Greenfield Advisors
Economic, Market and Valuation Analysts

The Greenfield Advisor

Issue 6-1, February, 2010

Seattle CFA Banquet

This may seem a bit parochial, but the Seattle CFA Society generally does an excellent annual economic briefing, with national-scope speakers addressing key issues of the day of interest to investors, economists, and all of us in the financial sector. (In fairness, I've also been to Portland's annual dinner, and they do an excellent job, too.) I had the pleasure of attending their 7th Annual Forecast Dinner here in Seattle last week (February 18), and came away with my usual pile of notes.

The three main speakers were James Paulson, Ph.D., the Chief Investment Strategist for Wells Capital Management (part of Wells Fargo); Fran Kinniry, a Principal at Vangard, and Cindy Sweeting, CFA, the President of Templeton Global Equities. Collectively, their firms manage piles of money which exceed the GDP of small countries. As such, their presentations were very "big picture".

James Paulson, Ph.D.

Dr. Paulson was the lead-off speaker, and probably the most "general", which is not surprising given the broad scope of what they do at Wells. He lead off with a discussion of the "new normal" as the catch-phrase to describe the economic world post-recession. (We'll return to that phrase in a minute).

In Paulson's view, the most outstanding feature of the recent melt-down was the "...total obliteration of confidence — paralyzing key players." We would concur with Dr. Paulson on that. He notes that this obliteration of confidence has actually set the stage for what he calls the "6 forces for growth":

Massive government policy push
Reverse corporate purge
Returning to calm/confidence
(*Paulson would call these first three the "flip side of fear")*
Addition by <u>less</u> housing and automotive subtraction
U.S. trade improvement
Negatives have stalled

In the first category, Paulson notes the massive surge in M2-money supply since 2008. He tracks what he calls "fiscally adjusted M2 versus GDP growth" which is essentially the change in M2, adjusted for fiscal deficits, as a leading indicator for economic growth. His numbers — which he calls totally heuristic — would point to a surge in GDP, which he believes is already occurring this quarter and next quarter. (See graphic on Page 2).

(*A bit of a Greenfield note — if you read my semi-irregular blog, johnkilpatrick.wordpress.com, you'll recall I've also commented on the M2 surge. My "take" on this differs a bit from Dr. Paulson's. I'm more of the opinion that the M2 surge has served to replace "non-M2 liquidity" which was removed from the system due to the credit market melt-down.)*

Paulson believes that payrolls were purged far further than GDP decline would have called for — he calls this "fear driven". As the economy bottoms, firms will need to re-invigorate their workforces, what he calls the "reverse corporate purge", thus further driving up economic growth. In regard to the third point, he notes that the Conference Board's Consumer Confidence Index absolutely tanked in the wake of the meltdown, but now appears to be headed back up.

Paulson went on to discuss the housing and automotive markets, which be believes have bottomed, and his theories about U.S. trade improvement and how this will actually become a positive driver for GDP, rather than a negative pull as it has been in the past. He concluded by noting that his measure of private sector cash holdings as a percentage of GDP are at a

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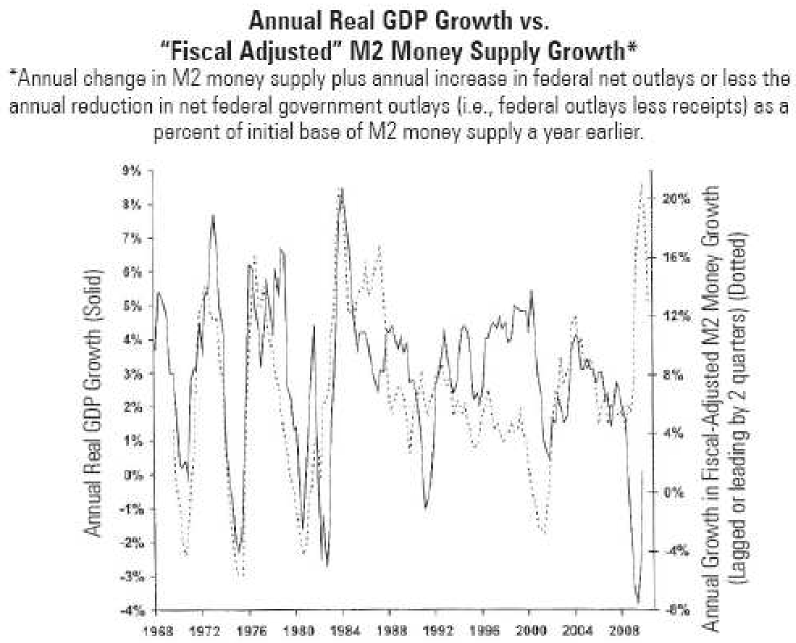

record high — comparable to the early 1980's. If this is any indicator, we could be in for a bull-run in both the markets and the general economy comparable to the second half of the 1980's and the 1990's.

Graphic taken from Dr. Paulson's current newsletter, and presented at the Seattle CFA Society Economic Forecast Dinner. Dr. Paulson reads this to suggest that Fiscally-adjusted M2 growth is a leading indicator of GDP growth.

For more information about Dr. Paulson, you can access his publication, Economic and Market Perspective, by visiting:

https://www.wellscap.com/docs/ecomonic_and_market_perspective/EMP0210.pdf

Fran Kinnery

It's helpful to note that Mr. Kinnery represents Vanguard, and as such comes to the table with a fixed-income perspective on things. Kinnery also used the phrase "New Normal" to describe the significant paradigm shift in economic forecasting.

Kinnery takes a somewhat different view than Paulson. Kinnery is still bullish on investments (as is Paulson), but is more bearish on the economy. Indeed, he began his talk by defending the idea that it is possible to be bearish on the economy yet bullish on investments. Why? Much of his logic focuses on the fixed income side — he notes that consumer price index expectations are low and projected to remain low into the significant future. Fears of returning to a 1970's style "stagflation" are misplaced, and he would hold that the 1970's were an anomaly not to be repeated.

He would, however, voice three concerns about the future of the U.S. economy:

Fed balance sheet & the money supply
Fiscal deficits
Future status of the dollar
Global industrialization

All of these combined suggest somewhat flatter growth for GDP in out-years. Nonetheless, the combination of low inflation and the blow-back from the market melt-off suggests positive things for investments, irrespective of whether or not the economy comes back around.

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Cindy Sweeting, CFA

Ms. Sweeting comes from Templeton, which made its mark a half-century ago with a very "fundamental" view of investments. They still carry that idea around, so the general tone of the market is less important to them than analyzing specific investments. (*Greenfield note: Without indorsing Templeton over any other fund, we find that outlook to be rather useful.)*

Nonetheless, Ms. Sweeting does come to the table with some views about the overall state of the economy, and she was probably the bear-est of the three speakers. She sees deleveraging happening more slowly than some other pundits. She is also concerned that the reduction in debt, both in the U.S. and globally, is simply a transfer of debt from private balance sheets to the public ones. This could lead to governments getting into trouble, and we're already seeing that happening.

Globally, she sees a real problem with sovereign debt, and believes that fiscal retrenchment is inevitable at some point. She is particularly critical of Japan, which she calls a "ponzi scheme at play". She believes their flat-lined GDP cannot sustain their growth in debt (which until now has largely been financed domestically at very low rates). Once Japan has to go abroad to finance in world markets, at world-market rates, their house of cards will begin to collapse.

China didn't escape her wrath either. She notes that some 90% of China's growth this year has been from government stimulus, a level they cannot sustain without some economic blow-back.

Summary

Last year, I attended the Portland CFA dinner, and one of the speakers lead off with the observation that the the ***2008*** speakers had been quite bullish on the economy — and that they hadn't been invited back. (One wonders if they're still employed!) Of the three principle speakers, only Dr. Paulson was vigorously bullish, and even he couched his forecasts in the mantle of tea-leaf reading: how things like "fiscally-adjusted M2" seems to be a leading indicator for GDP resurgence.

Does this suggest we should come away with negative "vibes" about the economy? Probably not. The "New Normal" among economic forecasters is to soft-play positive forecasts. Nonetheless, economic forecasters of all stripes seem to concur that the U.S. economy has hit its cyclical bottom. The question now is whether the recovery — which appears to be underway — will be rapid (a "V" shape), slow (a "U" shape), or stuttering (a "W" shaped recovery).

One Final Note

The moderator this year — as he has for the past three years — was Dr. Yoram Bauman, who bills himself as the "worlds first and only stand-up economist". Dr. Bauman has just produced a book titled The Cartoon Introduction to Economics, which has been cited by no less an authority than Prof. Greg Mankiw as "A painless way to learn economics." (We would add, now cited by us as well!).

For more on Dr. Bauman, please visit his website, http://www.standupeconomist.com.

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Multiple Disamenities

Greenfield is regularly faced with the complexity of separating the impact of multiple disamenities on property values. One of the most significant recent projects was the *Murphy Oil Case* in Chalmette, Louisiana, following Hurricane Katrina. About 6,700 properties in that suburb of New Orleans — mostly single family homes — were flooded during and immediately after Katrina. Three days later, a nearby oil refinery spilled about 1.05 million gallons of unrefined crude over the top of the flood waters. Properties already damaged by water now had a double-injury.

In *Murphy*, we began with focus groups, and were able to craft a survey research project which could aid in separating the oil damage from the flood damage. (*Note: the standards for admissibility of survey research for real estate valuation in the Federal courts is well established and summarized in the Handbook on Scientific Evidence published by the Justice Department.)* In the end, our research contributed to a $330 million settlement for the property owners.

In recent residential toxic tort cases, the issue of separating localized damages from the overall real estate market meltdown has come up. This is actually a fairly trivial problem, since well-defined control areas will also suffer from the same general market conditions problems. Thus, property values are simply adjusted to the effective date of value using the appropriate metrics (e.g. — Case-Shiller Index, Federal Housing indices, etc.). Since these litigation cases usually have an effective date of value in the recent past, such analyses benefit from the use of comparable control-area transactions both before and after the effective date of value. In large-scale cases (mass torts and class actions), hedonic modeling is the preferred method, as discussed in Colwell, et. al. (Appraisal Journal, 2009).

Prof. G.S. Tolley of the U. Chicago specifically investigated the complex interaction of multiple power plants on property values, which is of particular interest when one is a significantly greater disamenity than the other. His work notes that the value impacts are directly linked to differential perceptions, and this points directly at the use of survey techniques to parse the difference between or among the externalities. We'll keep you apprised as we focus more attention on this topic in the future.

Some News from Greenfield

Time to report on new faces here at Greenfield. We welcome Katie Postlewait to our analysis staff. Katie holds a Masters in Sociology from the U. of Washington, and comes to us with significant experience in the survey/market research field.

We've experimented with several formats/frequencies for **The Greenfield Advisor** over the past few years. This year, we're shooting for bi-monthly, and we'll see how that works out. In the meantime, we're supplementing the longer-form newsletter with a less regular but more frequent blog, titled "...from a small northwest observatory, which you can visit at http://johnkilpatrick.wordpress.com. We've been working on the blog for some months, although keeping it mostly under wraps as we built up a critical mass of (hopefully!) interesting stuff to read.

Additionally, and as usual, Greenfield will have a significant presence at this year's meetings of the American Real Estate Society, to be held in April in Florida. We'll devote the next issue of this newsletter to that meeting, with some "sneak peeks" on the blog.

As always, if you have an interest in someone from Greenfield speaking at a gathering or making a presentation on the real estate side of the economy, please contact our Client Relations Manager, John Casker, either by phone (206.972.9793, toll free 800-755-0966), or via e-mail (jcasker@greenfieldadvisors.com).

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