Pangea Market Advisory

June 15, 2009

# Blitz Report On Real Estate Markets

Inside This Report

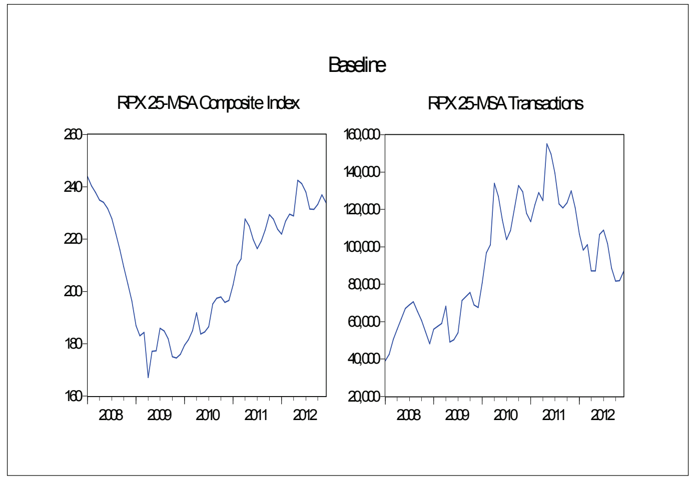


**This inaugural issue of *Blitz Report on Real Estate Markets* is more introductory in nature than not. Ensuing monthly issues will explore more specific economic trends and activities with a focus on recognizing real estate related opportunities in the capital markets.**

**If you have any comments or suggestions, please feel free to email Steve Blitz — sblitz@econmkts.com**

## Economic Overview

***The economy will manage just enough positive growth through the second half of 2009 to allow for home prices to appreciate between now and year-end.***




The argument as to whether the economic landscape shows "green shoots" or is still a brownfield is, to my thinking, beside the point. Many indicators lead, many lag, and their timing relationship with the economy changes some with each cycle. To be clear, consumption and production data have yet to turn up broadly enough or even narrowly enough for that matter to suggest recovery. A slower pace of decline is a positive development but it isn't positive growth and changes in economic activity during a recovery have a plus sign in front of them.

My view on most economic forecasts is that the bias is to look for growth in all the usual places, especially where the collapse had occurred, and look forward from there. In truth, it is impossible to tell in advance where the drivers of growth are going to be – no one would have forecast hi-tech in 1992 or single-family homes in 2002. The model that Pangea has developed is driven by interest rates, yield curves and credit spreads. Markets signal first the economy's direction — fundamental data naturally lag. If Chairman Bernanke et al had understood credit markets a bit better in August 2007 the extent of the negative spasm in the economy might very well have been mitigated.

Monetary and fiscal policy, yield curves, credit spreads, inventories, and the price of oil suggest that the worst is behind us and an upside is about to begin. The recent rise in oil prices is particularly telling. As the chart on the next page illustrates oil price spikes precede recessions and recoveries begin when falling oil prices stabilize and start rising. Delays and revisions in fundamental data consequently turn current market oil prices a leading indicator.

There will not, however, be a "V" shaped recovery. If there has been one constant since the 1980-82 recession it is that it takes longer than expected for recoveries to ramp up employment growth.

As for what drives the coming recovery, now that the historic twin engines of expansion — autos and

# Economic Overview cont'd

homebuilding — are sidelined, look for a cheaper dollar.

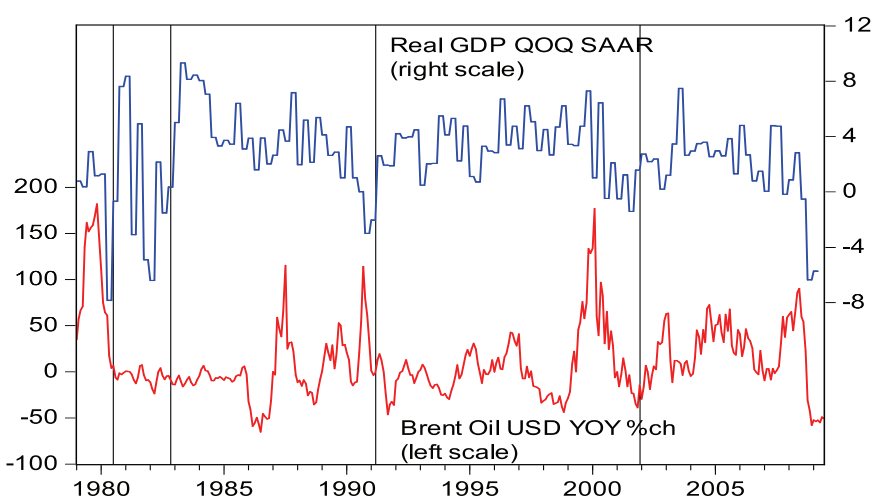
It is hoped that a cheaper dollar will generate growth through import substitution as well as growing the export sector. This potential source of growth becomes all the more important because consumption will grow more slowly with households frightened into saving and the collapse of asset prices keeping debt onerous and avenues for new credit closed..

The critical dollar relationship that needs to change is with the Chinese Yuan. Think of it not so much as dollar depreciation but East Asian currencies revaluing to the dollar to the extent that their trade surpluses would indicate. Keeping their currencies too cheap to the dollar is how China and the rest of East Asia ended up holding too many dollar assets in the first place.

## Baseline Forecast

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| ***YearEnd-Over-YearEnd Percent Change*** | | | | | |
| Personal Income (After-tax) | 2.2% | 5.0% | 3.9% | 3.8% | 3.7% |
| Consumption | -1.1% | -3.8% | 1.4% | 2.0% | 2.6% |
| Consumer Prices (x food & energy) | 1.7% | 1.5% | 1.6% | 1.7% | 2.1% |
| Employment | -2.8% | -3.6% | 1.0% | 1.6% | 2.0% |
| *Year End Levels* | | | | | |
| Fed Funds | 0.2% | 0.3% | 1.5% | 3.0% | 3.8% |
| 2-Year Treasury | 0.8% | 1.5% | 2.6% | 3.7% | 4.5% |
| 10-Year Treasury | 2.4% | 4.3% | 4.8% | 5.2% | 5.5% |
| Mortgage Rate* | 5.3% | 6.0% | 6.4% | 7.0% | 7.3% |
| ***YearEnd-Over-YearEnd Percent Change*** | | | | | |
| **RPX 25-Msa Composite** | **-21.6%** | **-10.4%** | **11.7%** | **13.8%** | **4.1%** |

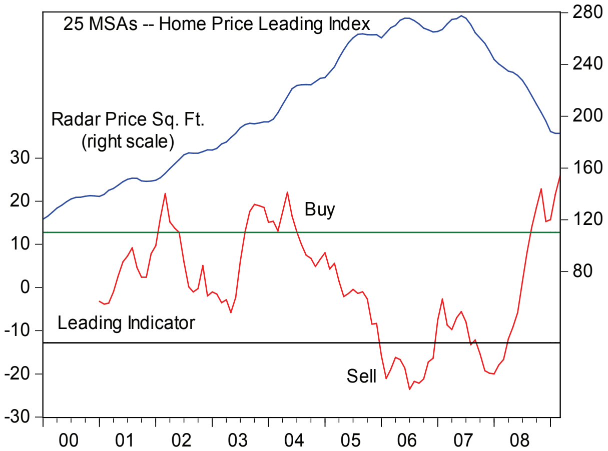
Real GDP Growth Vs Oil

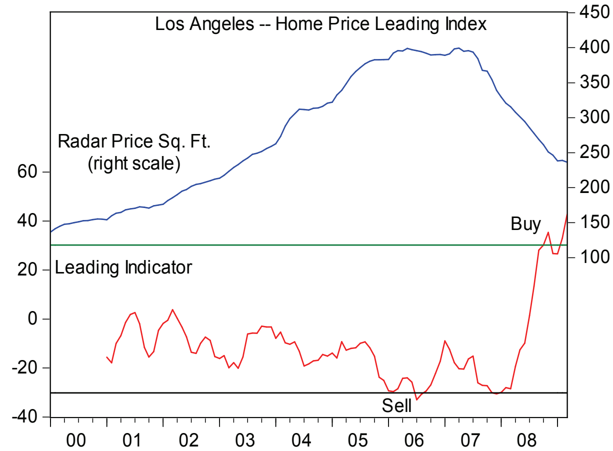


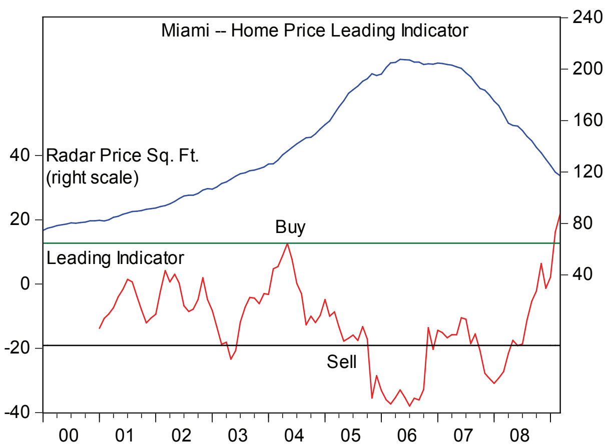

Vertical Lines Mark Recession End

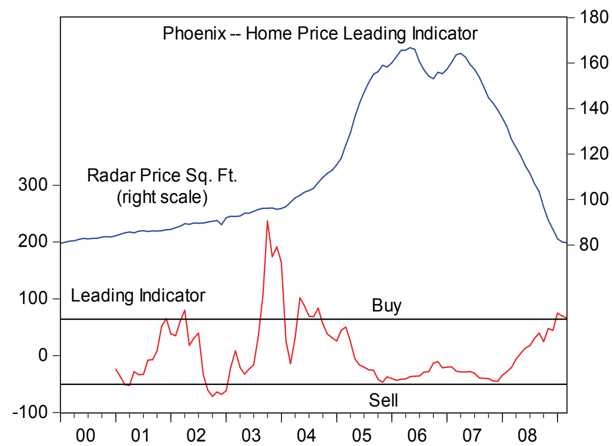
# Leading Indicators For RPX

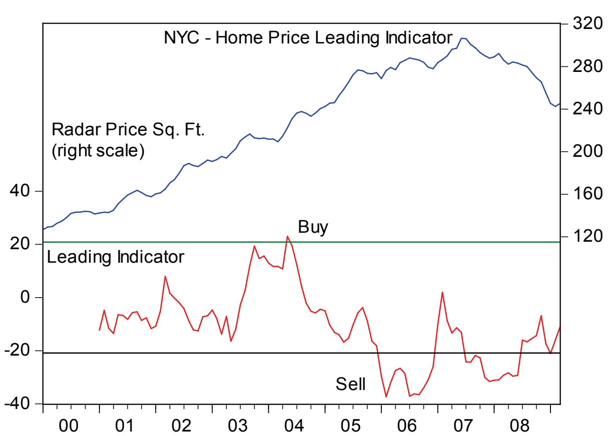
The proprietary leading indicators that Pangea has developed are, like the fundamental model, pointing to higher prices – especially in those markets that have been hit the hardest. The major exception is the New York market, where the downturn has been less severe relative to Miami, Phoenix, and Los Angeles. The result is none too surprising considering that NYC has less possible recovery in price and still potential downfall from the losses in employment and income in the financial related industries that drive much of the New York area economy.



# RPX and Capital Market Pricing

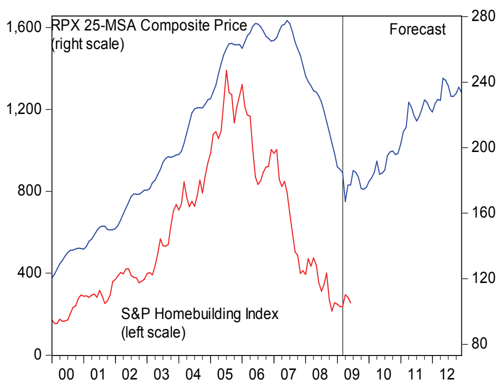
Capital markets continue to price for lower home prices thereby creating investment and trading opportunities. Outright long positions could be taken in RPX forwards, ABS/ABX HEL or in various equity indexes tied to the residential housing market (see charts below). If less certain about HPA recovery but more certain that house price increases will be evident in RPX data before capital markets prices adjust then a long position in RPX forwards against short positions in any of these asset classes is an attractive opportunity worth looking into.

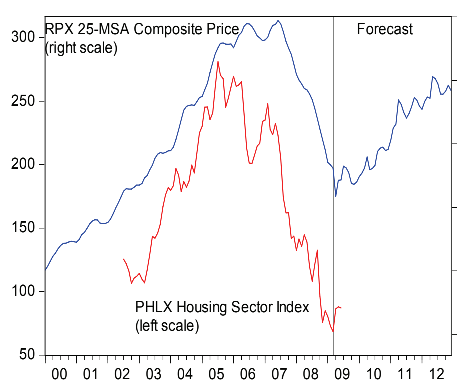
Forward Contract Implied HPA For MSA Composite* vs Model Forecast
(Cumulative %Ch from Initial Index Value of $207.49)

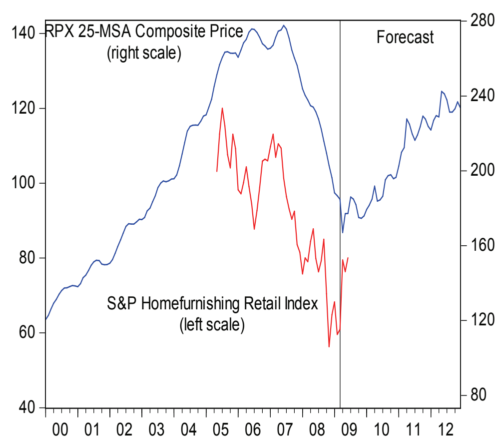
| | Dec-09 | Dec-10 | Dec-11 | Dec-12 | Dec-13 |
|---|---|---|---|---|---|
| Forward Market* | -22.89% | -31.56% | -31.08% | -26.74% | -23.85% |
| Model Forecast | -15.31% | -5.26% | 7.86% | 12.69% | |

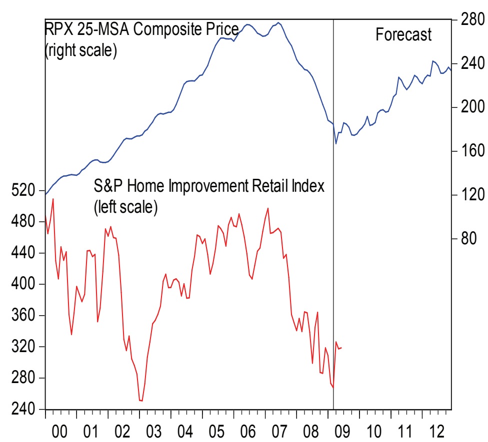
*Fixing date: 06/09/2009

## RPX vs. Select Equity Indexes



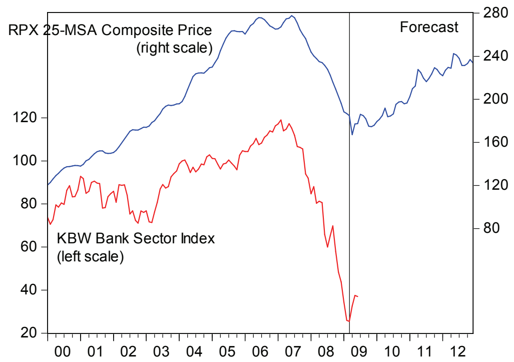



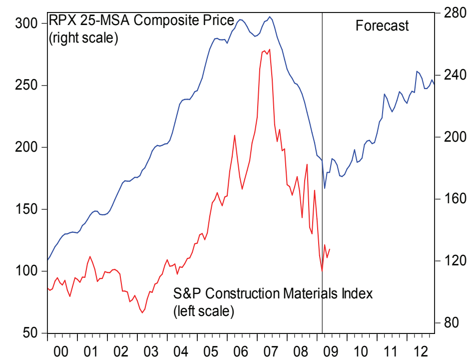



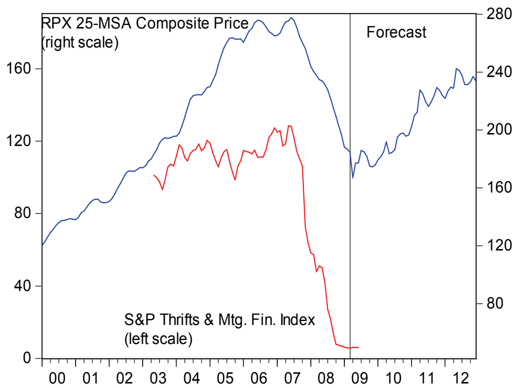




*Capital markets continue to price for lower home prices, thereby creating opportunities …*

# RPX vs. Select Equity Indexes cont'd

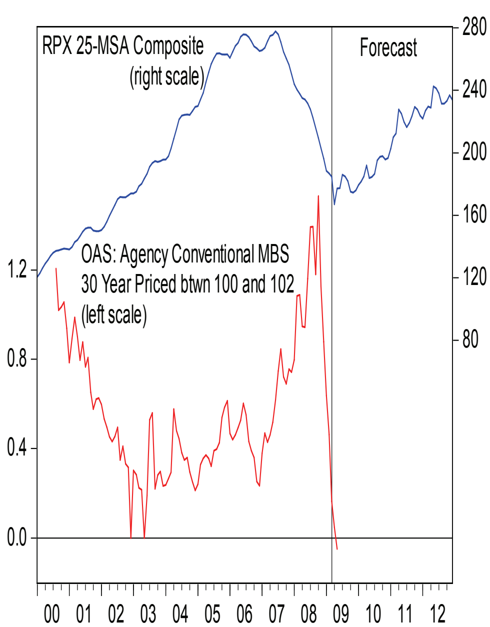


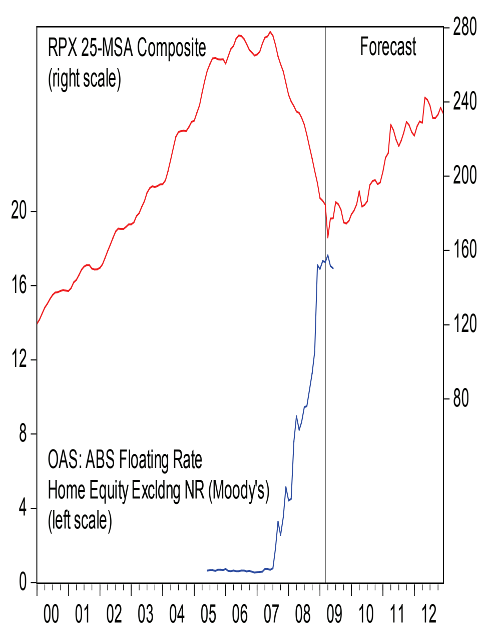




*The strong correlation between the price behavior of these Equity Indexes and the RPX 25-MSA Composite creates opportunities to construct any number of attractive positions, hedged and not, that profit from the direction of home prices.*

# RPX and Fixed-Income Spreads




OAS spreads are from Barclays Fixed-Income Indexes

*Quantitative easing collapsed the OAS between Agency RMBS and Treasurys. When house prices do increase the OAS might actually widen as the Fed then chooses to reduce purchases or become an outright seller. There will be more opportunity in the OAS of related ABS when home price appreciation turns positive. Because our Model and leading indicators point to higher home prices, they suggest being long ABS and/ or ABX against Agency RMBS.*

# Pangea Market Advisory

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