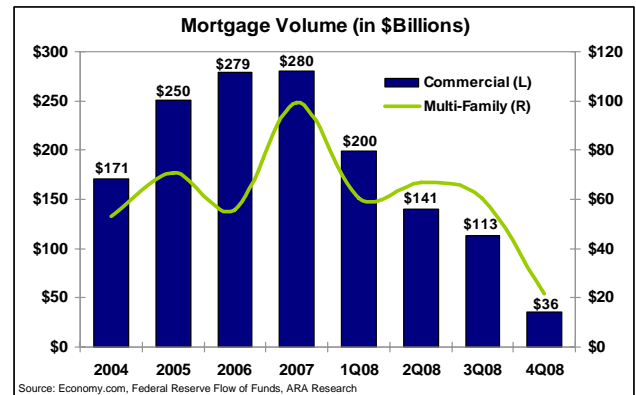


Other Factors That Correspond With a Recovery

While it is commonly understood that economic recoveries are built upon the growth of one leading industry, typically this is not the case. Rather employment growth is likely to follow the path detailed below:

- **Rising Temporary Help Employment:** Temporary help employment tends to lead the job market slightly, as employers often choose to bring on contract and temporary workers, rather than expanding total full-time employment.
- **Broad Base of Expanding Industries:** Historically, economic expansions are usually broadly based, with over 80% of the employment sectors reporting job growth within a quarter or two following the resumption of total employment growth.

- Rise in Net Commercial Mortgage Loan Volume:**
 The ultimate indicator of economic and credit market conditions is to track the total net volume of commercial mortgage loans, which is the net value of loan repayments vs. new loans. Based on annualized 4Q2008 data, commercial loan borrowing is at an exceptionally low level at \$36 billion. As a means of perspective, this represents a sharp reversal from over \$250 billion of net lending each year in 2005, 2006 and 2007. While lending activity is traditionally a lagging indicator, any increase in this metric would serve as a key indicator that the debt markets are providing capital to real estate.



Conclusion

No one can pinpoint the exact bottom of a recession until after it has passed. However, we have selected six early indicators to watch as likely metrics to signify the end. Currently, we have only witnessed a small part of this framework, with rising home sales in seven states and some improvement in the manufacturing supply level. However, history has shown that eventually the economy will stage a rebound. As parts of the puzzle become clearer, the stage should be set for the recovery process to begin for all asset classes, including commercial real estate, and such recoveries should provide opportunities for periods of subsequent positive economic growth.

For more information regarding
American Realty Advisors, please contact:

Jay Butterfield, CFA

Managing Director,
 Fund/Separate Account Operations
 801 North Brand Boulevard, Suite 800
 Glendale, CA 91203

Phone: (818) 545-1152 ■ Fax: (818) 545-8460

butterfield@americanreal.com ■ www.americanreal.com

This newsletter is for your information only; is not intended to be relied on to make any investments decisions, and is neither an offer to sell nor a solicitation of an offer to buy any securities or financial instruments. The information in this newsletter has been obtained or derived from sources believed by American Realty Advisors ("American") to be reliable but American does not represent that this information is accurate or complete. Any opinions or estimates contained in this newsletter represent the judgment of American at the time this newsletter was prepared and are subject to change without notice. Models used in any analysis may be proprietary, making the results difficult for any third party to reproduce.

This newsletter should be considered confidential and may not be reproduced in whole or in part, and may not be circulated or redelivered to any person without the prior written consent of American.

Forward-Looking Statements: This newsletter may contain forward-looking statements within the meaning of the federal securities laws. Forward-looking statements are statements that do not represent historical facts and are based on our beliefs, assumptions made by us, and information currently available to us. Forward-looking statements in this newsletter are based on our current expectations as of the date of this newsletter, which could change or not materialize as expected. Actual results may differ materially due to a variety of uncertainties and risk factors. Except as required by law, we assume no obligation to update any such forward-looking statements.

