THE NEW YORK FAMILY OFFICE

Your Contact in the U.S.

Newsletter: 2nd Quarter 2012

Dèjá Vue 2010 & 2011: Optimism in 1st Quarter is Facing Strong Headwinds

After several positive trends and surging optimism this past winter, increasing signs of a global slowdown are darkening the economic outlook in spring. There are indications that activity is slowing in sync around the globe. While Europe's problems are at the center of attention, there are more and more signs of economic trouble emerging in China, India, and elsewhere. Today's global economy is more strongly interconnected than 10 or 20 years ago. When performing well, synchronized growth reinforces itself and spreads prosperity wide and far. However, in downturns the opposite effects seem to be true as well.

The latest U.S. economic data suggest that the moderate acceleration in economic activity that had previously been forecasted for the second half of this year may be unlikely to unfold. Disappointing employment gains signal weaker economic growth in the 2nd quarter. In addition, growth in wages remains too slow to allow consumer spending to gain more momentum. With the U.S. economy adding more than 200,000 jobs a month from December to February, many consumers started spending more and saving less. From January to April consumer spending grew faster than paychecks in three out of four months. The New York Times reported that write-offs, foreclosures, and low interest rates have driven Americans' debt obligations down to 10.9% at the end of 2011 from 14% of disposable income in 2007. The decrease in household debt which is at the lowest point since 1994 supported stronger retail sales. Next quarter's data will give indications of how American households react to sobering information in the U.S. and around the globe. However, given the available data it seems that growth in the U.S. is poised to remain at or below a 2% annualized pace.

Increasing concerns regarding an uncertain outcome in the Euro zone coupled with deteriorating emerging markets add downside risk to the U.S. and the overall global economic outlook. One positive outcome of the deepening crisis in Europe and rising concerns about a severe global slowdown has been the sharp decline in U.S. Treasury yields and oil prices. This effect offers some stimulus and offsets some of the negative impact of falling equity prices and a stronger U.S. dollar.

The U.S. faces a massive year-end fiscal cliff – the combination of tax increases and spending cuts that will come in 2013 if Congress and the President do not act – but temporary measures are expected to help avoid a large economic contraction. Given the situation in Washington no ground breaking political decisions are expected until after the November 6, 2012 presidential election. This political uncertainty will continue to weigh on the U.S. economy and the financial system at large.

Big Apple is the No. 2 Tech Hub in the U.S. Behind Silicon Valley

The technological landscape is changing. According to the Center for an Urban Future, a New York City (NYC) based think tank, NYC has the nation's fastest-growing tech sector and has surpassed Boston as the No. 2 hub, behind Silicon Valley, for Internet and mobile technologies.

The report identified 486 digital start-ups formed in NYC since 2007 that have received angel, seed or VC funding. Overall, there are well over 1,000 Web-based technology start-ups in NYC, most of which have not secured investment capital. Of the seven leading technology regions in the U.S., NYC was the only one to see an increase in the number of VC deals between 2007 and 2011, while nationally there was an 11 % decline in VC deals.

Increasingly more NYC based tech start-ups are achieving significant growth. Of the tech start-ups founded in NYC since 2007, 15 have raised more than $50 million in investments (including Gilt Groupe, ZocDoc, Tumblr, and Foursquare), 27 have investments of at least $25 million and 81 have raised at least $10 million. In 2011 55 of the NYC's digital companies got acquired by other firms more than the 54 that were acquired in 2008 and 2009 combined.

Today's tech companies are creating content to keep up with the increased appetite for digital solutions to market products and provide online services. There has been a dramatic increase in Internet and mobile device usage to acquire information in the media, fashion, advertising, finance and healthcare industries which are prominent in NYC.

Over the past few years NYC has seen an explosion of tech start-ups in Manhattan neighborhoods such as the Flatiron District, Hudson Square and SoHo ("Silicon Alley"), and more recently in Dumbo, Brooklyn. A huge draw was Google's 2010 purchase of a former freight warehouse in Chelsea with almost three million square feet or approx. 278,000 square meters. The company's move signaled the tech world was taking NYC seriously and has acted as a magnet, pulling other digital companies to the City. In the last five years, NYC's tech sector has created 11,800 jobs, an increase of 28.7 % to a total of 52,900 information technology jobs.

Foreign Direct Investment in the U.S. Rises Again in 2011

Foreign direct investment (FDI) collapsed in 2009 at the height of the financial crisis but rebounded in 2010 and 2011. Last year FDI surged 14% to a total of $234 billion. Although still below the historical peak of $328 billion in 2008, it is well above the low of $64 billion in 2003. From 2001 to 2010, FDI totaled $1.7 trillion with a significant portion, approximately 41%, contributed to the U.S. manufacturing sector in 2010. In general, FDI flows vary greatly year-to-year and mostly follow the U.S. business cycle. From 1997 to 2010, manufacturing's share of FDI has varied from a low of 15% in 2004 to a high of 81% in 1998, averaging 39% over the period.

By definition, FDI occurs when a foreigner invests in an affiliate located in the United States. An affiliate is a business in which the foreign investor has a substantial interest, defined as ownership of at least 10% of the voting stock of the business.

Interestingly, relatively few countries invested in the U.S. in 2010. In fact, 84% of FDI came from or through eight countries: Switzerland, the United Kingdom, Japan, France, Germany, Luxembourg, the Netherlands,

and Canada. In 2011 about two-thirds of FDI came from Europe and some experts expect this trend to continue given mounting problems in the Euro zone. While America has several unsolved problems, the perpetual trend seems to be that in difficult times America benefits from global economic uncertainties and its reputation as a safe haven for long-term investments will ensure that it remains the world's most popular destination for capital.

America's Southeast: Clusters and the New Economics of Competition

In theory, location should no longer be a source of competitive advantage. Open global markets, rapid transportation, and high-speed communications should allow any company to source anything from any place at any time. But in practice, location remains central to competition. Geographic, cultural, and institutional proximity provides companies with special access, closer relationships, better information, powerful incentives, and other advantages that are difficult to tap from a distance. The more complex, knowledge-based, and dynamic the world economy becomes, the more this is true.

In November 1998, the Harvard Business School Professor Michael Porter published his article "Clusters and the New Economics of Competition." In this article he states that "paradoxically, the enduring competitive advantages in a global economy lie increasingly in local things – knowledge, relationships, and motivation that distant rivals cannot match." Today's economic map of the world is characterized by what Porter calls clusters: critical masses in one place of linked industries and institutions – from suppliers to universities to government agencies – that enjoy unusual competitive success in a particular field. The most famous examples are found in Silicon Valley and Hollywood, but clusters are found also in many other parts of the world like high-performance auto companies in southern Germany or fashion shoe companies in northern Italy.

In America's southeast manufacturing "clusters" developed, for example in the Greenville/Spartanburg corridor in South Carolina. In this area companies like General Electric, Michelin, and BMW coordinate with local colleges to provide the supply for engineers and machinists working in their plants. These manufacturers built a symbiosis between factory and school and developed apprentice programs, where students study at the school while working at the company and the company pays for the education. The idea with apprenticeship programs is not new. Robert Bosch GmbH, a German auto-parts and engineering company, has been running such a program in Charleston, SC since the 1970s. Despite America's high unemployment rate, companies struggle to find qualified workforce for certain positions. Volkswagen (VW) learned that it is better to build workforce in the U.S. than to rely on the market. As VW increased production at its new Passat plant in Chattanooga, TN it had to launch a nationwide advertising campaign to fill 100 of the more specialized jobs. To meet future demand VW started a three-year apprenticeship program for workers to maintain and trouble-shoot robotics and assembly-line systems.

The pros for many investment decisions in America's southeast are the region's technical schools, nonunion

workforce, infrastructure, incentives from the states, and an effective supply chain. It is the combination of all the aforementioned benefits that leads these clusters to increased productivity and quality which offsets America's higher corporate taxes and wages compared to countries like China.

Large Investors Avoid Real Estate Funds and Invest on Their Own

Investors are progressively making direct investments independent of fund managers. According to the Wall Street Journal article "Large Investors Choose to Swim on Their Own," major institutions such as Harvard University's endowment, Canada Pension Plan and Abu Dhabi Investment Authority are building in-house real estate investment divisions to acquire property directly. In a poll of 472 investors world-wide with $10 billion or more in assets, 80% said they were either investing in real estate directly or considering it. These investors decide not to commingle their assets due to higher fees collected by fund managers, less than spectacular performance and the risks with investing in funds. Investors who venture on their own have better oversight and control of their investment properties. In addition, tax consequences can be mitigated since investors will determine to sell their assets when the timing is in their favor. What investors need to make these investments are the capabilities and local expertise on how to make and manage direct investments including knowledge of the geography and property types. The major advantages of direct investments are lower fees, increased transparency, and more involvement in making key decisions.

Online Shopping is Changing Retail Space Demand

Investors of commercial real estate might be interested in an increasing trend of landlords reducing retail space throughout the country due to online shopping. Big box stores and many other retailers and are facing mounting margin pressure from Internet retailers. As a result, stores tend to close or shrink. In Manhattan landlords are having problems to find 25,000-square-foot (approx. 2,300 square meters) single-use tenants and are starting to split those spaces up for smaller shops and restaurants. Even though the U.S. is far away from a disappearance of brick-and-mortar stores, the retail landscape is changing.

Foreigners Buying Residential Real Estate in the U.S.

The decline in U.S. home prices and the U.S. dollar's weakness against some currencies attracted foreigners looking to buy residential real estate in the U.S.

According to the National Association of Realtors, in the 12-month period that ended in March 2012 international buyers accounted for $82.5 billion, or 8.9%, of the $928 billion spent on residential real estate. This resulted in a 24% increase from $66.4 billion in the previous-year period. About 55% of all international buyers came from Canada, China, Mexico, India, and the United Kingdom. The states Florida, California, Texas, Arizona, and New York accounted for 55% of all sales to international buyers.

Economic Indicators & U.S. Dollar Foreign-Exchange Rates

Economic Indicators	May 2012	Mar. 2012	May 2011	May 2009	May 2007
Employment	69,000	143,000	54,000	(345,000)	157,000
Unemployment Rate	8.2%	8.2%	9.0%	9.4%	4.5%
Avg. Weekly Hours (Manuf.)	40.5	40.7	40.5	38.5	40.0
Avg. Overtime Hours (Manuf.)	3.2	3.3	3.1	2.1	3.2
Building Permits	780,000	769,000	624,000	556,000	1,493,000
Housing Starts	708,000	706,000	551,000	540,000	1,415,000
Consumer Confidence Index	64.4	69.5	61.7	54.8	108.5
Purchasing Managers Index	53.5	53.4	54.2	42.0	52.5

Other Indicators	May 31 2012	Mar. 30 2012	May 31 2011	May 29 2009	May 31 2007
S&P 500 Index	1,310.33	1,408.47	1,345.20	919.14	1,530.62
S&P 500 - Trading Volume (in thousands)	4,557,620	3,676,890	4,696,240	6,050,420	3,335,530
VIX (Volatility Index)	24.06	15.50	15.45	28.92	13.05

Real GDP	2012 Q1	2011 Q4	2011	2009	2007
Real GDP	1.9%	3.0%	1.7%	(3.5%)	1.9%

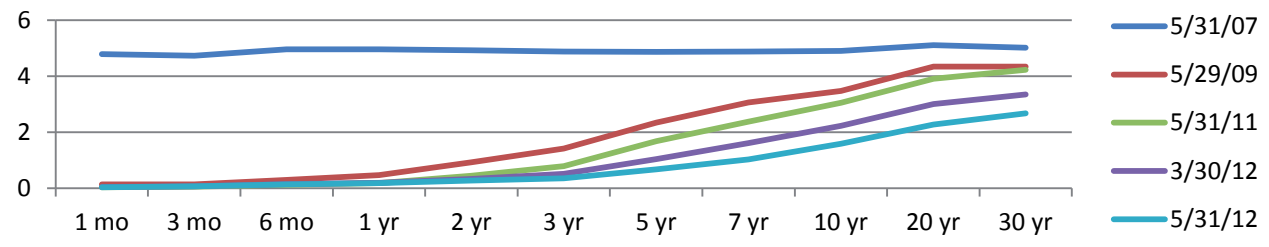
Inflation	May 2012	Mar. 2012	2011	2009	2007
Inflation	1.7%	2.7%	3.2%	(0.4%)	2.8%

Currency Exchange Rates	May 31 2012	Mar. 30 2012	May 31 2011	May 29 2009	May 31 2007
EUR / USD	1.2440	1.3301	1.4282	1.4144	1.3437
GBP / USD	1.5576	1.5903	1.6472	1.5938	1.9780
CHF / USD	1.0357	1.1035	1.1742	0.9178	0.8160
CAD / USD	0.9740	1.0011	1.0236	0.8936	0.9316
CNY / USD	0.1576	0.1580	0.1539	0.1462	0.1306
JPY / USD	0.0126	0.0121	0.0124	0.0104	0.0082

Note: Some Numbers May Be Updated Due to Revisions of Official Statistics.

Interest Rates, Real Estate & Taxes

Treasury Yield Curve (in %)



Base Rates	June 28, 2012	2 Weeks Ago	One Year Ago
30 Day LIBOR	0.25%	0.24%	0.19%
U.S. Treasury			
5 Year	0.70%	0.73%	1.67%
10 Year	1.59%	1.64%	3.11%

Source: Cushman & Wakefield

10-Year Fixed Rate Ranges by Asset Class	Max. LTV	Class A	Class B/C
Anchored Retail	70-75%	T + 305	T + 315
Strip Center	65-70%	T + 325	T + 335
Multi Family (Non-Agency)	70-75%	T + 250	T + 255
Multi Family (Agency)	75-80%	T + 235	T + 240
Distribution/Warehouse	65-70%	T + 310	T + 320
R&D/Flex/Industrial	60-65%	T + 325	T + 340
Office	65-70%	T + 305	T + 320
Full Service Hotel	55-65%	T + 340	T + 365

Note: T = Interest Rate for 10-Year U.S. Treasury (1.59%)
Source: Cushman & Wakefield (June 28, 2012)

Simplified Presentation of the Most Important U.S. Federal Tax Rates:	
Income Tax	10-35%
Long-Term Capital Gains (LTCG)	15%
"Qualified" Dividends	15%
Corporate Tax	15-35%
Gift and Estate Tax	18-35%

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For questions or scheduling meetings, please contact us.
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