



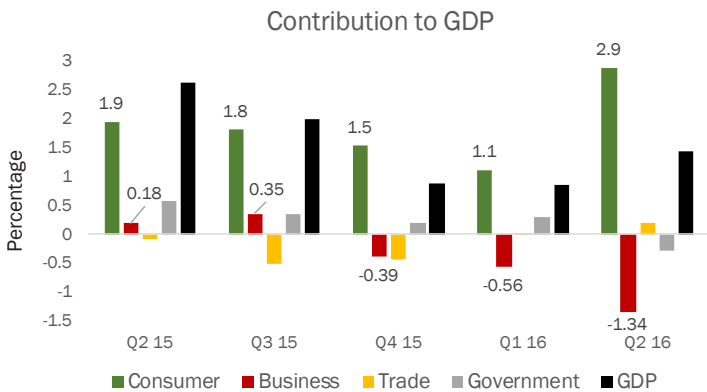
Christopher Macke
Managing Director,
Research & Strategy

Stanley L. Iezman
Chairman & CEO

ECONOMY

GDP

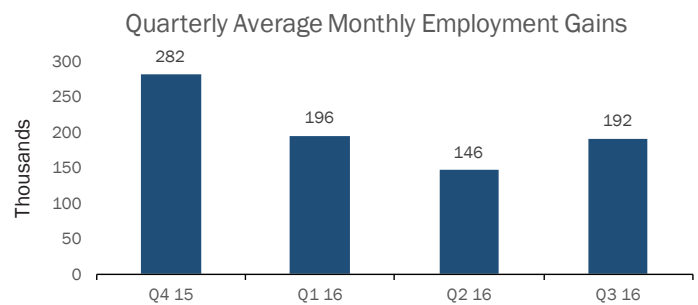
Economic growth continues to be driven by the consumer. Personal consumption expenditures, a positive contributor to GDP growth since the first quarter of 2010, added 290 basis points to second quarter GDP. Conversely, business investment has been a material drag on GDP in three of the last four quarters, subtracting 134 basis points from second quarter GDP. With net exports slightly positive in the second quarter and government expenditures detracting 30 basis points, second quarter GDP increased from a paltry .82% gain in the first quarter to a 1.42% second quarter gain. While not robust, it was a welcome uptick in economic growth. We expect this pattern to continue – personal consumption positive while businesses contend with rising wages, a strengthening dollar, weakening global demand, and declining corporate profits and earnings growth. At some point, however, without a reversal in corporate profits, employment may feel the impact of weak profits and earnings.



Employment

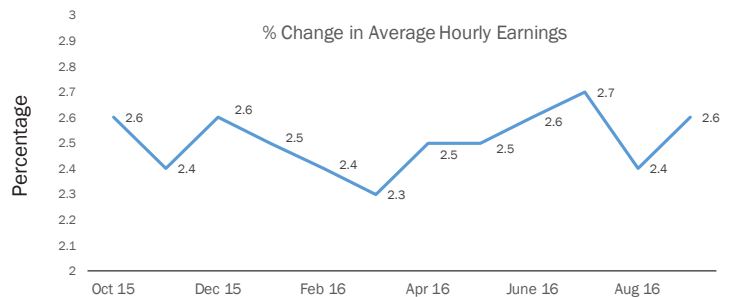
The third quarter brought a welcome stabilization in employment growth, delivering nearly 200,000 jobs per month after a roller coaster second quarter that featured two months of job growth below 150,000 – including a disconcerting 24,000 in May. Setting aside the bounce back

employment growth in July, the 150,000 job gain average in August and September is in line with our expectations for continued near-term employment growth closer to 150,000 jobs per month than 200,000 jobs per month, as labor market slack makes finding qualified employees increasingly difficult.



Employee Earnings

Although employment growth is moderating, because it is supply side driven, future earnings are not necessarily in jeopardy. Wage growth continues due to limited qualified labor supply, with year-to-date average hourly earnings growth up 2.5%, a 30 bps increase over the same time period in 2015. We expect this growth trend to continue.

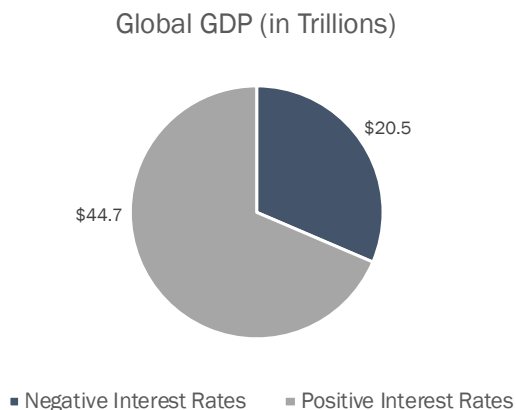


Global Economy

The global economic and political landscape remains uncertain. Japan is fighting deflation; the European Union is in a state of flux due both to Brexit and increasing questions surrounding the European banking system; and

China continues the delicate balancing act of transitioning from an investment-driven economy to a consumption-based one. As evidence of these collective challenges, one-third of the world's GDP is now operating under negative sovereign debt yields.

We expect the U.S. economy, however, to continue on its current pace, generating adequate employment growth and increasingly favorable employee earnings to support future consumption. This should, in turn, support retail, office, industrial, and multifamily demand.



INTEREST RATES

Long-Term Rates

U.S. 10 Year Treasury rates reached a historic low of 1.36% in the beginning of the third quarter, peaked at 1.73% in the middle of September, and trended slightly downward to end the quarter at 1.60%. While a 37 bps increase is significant on a percentage change basis, rates remained in a very favorable range for commercial real estate.

A likely increase in equity market volatility will battle with future economic reports, including employment and inflation readings, to determine the trajectory of long-term rates between now and the end of the year. Absent a significant exogenous event, we expect Treasury rates will remain in their current range.

Short-Term Rates

Short-term rates will also likely remain low. The Federal Reserve is constrained by a number of factors including foreign central bank policy, the impact of a rising dollar on exports, and, most important, a heightened sensitivity

of equity markets to real or anticipated Federal Reserve action. Add to this muted market inflation expectations and actual inflation, and the Federal Reserve will likely stick to its repeated mantra of a gradual rate increase trajectory.

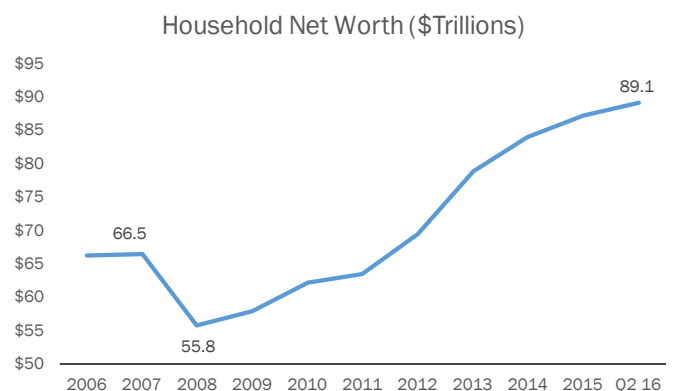
Corporate Bond Yields

Corporate bond yields will also likely remain subdued. However, a surprising acceleration in the rate of decline in corporate profits and/or earnings growth could shock fixed income markets, and a resultant flight to safety would cause an increase in corporate yields, especially at the lower end of the quality spectrum.

Absent such a spike in corporate bond yields, we expect the interest rate environment to remain favorable for commercial real estate.

CONSUMER SECTOR OUTLOOK

Consumers are buoyed by continuing employment growth, an increasingly favorable ratio of job openings to applicants, rising household net worth, and increasing pay. While there is the risk that a slowdown in employment due to corporate cost cutting or a significant and sustained decline in equity markets could have a negative impact on personal spending, our baseline outlook is for consumption to remain healthy, providing a continued tailwind to future economic growth, and, in particular, demand for retail space.

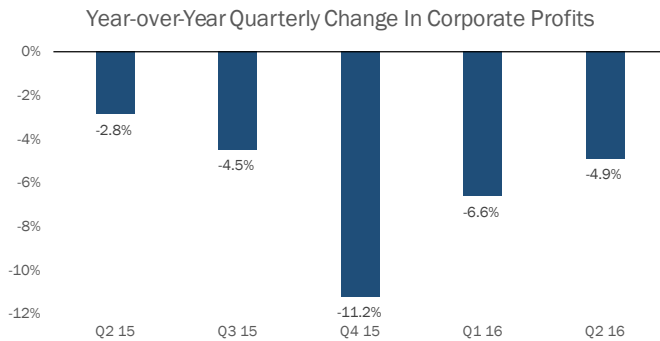


BUSINESS SECTOR OUTLOOK

Businesses on the other hand are facing multiple headwinds. Profits have declined on a year-over-year basis for five consecutive quarters, falling 4.9% in the second quarter alone. In addition, corporate earnings growth is decelerating.

While the hope is that stabilizing oil prices and foreign central bank policies will eventually drive increasing global economic growth, these outcomes are far from certain.

We have not seen a connection between declining corporate profits and demand for commercial real estate space, outside of energy dependent markets. However, we believe it is prudent to remain defensive given current uncertainties in the economy and asset pricing.



POLITICS

Political prognostication is one of the most challenging areas of forecasting. It is looking increasingly likely that former Secretary of State Hillary Clinton will be the winner in November, and we expect this to be a near-term non-event, with much opinion already baked into market activities and little likelihood of a change in Washington political gridlock. On the other hand, an "October Surprise" and a Donald Trump victory would bring an increase in financial market volatility due to both the unexpected result and uncertainty regarding resulting policy positions going forward.

EQUITY MARKETS

Equity markets remained relatively calm with the standard deviation of intraday price movements and daily price change remaining half that of the much more volatile first quarter. We do expect a material uptick in equity market volatility through the end of the year due to speculation

surrounding a rise in short-term rates, the election, increasing geopolitical risks, October's historical equity market antics, and elevated pricing overall, all keeping investors on edge.

A significant and sustained decline in equity values would provide a significant headwind to future commercial real estate capital flows as investors would be forced to rebalance portfolios due to a likely overweight to the asset class. Conversely, if the decline is not sustained, then a temporary pullback in equity markets could provide a boost for real estate capital flows as investors place increasing value on the relative stability of private commercial real estate.

IMPLICATIONS FOR REAL ESTATE

We have been preparing for this environment of increasing economic and market uncertainty for the last several years by acquiring higher-quality assets with longer-term leases and stronger credit tenants, and affirming our commitment to primary markets driven by superior education concentration levels and high income levels as well as higher quality assets with greater price stability and resiliency. Additionally, we have been recycling capital out of assets with shorter lease terms and smaller tenants, as well as selling assets that are moving into the mature phase of their lifecycle. We will continue to maintain an overweight to a prudently defensive position.



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801 North Brand Blvd | Suite 800 | Glendale, CA 91203

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