"Nobody ever did, or ever will, escape the consequences of his choices."
— Alfred A. Montapert

"Without the element of uncertainty, the bringing off of even, the greatest business triumph would be dull, routine, and eminently unsatisfying."
— Jean Paul Getty

I doubt that too many of you regularly watch the Weather Channel, but if you do, you will likely stumble across an episode or three of "Storm Chasers," a show about folks apparently missing their amygdalae who "chase" tornadoes and other extreme weather events for a living. I suppose there must be something exhilarating about getting as close to the eye of a tornado or hurricane as possible and cheating serious injury or death in the process.

However, as someone who thinks that driving the 405 Freeway during rush hour or visiting Costco on any given weekend (those gold bars will only be available for so long and don't even get me started on the free samples) are excitement enough, I can't say I understand these sorts of thrill-seeking endeavors. Then again, my mother would never let me near a motorcycle growing up, so there's that impactful upbringing as well, I am sure.


Regardless, anyone involved in commercial real estate during the last couple of years – sponsors, developers, investors, and other capital and service providers – likely knows what it feels like to be a proverbial storm chaser, having spent the last 12 to 18 months in the "I" of an historic storm battering the industry: increasing interest rates, inflation, and insurance costs; inadequate rental growth; illiquidity; and industry regulation. Add in the political battles surrounding immigration and its impact on construction labor, and we have multiple, hurricane-worthy "I's" simultaneously buffeting the industry.

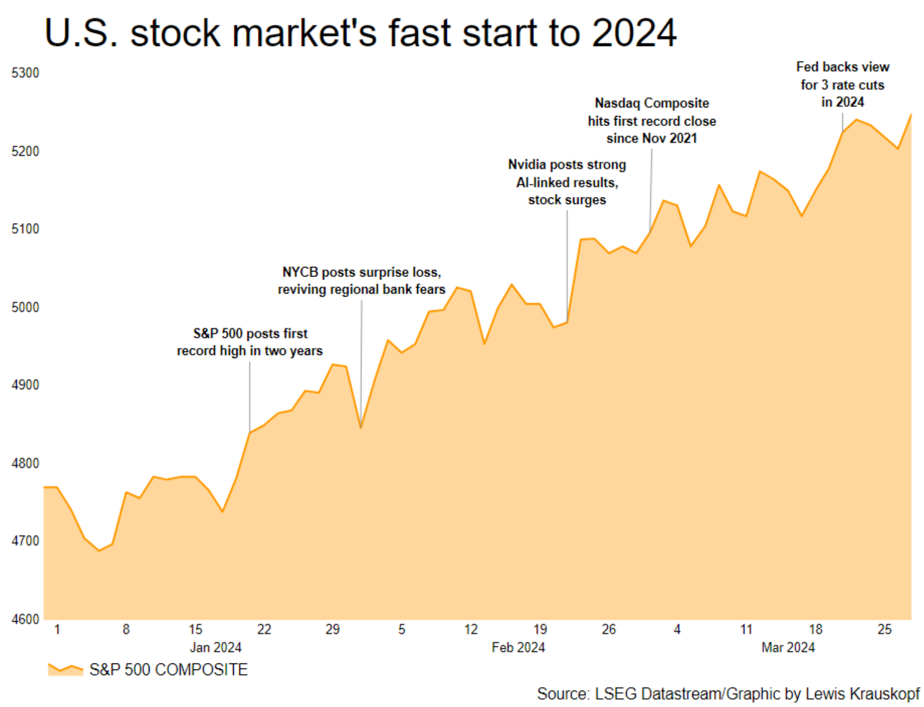
The results have not been pretty. Reduced or eliminated distributions. Capital calls. Cash-in refinancings and/or recapitalizations with new and expensive equity or mezzanine debt if it is even available. As though an earthquake on the East Coast, a total solar eclipse, increasing tensions in the Middle East and elsewhere, non-stop political theatre in D.C. (oh, and now New York City), and the shocking dissolution of the Golden Bachelor betrothal weren't unsettling enough events this past quarter, the commercial real estate landscape has continued its dramatic and rapid shift.

That's what happens when you increase interest rates from zero to 5.5% in less than two years, while sprinkling in some global unrest, excessive government largesse in response to a pandemic (over three times what was required), and inane or inadequate policies in response to everything from climate change to immigration to housing.

Significant questions follow. When will the commercial real estate market bottom? When will the Fed lower rates and the next easing cycle begin? When will Washington get its you know what together and put an end to the reckless U.S. deficit spending and borrowing? What will happen in November and what impact might that have on anything and everything? Should one put more capital into projects into which they have invested?

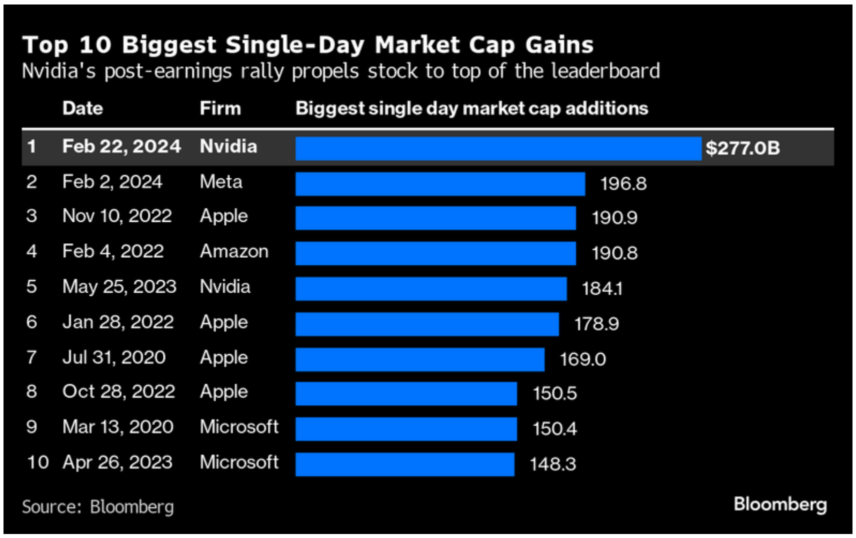
The questions are numerous and challenging to answer, but I will try to give the best perspective I can in this predictably lengthy missive. However, regardless of my efforts, I am fairly sure that I don't have all the answers, as this economy and market are about as challenging and confounding as any I have experienced in my nearly 30 years in the industry, as both an academic and practitioner.

Let's take a quick look at the data. On the one hand, the equity markets, until recently, were trading as though the Fed had already reduced rates or that three rate cuts in 2024 were a foregone conclusion. Through the end of the first quarter, the S&P 500 was up about 10% and don't even get me started about the returns of anything or everything associated with "A.I." Nvidia was up some 80% in just the first quarter alone, while another A.I. stock you have likely never heard of, Super Micro Computer, was up over 255%, all while 10-year Treasury yields increased from about 3.9% to 4.2% and those anticipated rate cuts became less certain. Really?

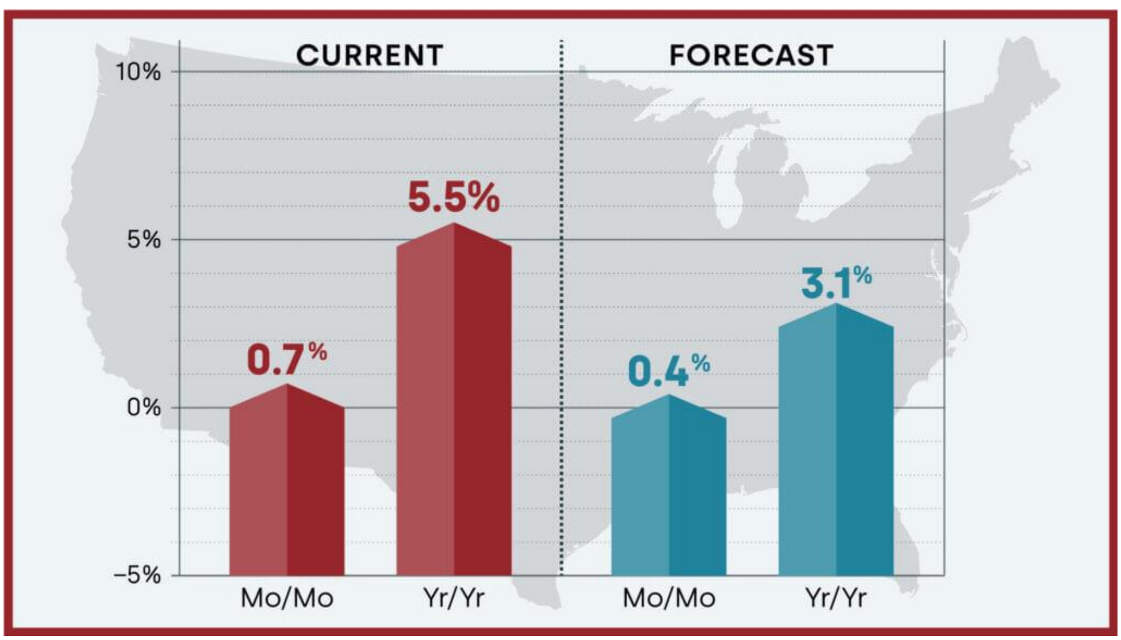


Gold prices surpassed $2,200 an ounce, up over 7.1%. Bitcoin whizzed past $70,000, up over 119% in just the past six months. And speaking again of Nvidia, its market capitalization exceeded $2.1 trillion (yep, trillion with a "t") at one point during the quarter, exceeding the GDPs of Russia ($2.1 trillion), Mexico ($2.0 trillion), and Australia ($1.8 trillion). In late

February, Nvidia saw its market value increase nearly $277 billion in a single trading day, humbling Meta's mere pittance of a daily gain ($197 billion) experienced three weeks earlier. That's right. Nvidia's value increased nearly $280 billion in one day. It's no wonder that virtually every single company is trying to recast itself as somehow benefiting from A.I.



Meantime, housing prices remained steady, with the median home price nationally up over 5.5% during the quarter, according to CoreLogic, despite those increases in interest rates (see below).



However, commercial real estate is a different story. Publicly traded REITs declined about 3% during the quarter, significantly underperforming broader equity indices. Office prices continued to swoon, facing unprecedented headwinds. Every day I read yet another story about this office foreclosure or that one, or assets or another selling for fractions of previous values. Just imagine that the largest office building in all of Missouri, vacant for years, sold for $4.05

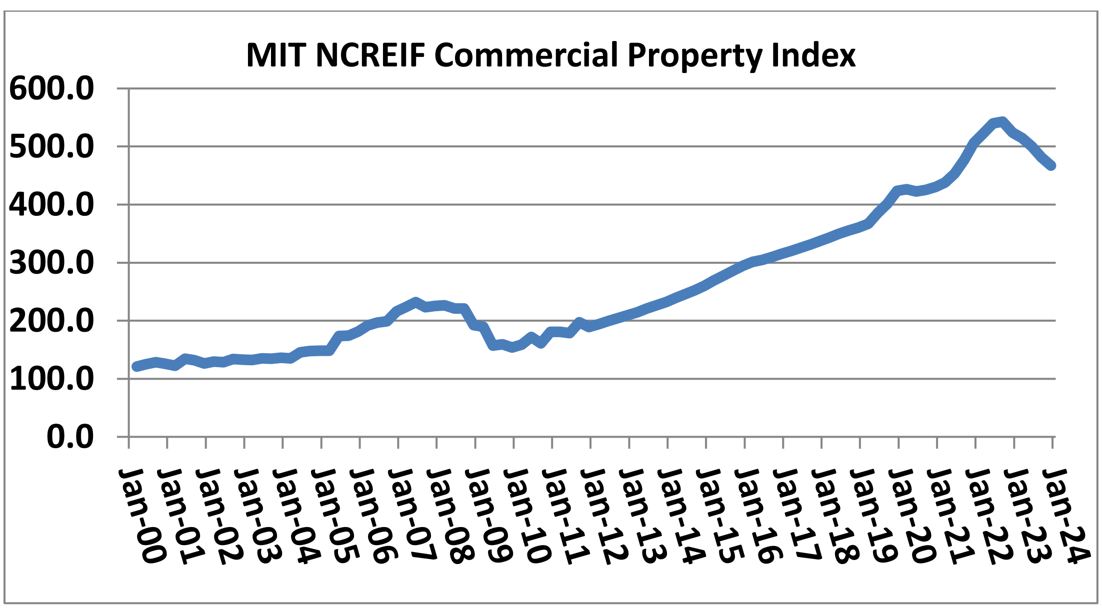
million last month, a pittance compared to the price realized when the building last sold in 2006 ($204.5 million). And closer to home, here is yet another example of the office market implosion.

California office building sells at 52% less than 2018 price

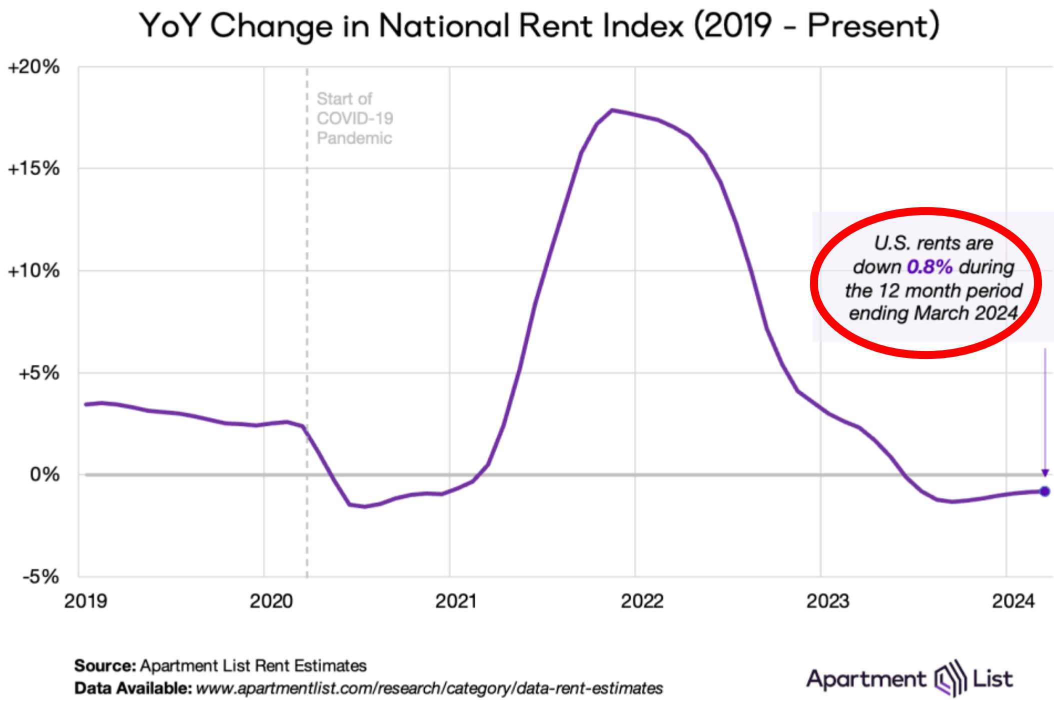
Harbor Associates says distress is starting to hit the market

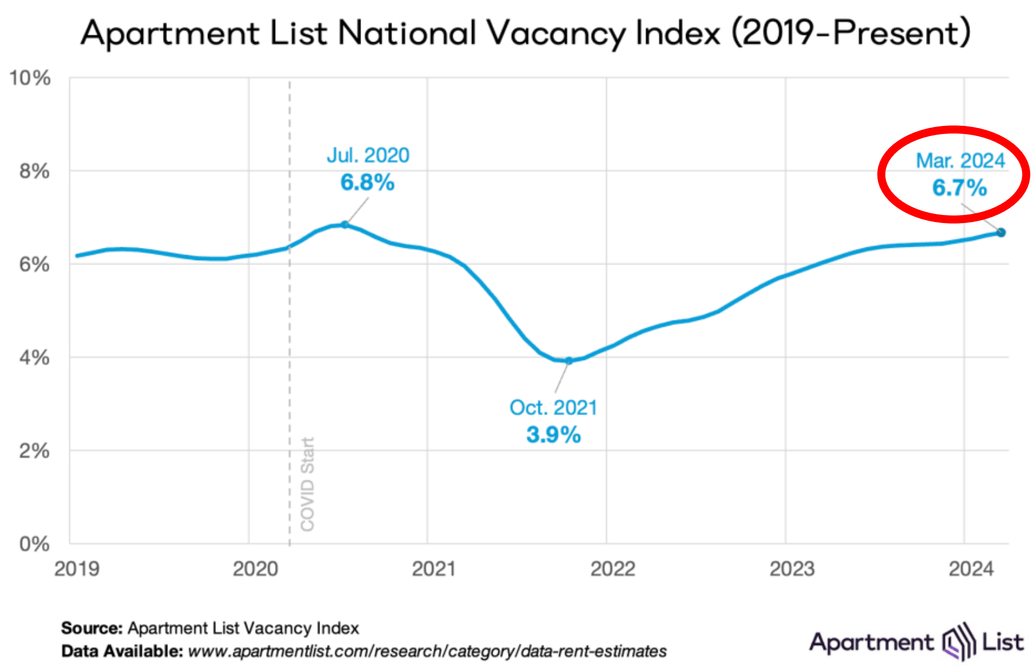
LA office building at 1640 Sepulveda Blvd. (Harbor Associates)

Meantime, it's not just the office market which is smarting, as demand for warehouse/industrial space also softens. Prologis, the world's largest industrial landlord, just warned investors last week of an anticipated slowdown in warehousing demand in upcoming quarters and cut its annual 2024 guidance as a result. The stock cratered and is now down about 22% for the year. Ouch. In the Inland Empire, where we own several assets, warehousing and storage-related jobs declined last year for first time in some 20 years as wholesale trade employment slowed, following the pandemic lift. Amazon has mothballed several projects, also meaningfully reducing demand.



Multifamily fundamentals – principally rental growth and occupancies – also weakened, with national rents down approximately 0.8% for the year ending in March. The national vacancy rate increased from about 6.0% to approximately 6.7% during that same time period, principally reflecting increased supply relative to demand.



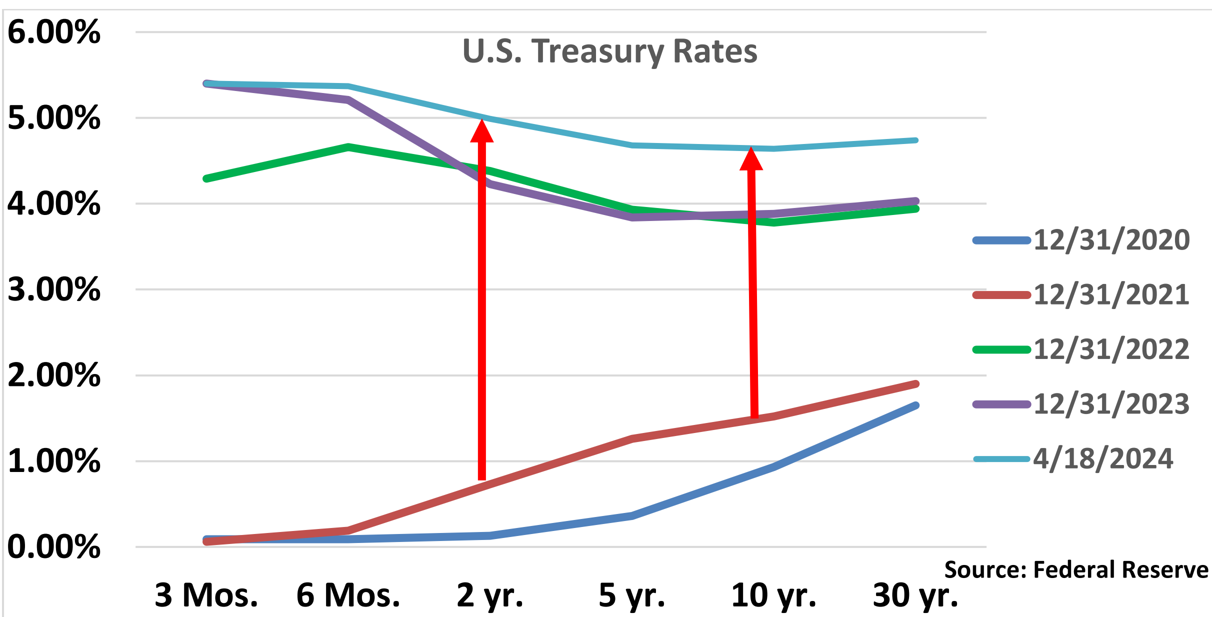


Perhaps office values will not recover for a decade or more (if ever), but I cannot imagine that multifamily asset values will follow that same path. You can't effectively outsource housing and the significant new supply that has been added in recent years will eventually be absorbed, new construction ultimately halted, and all those Millennials and Gen-Zer's currently living in their childhood homes (freeloading?) will presumably move out of their parents' basements and seek alternative living arrangements in time…or so we can hope.

Therefore, it is my strong view that multifamily real estate values will recover once interest rates come down and stabilize, liquidity returns, and investor confidence is restored. It is only a question of when and whether we need to "stay alive until '25" as many have mused, or "stay in the mix until '26." Obviously, making forecasts with that sort of accuracy is impossible, but I remain convinced that asset values will recover sometime in this time frame. The key is holding on and surviving the tempest.

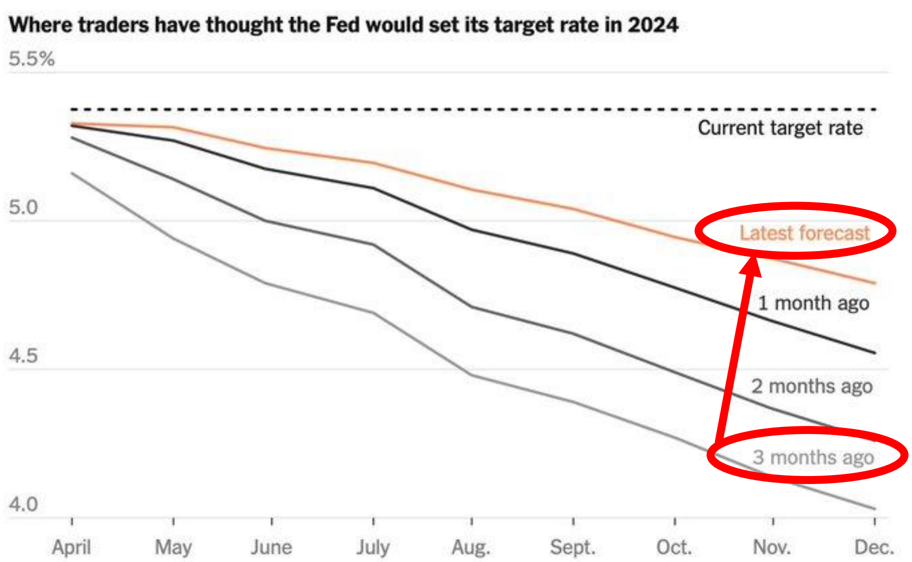
With all this being said, let's take a closer look at those storm worthy "I's" that have characterized much of the commercial and multifamily real estate landscape over the past year or two.

- ***Interest Rate Rise***: Despite most predictions to the contrary, the economy continues to grow and consumers continue to spend, driving inflation and interest rates higher. Yields on the 10-year Treasury increased from about 3.9% at the start of the first quarter to over 4.6% at last glance, while 30-year mortgage rates leapt from about 6.6% to 7.0%.



With ever changing and conflicting data and market expectations, Jerome Powell, our intrepid Fed Chair, has assumed the role of Al Michaels or Jim Nance, a play-by-play announcer calling daily interest rate machinations. One day it's "We are still on track for three rate cuts this year" (March 20th) and then, just a few days ago, it's "higher inflation does persist…and therefore, we can maintain the current level of (interest rates) for as long as needed." With this sort of rhetorical whiplash, it's no wonder markets and market participants are confused.

In response, the forward yield curve and related expectations shift almost daily, unlike anything I can recall. Even market "professionals" and traders aren't sure where interest rates are headed and the significant rate volatility is not helping. Uncertainty, volatility, and investor confidence are not welcome bedfellows.



Note: Average monthly effective Fed funds rate based on futures contract prices. · Source: FactSet · Jason Karaian

So…when will the Fed ultimately lower rates? At this point, the best answer might just be the same response to that to that old, corny riddle: "What do you get when you cross an elephant and a rhinoceros?" The answer? Hell if I know. At this point, it is unclear whether the Fed will cut rates at all this year, as it is likely a "play by play" decision, though I have to believe, and do believe, that we will experience at least one rate reduction this year.

Interestingly enough, some contrarians – certainly a minority – argue that the increases in interest rates are actually buoying the economy, with investors earning much more income on cash balances (e.g., money market funds, CDs) and fixed income securities, which they are, in turn, spending. Combining higher rates with profligate government borrowing and spending (resulting in annual issuances of some $2 trillion a year in Treasuries), adds another $50 to $100 billion a year of interest payments to juice retail sales and consumer spending (see below).

Perhaps. My sense is that the excessive government largesse during Covid ($5 trillion, far larger than what was required), ongoing supply chain challenges, and global conflicts are far more impactful. Or maybe it is merely idiosyncrasies in how inflation is measured, with significant lags between actual inflation and how it is measured (see below).

- ***Inflation in Operating Expenses and Higher Inflation Generally***: Commercial real estate developers, owners, and sponsors are facing significantly higher prices in just about anything and everything: wages, construction, repairs, and maintenance costs, insurance premiums, utilities, and property taxes. No expense has been spared.

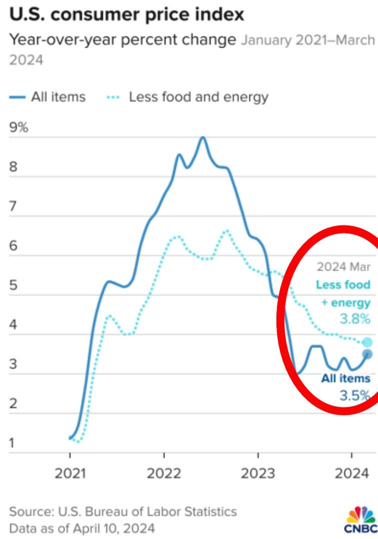
Growth in Costs by Expense Category*

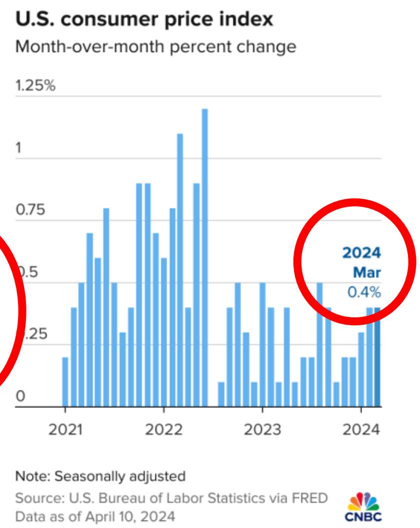
Expense Category	YOY % Change
Insurance	27.7%
Marketing	12.3%
Administrative	9.6%
Repairs/Maintenance	8.8%
Total Operating Expense	**7.1%**
Payroll	6.1%
Utilities	3.7%
Taxes	3.5%
Management	3.2%
Total NOI	**4.2%**

*Source:Yardi Matrix; *12 months ending January 2024*

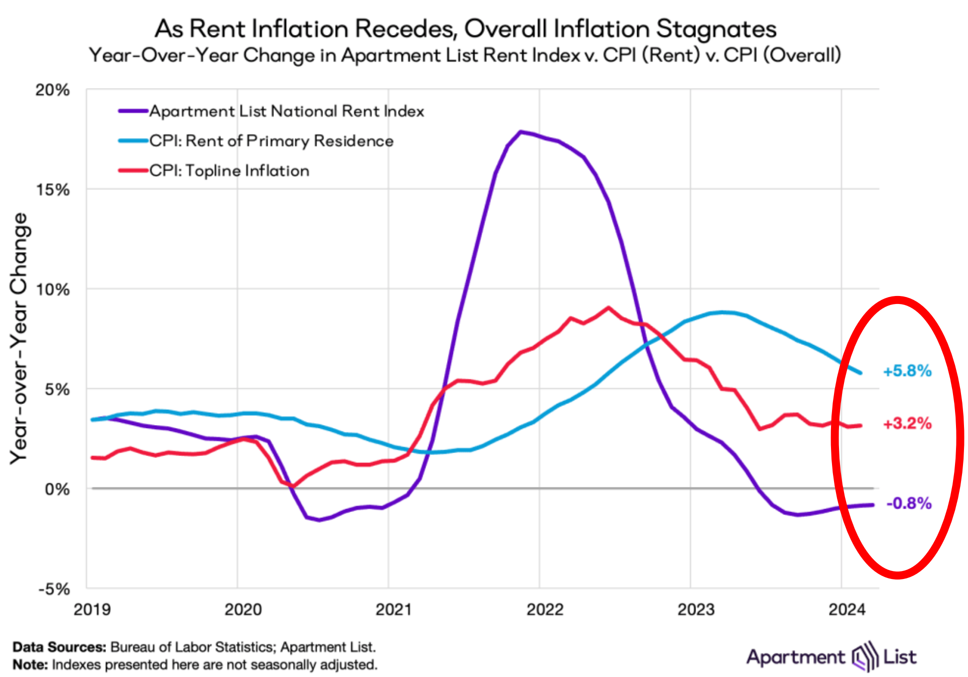
Substantially higher operating costs coupled with flat to modestly lower rental growth and higher vacancy rates (again, see below) have resulted in Net Operating Income (e.g., property-level cash flow) figures and forecasts generally underperforming pro forma projections and budgets. Higher interest rates, combined with increased investor uncertainty, compound the challenges commercial real estate industry participants face.

Recent inflation data is sobering inasmuch as it appears that the Fed's two-percent target remains in a galaxy far away, pushing out the expected timing for those interest rate cuts. Specifically, the March 2024 Consumer Price Index (CPI) increased 3.5% year-over-year and 0.4% for the month, reversing more favorable trends witnessed earlier this year.





One interesting statistical idiocrasy is the relationship between the cost of housing ("Owners' Equivalent Rent" and "Rents of Primary Residences") and reported inflation figures. As I have mentioned in previous memos, housing costs comprise the single largest component (over a third) of the CPI, so they are singularly impactful. Yet, it is a complex, if not confounding, relationship. For example, as mentioned above, multifamily rents declined 0.8% nationally during the year ending in March and single-family housing prices were generally flat. However, the "Rents of Primary Residence" component of the CPI increased 5.8% during that same period, a sizable delta from both top-line CPI and the actual change in housing costs, however measured.

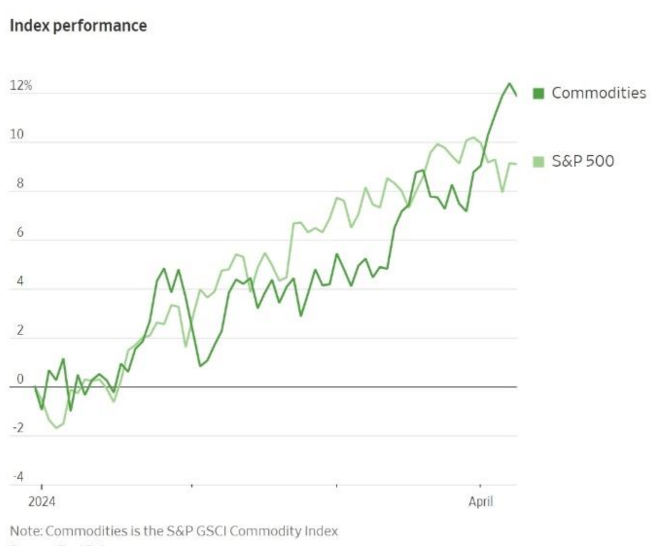


How can we explain or reconcile the conflicting data? As the Economist accurately and succinctly characterized it, it's merely a "very long lag" along with more technical aspects as to how the Bureau of Labor and Statistics collects, aggregates, and measures the data.

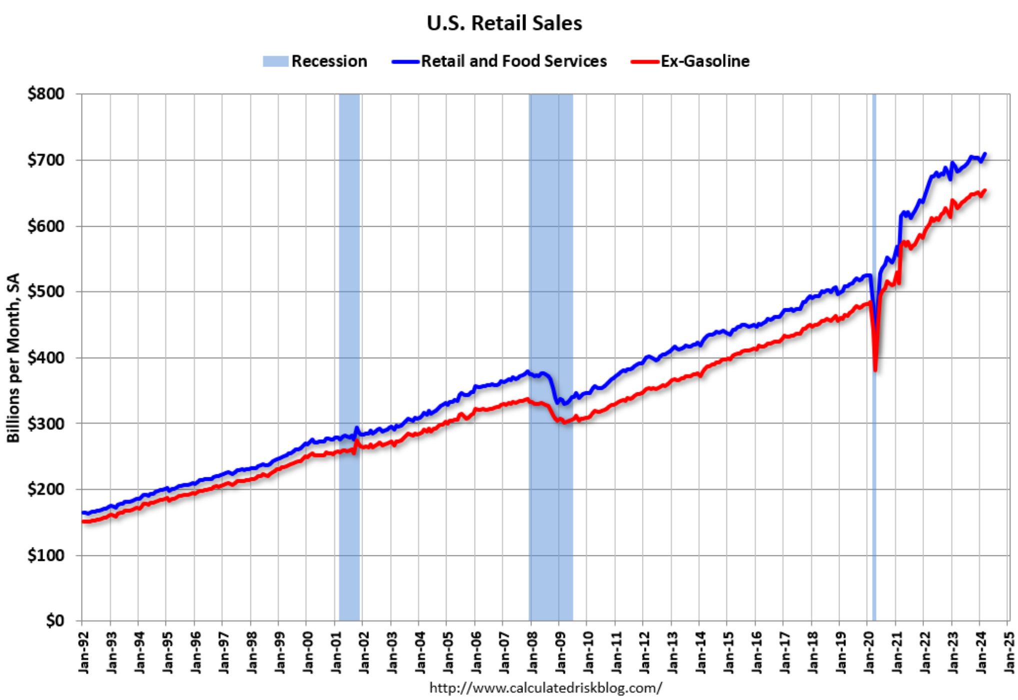
In any event, recently reported inflation figures are still capturing higher rental costs from Covid when multifamily rents spiked some 20%. One picture tells a thousand words.

Realistically, it may simply be that the Fed's two percent inflation target is a pipe dream and now unreachable, at least for the time being. Keep in mind that the Fed supposedly determines the "neutral" Federal Funds Rate by setting it at 50 basis points (0.5%) above long-term inflation. With a current Fed Funds Rate of 5.25-5.50%, and annual inflation presently clocking in at around 3.5%, the Fed can theoretically reduce rates. However, I have recently read some economists arguing that the "Fed Spread" is no longer 50 basis points, but 100. That would mean that the Fed is excessively restrictive at the moment, but not excessively so, and may explain why the economy overall seems to keep humming along. It is all hard to say because transparency is a tad lacking here.

Meanwhile, rising commodity prices aren't helping. Increases in manufacturing activity here and elsewhere, global conflicts and remilitarization, and perhaps good old psychology, have pushed up S&P's Commodity Index over 11% year-to-date, well exceeding the return of the S&P 500.



Finally, consumers continue to spend and spend on just about anything and everything, from travel to restaurants to entertainment. It's no wonder that every aging rock and roller (sorry, Mick, Bruce, Bono, Don, and Elton, but you are no longer spring chickens) continues to squeeze into ill-fitting jeans to croon to one full house after another. March U.S. retail sales increased a seasonally adjusted 0.7%, surpassing expectations, despite news stories about the closure of numerous discount stores, from 99 Cents' Only upcoming liquidation to Dollar Trees closure of nearly 1,000 stores. The bottom line? Despite mixed news, consumers overall continue to tap, insert, or swipe and any recession or economic slowdown seem aways away.



- ***Insurance Premiums and Availability***: Unless you have been asleep for an extended period, you are well aware of the unprecedented increases in insurance premiums the markets have witnessed in recent years. Of every type. Overall commercial property and casualty premiums increased roughly 12% in the fourth quarter of 2023, year over year, representing the 25th consecutive quarter of premium increases. Oh, and that assumes you haven't been one of the unlucky campers whose insurance has been canceled, despite spotless claims histories. It's not pretty.

	COMM'L AUTO	WORKERS' COMP	COMM'L PROPERTY	GEN'L LIABILITY	UMBRELLA	AVERAGE
Fourth Quarter 2023	7.3%	-1.8%	11.8%	3.8%	7.6%	5.7%
Third Quarter 2023	8.8%	-2.0%	17.1%	4.2%	7.4%	7.1%
Second Quarter 2023	10.4%	-0.7%	18.3%	5.2%	8.1%	8.3%
First Quarter 2023	8.3%	-0.5%	20.4%	4.6%	8.5%	8.3%
Fourth Quarter 2022	7.3%	-1.1%	16.0%	4.9%	9.6%	7.4%
High	28.6%	24.9%	45.4%	26.0%	51.9%	35.3%
Low	-11.6%	-12.3%	-15.0%	-13.6%	-13.5%	-13.2%

Source:
The Council of Insurance Agents & Brokers

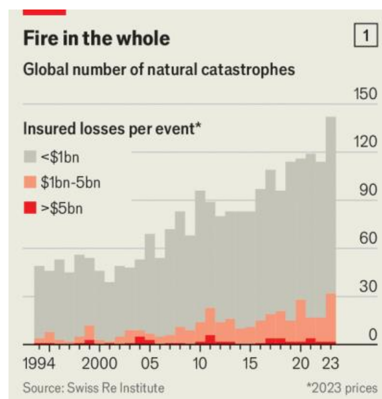
For the year ended January 2024, the cost of insurance per multifamily rental unit increased by some 25% on average, consistent with what we have seen in the Clear Capital portfolio. And unlike many commercial office, industrial, and retail leases, which allow landlords to pass through these higher operating costs to tenants via common area maintenance charges, multifamily landlords are not so fortunate. The impact of higher insurance on property-level cash flows and net operating income are beyond consequential. State Farm just announced that it will not be renewing another 70,000 policies in California, the latest insurer to pull out of the market, joining Allstate (they used to be a "good neighbor and there") and Farmers. Louisiana and Florida property owners are also contending with insurance access.

Whatever the cause, climate change is real and wreaking havoc. Los Angeles has received more rain in the last two years than ever before. Hurricanes hitting the Southeast each year are getting stronger and more frequent. And just last week, the UAE, where I have taken students many times over the years, received more rain in a single day (six inches) than they typically receive every two years. Locusts, frogs, and boils cannot be far behind. The only bright side is that storm chasers have ample opportunity to hone their craft and the Weather Channel has lots more news to report.

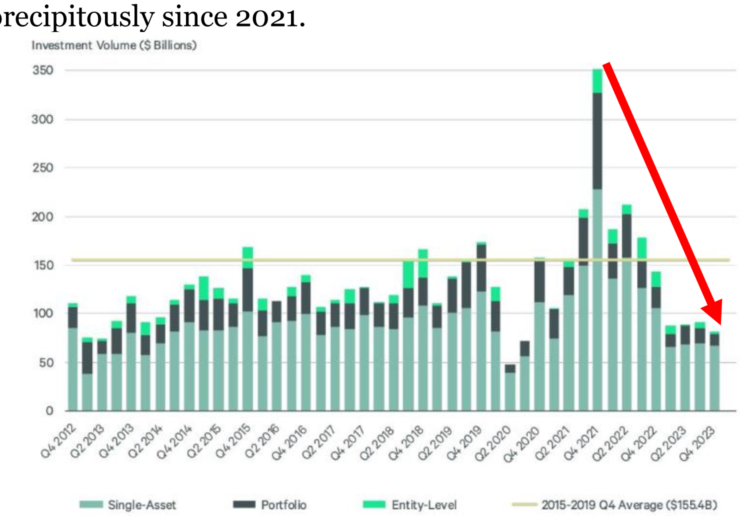
Growth in Insurance Costs by Region*

Region	YOY Insurance Per Unit
Southeast	35.7%
Southwest	29.0%
National	27.7%
Midwest	24.4%
West	23.6%
Northeast	21.1%

*Source: Yardi Matrix; *through January 2024*



- ***Illiquidity and Banking Challenges***: No matter where you look, whether loan originations or investment volumes, commercial real estate transaction volumes have declined precipitously since 2021.



Is it any wonder? Many banks have become operational zombies, as they try to right size their balance sheets while unable to raise fresh equity. Owning too many long-term, fixed rate assets (e.g., Treasuries, loans), as compared to variable, short-term deposits are challenging smaller, regional banks without the diverse sources of income enjoyed by larger money-center banks (e.g., credit card fees, sales of investment products, money management related revenues). The result? Many smaller and regional banks have all but ceased lending activity. I would be shocked if we didn't witness more bank failures in the coming quarters. New York Community Bank may be the poster child for this phenomenon, receiving the most press in recent months, but they are hardly alone.

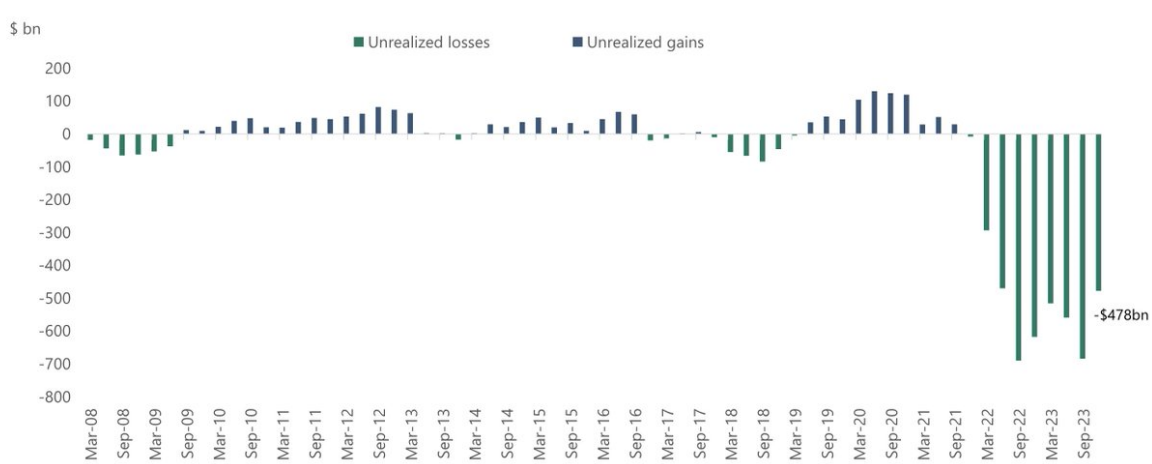
APOLLO

Regional bank stocks underperforming

There are a large number of publicly traded banks with high concentrations of potentially risky commercial real estate loans or those that have significant portfolios of fixed income securities which have not been "marked to market," potentially obfuscating the true risk of these banks failing.

APOLLO

Unrealized losses on investment securities for banks



Largest Publicly-Traded Banks With High Concentrations of Commercial Real Estate Loans

Regulators pay extra attention to banks in two instances: (1) Commercial real estate loans (CRE) exceed 300% of capital and have grown at least 50% in the past 36 months; (2) Construction and development loans (C&D) exceed 100% of capital.

Exceeds regulatory guidelines

Company / Ticker	Recent Price	12-Month Change	Total Assets (billion)	CRE/Capital > 300%	CRE growth > 50% in 36 mos.	C&D/Capital > 100%
Valley National Bancorp / VLY	$8.22	−29.4%	$61	472.7%	81.0%	63.7%
Columbia Banking System / COLB	$17.91	−40.6%	$52	317.3%	75.5%	55.7%
Bank OZK / OZK	$43.60	−5.4%	$34	399.3%	41.6%	237.4%
Simmons First National / SFNC	$19.07	−14.8%	$27	282.4%	43.5%	108.8%
WaFd / WAFD	$27.29	−23.0%	$23	366.2%	64.9%	101.3%
Axos Financial / AX	$53.00	11.3%	$21	364.0%	78.8%	127.8%
Independent Bank / INDB	$52.37	−34.8%	$19	318.2%	93.8%	41.5%
Merchants Bancorp / MBIN	$41.79	39.1%	$17	454.1%	174.4%	78.6%
ServisFirst Bancshares / SFBS	$62.44	−15.9%	$16	309.1%	97.3%	89.9%
Dime Community Bancshares / DCOM	$18.39	−39.7%	$14	549.8%	263.7%	12.0%
INDUSTRY MEDIAN				126.5%	41.5%	30.1%

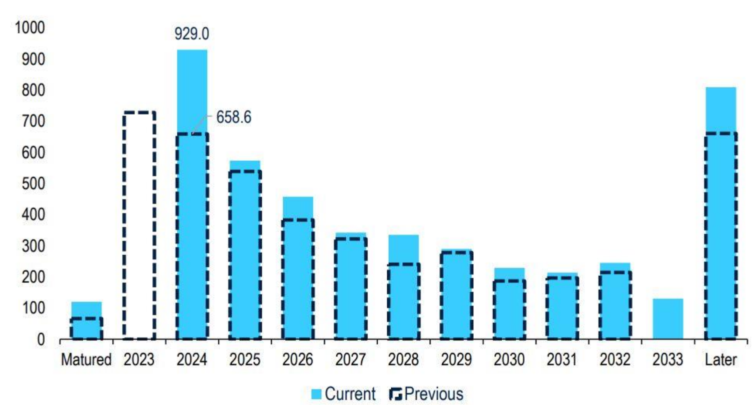
Note: "Capital" means equity, reserves, and allowance for loan losses; "nonperforming" means loans 90+ days past due or nonaccruing; data as of Dec. 31, 2023

Sources: S&P Global Market Intelligence, Bloomberg

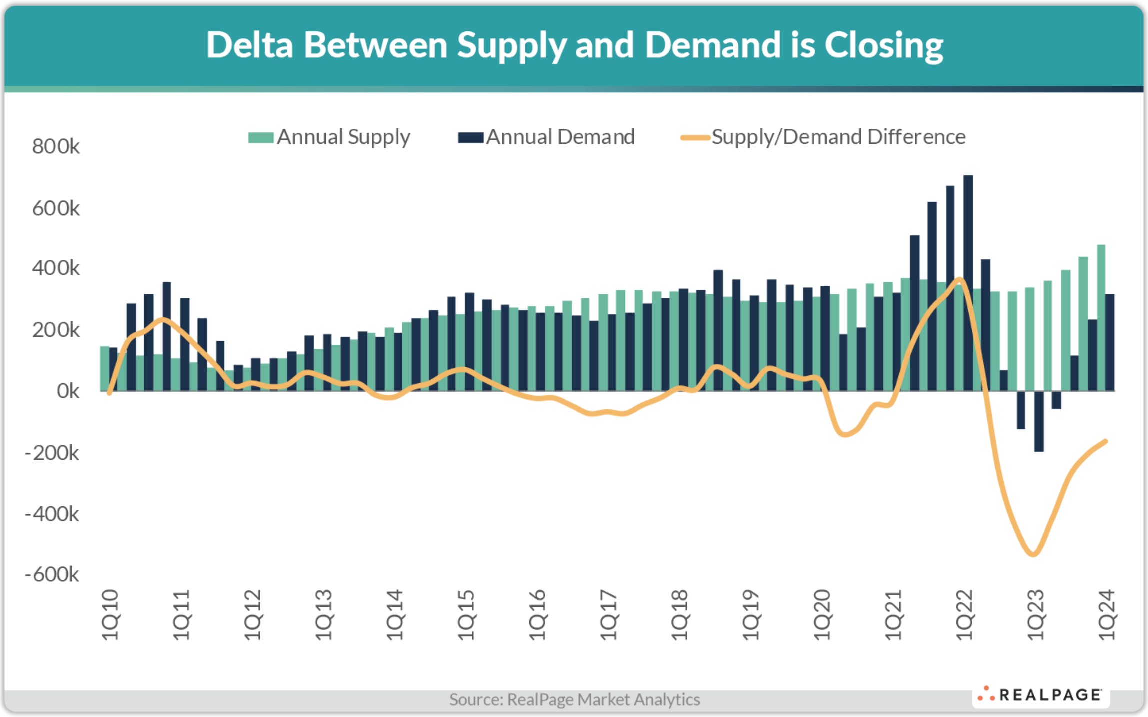
Complicating matters are loan maturities which have been extended. While the amount of real estate loans maturing in 2024 was approximately $660 billion, that figure has increased 41%, to $929 billion, due to extensions of loans originally set to mature last year. Of the loans now maturing in 2024, about a quarter are secured by offices and another 15% by multifamily assets. The amount of delinquent loans ($24.3 billion) more than doubled last year. Given the nearly $1 trillion of maturing loans this year, tighter lending conditions, and many banks turning off their lending spigots, borrowers will need to seek alternative financing alternatives this year and next, including more expensive preferred equity or mezzanine financing.

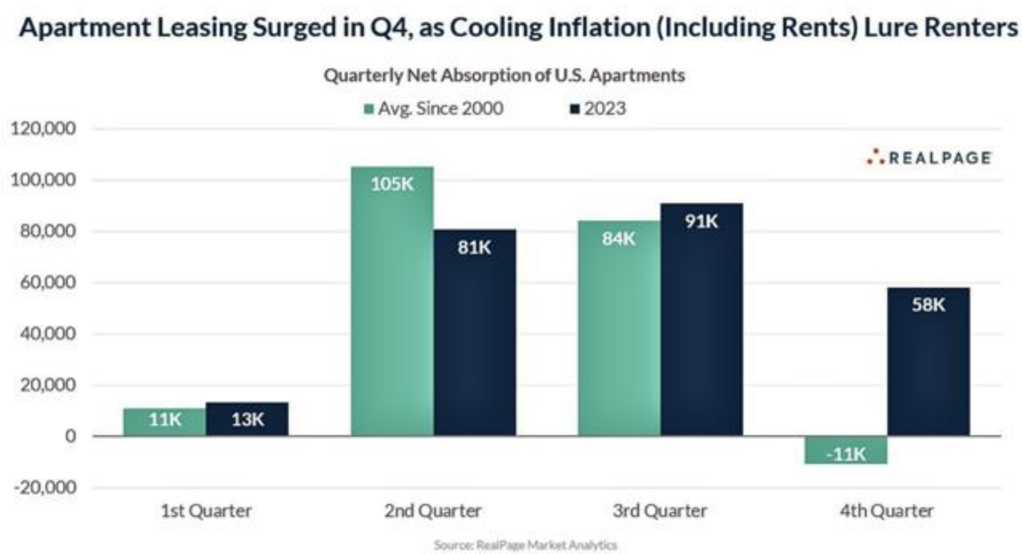
Exhibit 1: Spike in 2024 Commercial and Multifamily Loan Maturities

Loan Maturity Schedule by Investor Group: Current vs. Previous Projections (US$ Billions)



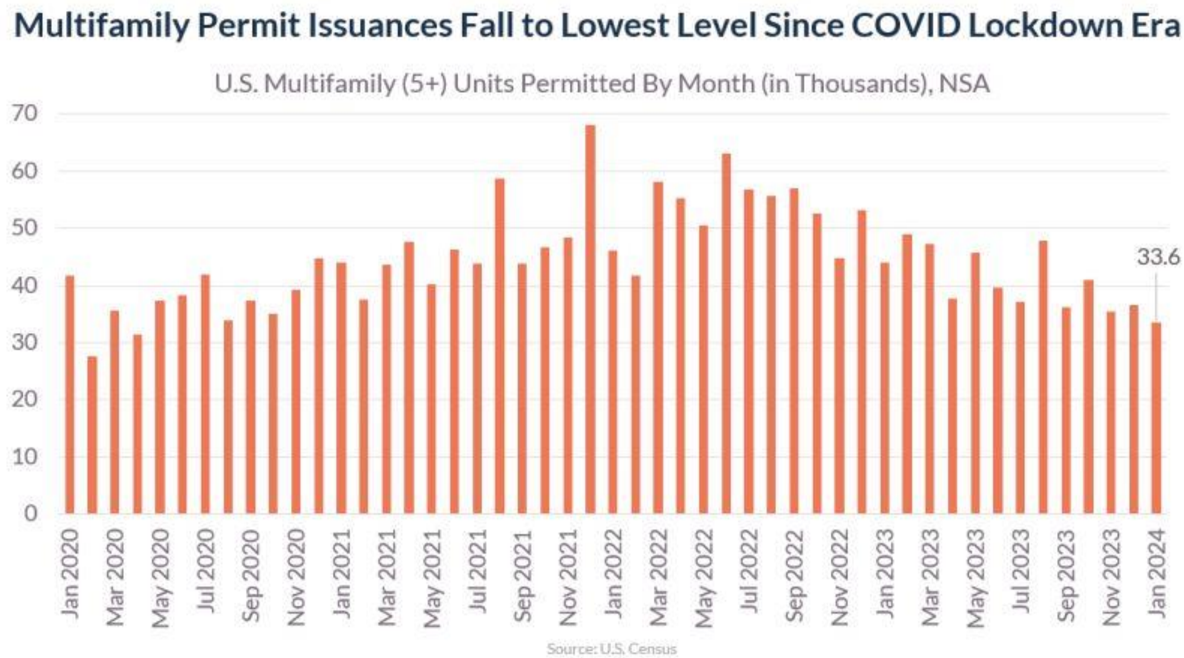
- ***Insufficient Rental Growth***: As mentioned above, multifamily rents decreased approximately 0.8% nationally last year, mostly reflecting an imbalance between demand and supply, a gap which is closing and will continue to narrow as new units are absorbed and fewer projects are brought to market.





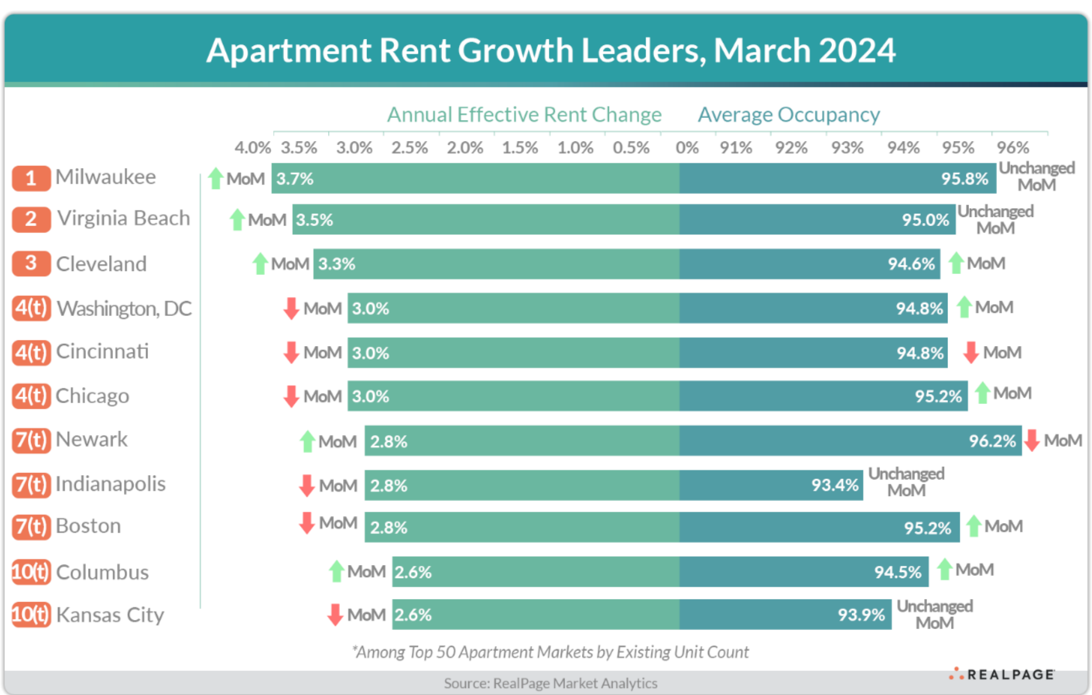
As I have mentioned in recent memos, I expect new multifamily construction to come to a grinding halt later this year, as new projects don't and won't pencil out in an environment of higher interest rates, increased construction costs, softer rents, and tighter lending standards, a prediction supported by new permit issuance data. Even projects that have been entitled and fully permitted will not be built as a result of changed fundamentals.

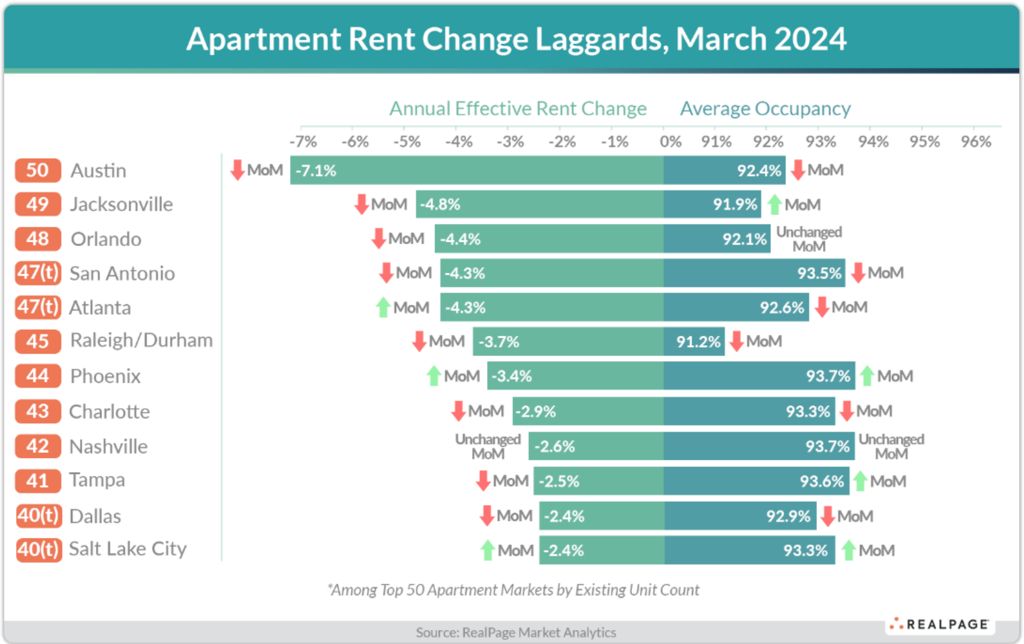
CLEARCAPITAL, LLC
THE UPSIDE OF REAL ESTATE



The bottom line is that apartment supply should drop substantially in the first part of 2025 and beyond, giving multifamily operators (and capital providers) greater (and badly needed) confidence. Meanwhile, according to Yardi, new supply will be largest in Austin, Nashville, Charlotte, Orlando, Raleigh, Phoenix, and Tampa.

Of course, not all markets are created or remain equal, so here is more granular, market-specific data:

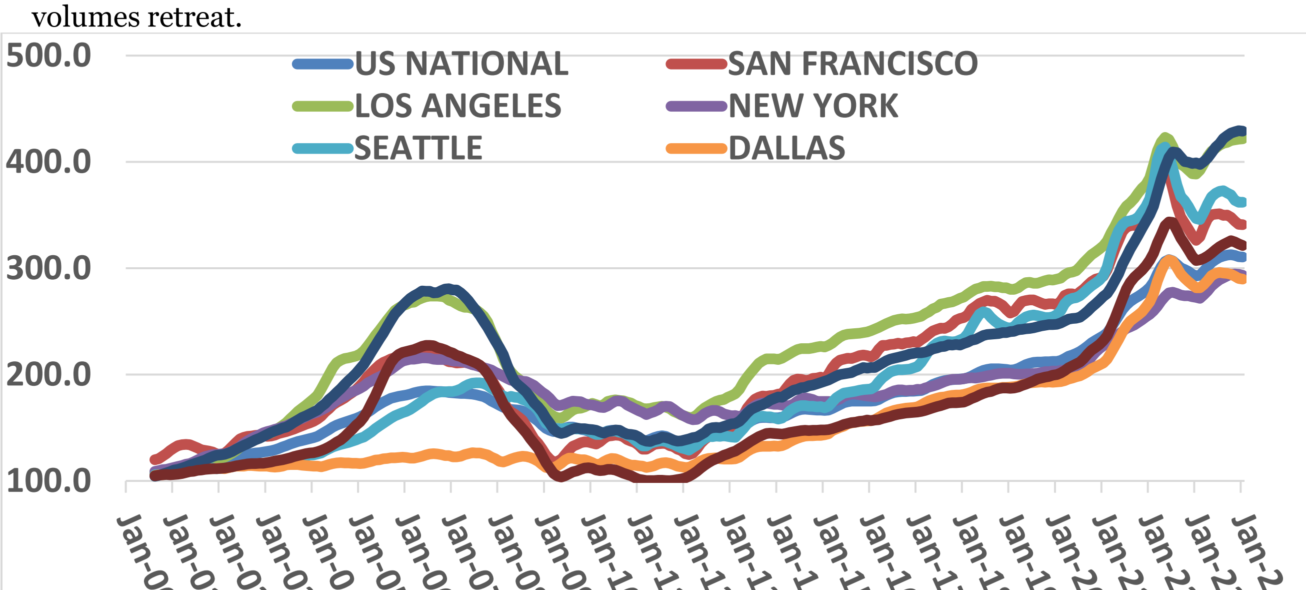




Perhaps it should come as no surprise that the softest markets in recent months are those that witnessed the largest rent increases between 2020 and 2021 and subsequently, significant increases in supply, while the strongest markets are those that have been mostly left behind in recent years. Of the ten markets with the strongest rental growth last month, seven are in the Midwest. Maybe my beloved Bruins, joining the Big 10 this coming year, know something.

Meantime, housing – both single- and multifamily – has never been less affordable, especially for the middle class.

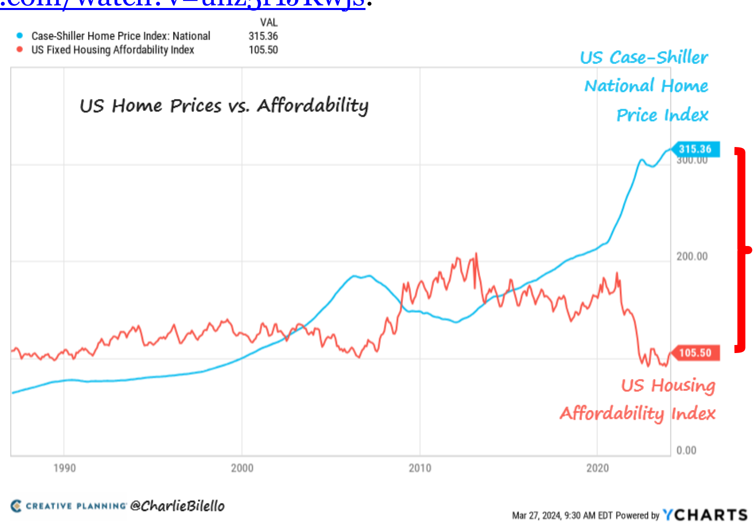
Overall, single-family home prices remain steady, across virtually all markets, while transaction volumes retreat.



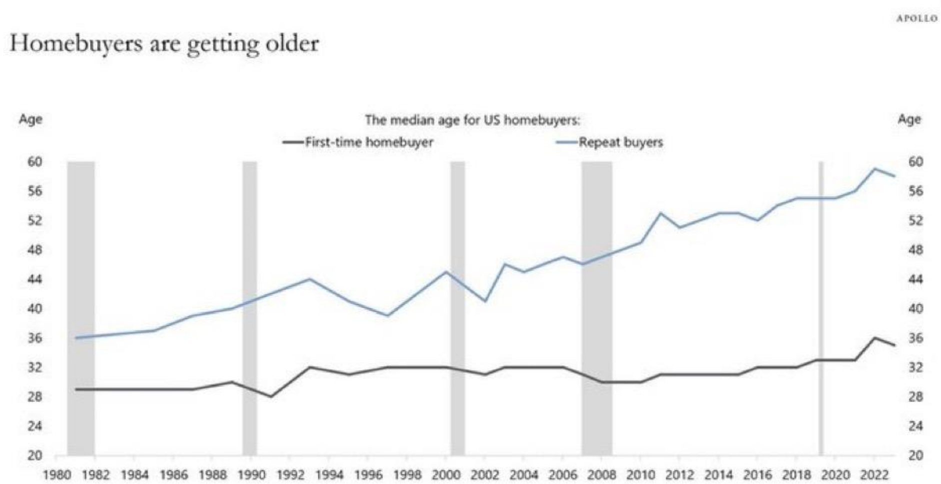
Source: Case-Shiller

The median existing-home sales price rose 4.8% from last March, to $393,500, the ninth consecutive month of year-over-year price increases, and the highest price ever for the month of March. Existing-home sales declined 4.3% in March from February and 3.7% from the prior year, likely the result of the recent spike in mortgage rates. The inventory of unsold existing homes increased 4.7% from February, the equivalent of 3.2 months' supply at current sales volumes.

Meanwhile, you want to know how bad the housing crisis is? I recently read a story about how some enterprising, and perhaps desperate, individuals are breaking into vacant houses, sometimes those listed and emptied for sale, and squatting, knowing that liberal tenant-friendly laws make evicting them no easy task. In response, desperate homeowners are hiring people to (and I kid you not) "out-squat the squatters." These folks sign short-term leases with the landlord, enter the residence, and create such a nuisance that the squatters decide to voluntarily pack up and leave, all recorded on YouTube for posterity, I guess: https://www.youtube.com/watch?v=uhz5r1JKwjs.



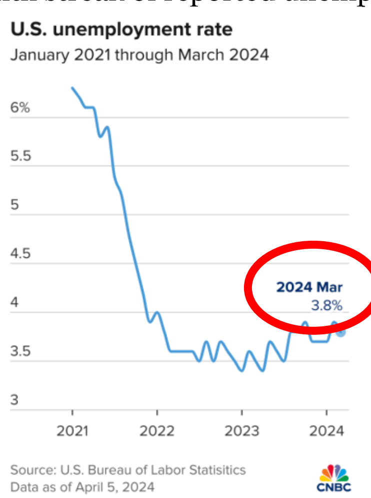
With the ever-widening gap in the cost of buying versus renting and the costs of homeownership continuing to rise, it cannot be any surprise many parents continue to subsidize adult children and that homebuyers – both first-time and repeat buyers – are getting older. I would be interested in knowing how many of you with grown children are still providing financial assistance to a grown child or a child that is older than you were when you became financially independent. I am not sure that an "empty nest" remains a thing, and perhaps the historical trend where children, once leaving home for college would leave the roost, never to return on any sort of long-term or even permanent basis, is over. Now, grown children not only willingly return to fill that empty nest, but do all they can to remain on the family cellphone plan and share streaming service passwords, something Netflix, Hulu, and HBO know all too well.

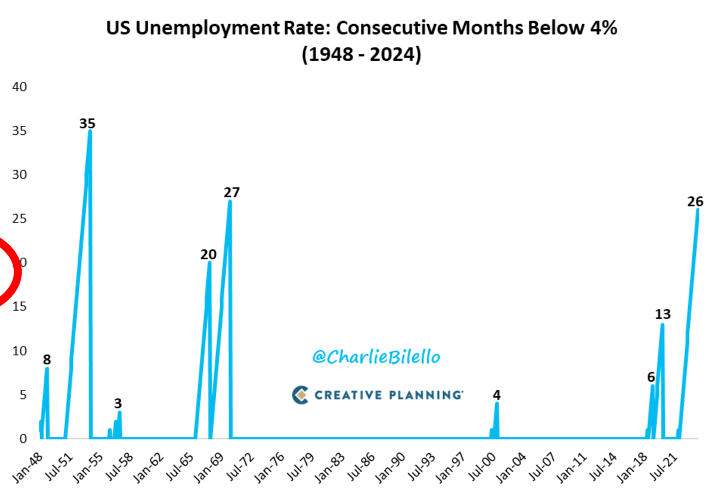


And in another related housing tidbits, the National Association of Realtors settled a series of lawsuits, eliminating its rules on commissions, ostensibly making it "easier" to negotiate commission rates on the sale of single-family homes from the traditional (and generally excessive) six percent figure. However, color me a skeptic, but what impact the settlement will have on commission rates and the housing market generally remains to be seen.

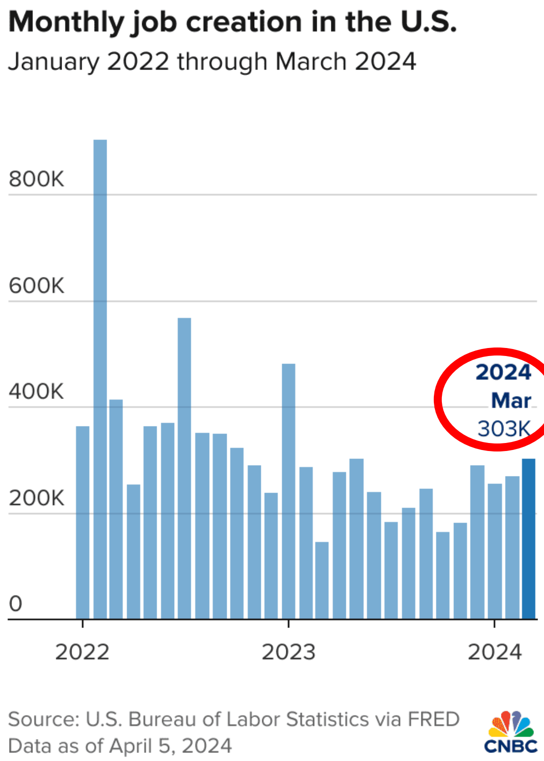
The Job Market Remains Tight, But Terribly Uneven

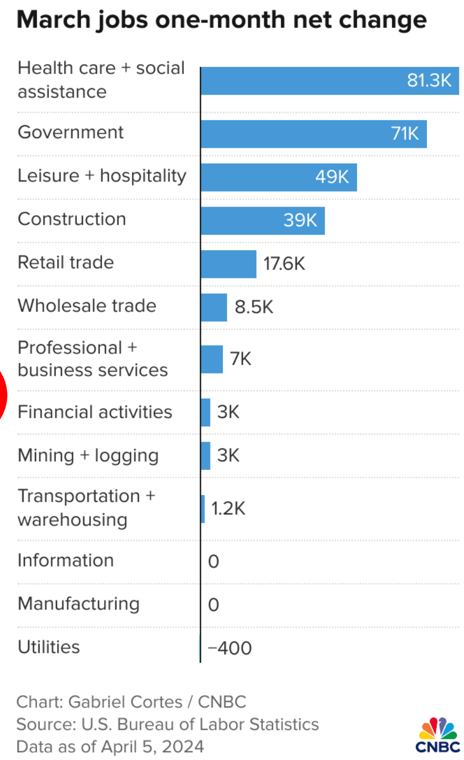
Top-line employment data speaks for itself. March's unemployment rate of 3.8% continued the 26-month streak of reported unemployment of less than 4.0%.





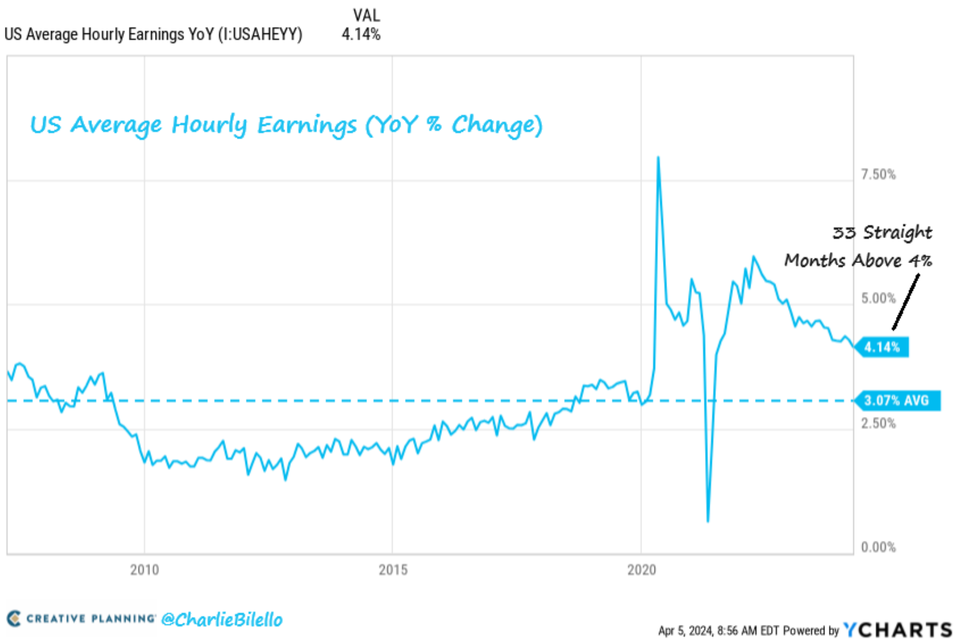
303,000 jobs were added in March, surpassing expectations (200,000), with most employment gains seen in health care, government, and hospitality/leisure.



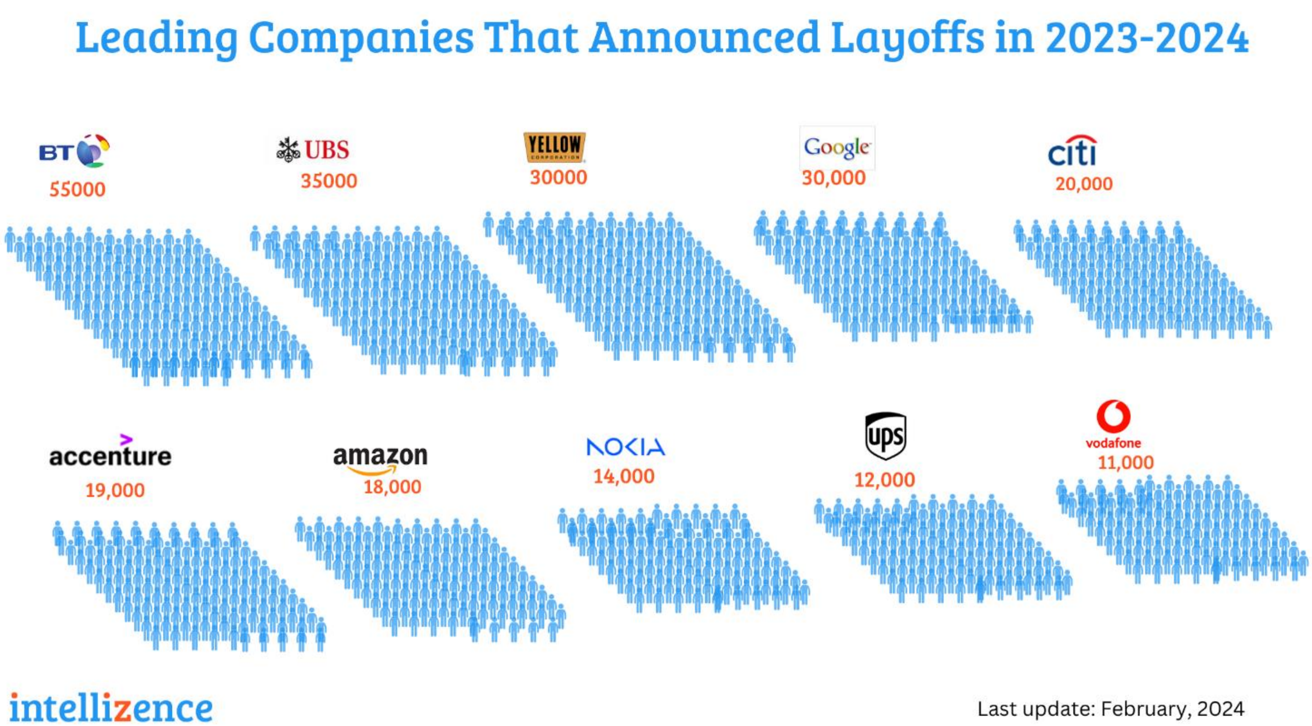


Anecdotally, I sense it is a bifurcated labor market. White-collar jobs are sluggish and hard to find…in banking, finance, real estate, consulting, and even technology. MBAs and law school graduates are finding tough sledding out there. Even those with MBAs from top schools have had difficulty landing jobs within three months of graduating, according to data from the schools themselves. A WSJ article from late January captured the sobering reality well: "Half of College Grads are Underemployed." I am not exactly sure what "underemployed" means, but I gather it means that a fair number of college graduates are serving us at Starbucks, schlepping us around in Ubers, or delivering food for GrubHub. Is it any wonder that so many young people are pessimistic about their futures and the direction of things generally? In early February, these two headlines appeared nearly side-by-side on the same day: "Wall Street Journal Shakes Up D.C. Bureau with Big Layoffs" and "Labor Market Grew 353,000 in January, Soaring Past Expectations."

So, how can we reconcile the seemingly contradictory employment data? Part of the answer comes from blue collar workers, who are finding far greater employment opportunities. In hospitality, leisure, restaurants, travel, entertainment, and construction. I believe that part of the robust demand for blue collar employees stems from our immigration debacle, where needed political will is so sorely lacking. Let's not kid ourselves. We need immigrants to fill certain jobs. Stemming the supply of such labor is not just inflationary, but also stymies economic growth and supply chains. This reality is reflected in U.S. average hourly earnings, which increased 4.1% in March, the 33rd consecutive month with year-over-year increases above 4.0%.

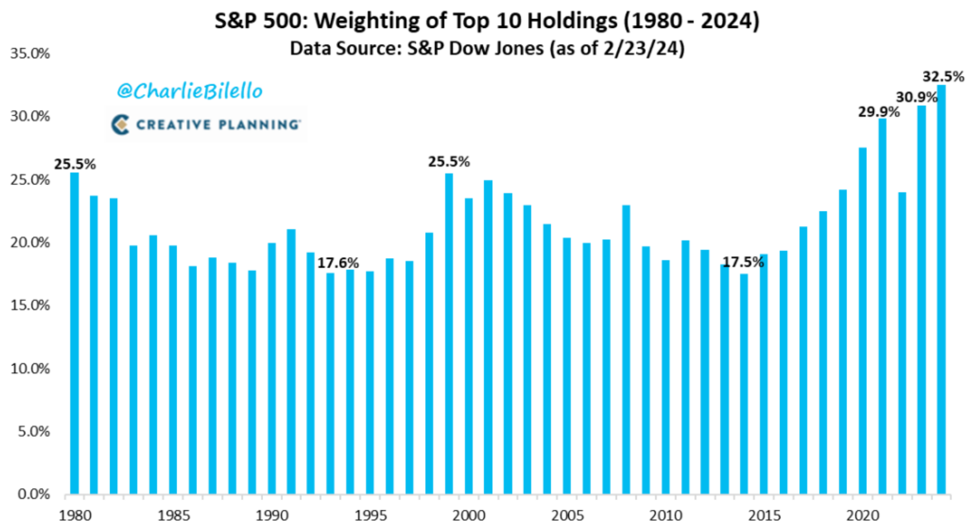


In other conflicting data, we are seeing increasing layoffs across numerous industries as we kick off 2024. In 2022 and 2023, there were over 300,000 layoffs, but they were almost exclusively technology related, as firms like Google, Amazon, and Microsoft reduced headcounts. Now, we are witnessing layoffs across a wider swath of companies. For example, UPS recently announced that it will cut 12,000 jobs after what its CEO called a "difficult and disappointing quarter." Over the last three months, layoffs have quickly spread to just about every industry.

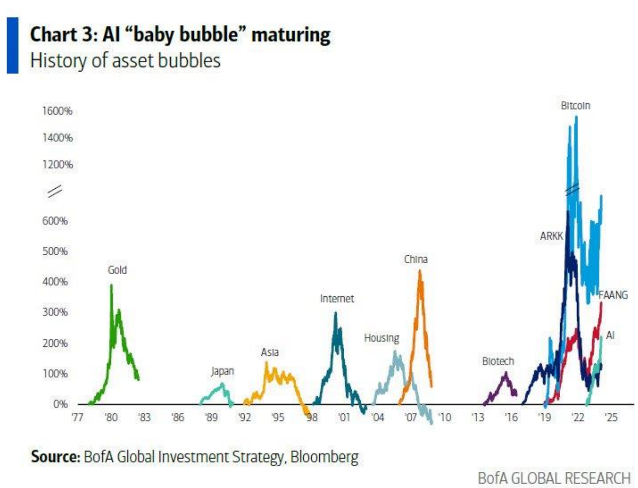


Equity markets enjoyed a remarkable first quarter, but have weakened more recently

Through the first quarter of 2024, the S&P 500 had not experienced a weekly drop of two percent or more since last October and only two weekly declines at all, while adding some $11 trillion in gross market capitalization. To put this in perspective, the market capitalization of China's entire stock market is about $11 trillion. But as I mentioned in my last update, the level of concentration is concerning, where a handful of stocks (e.g., FANG, the Significant Seven, the Fab Four) – Alphabet, Meta, Nvidia, Netflix – are principally driving returns. At present, the U.S. stock market is the most concentrated it has been since at least 1980, with the top ten holdings in the S&P 500 now representing nearly a third of the entire index.



Meanwhile, as mentioned above, anything and everything "A.I" was on fire, the latest equity market bubble, with stocks like Nvidia and Super Micro representing the poster children for the recent surge. But history tells us to be very wary of these sorts of trends…and last week's plunge in both of these stocks (Super Micro dropped 23% in a single day last week) offers yet another painful lesson about equity markets, fickle investors, and the risks associated with chasing trends and parabolic stock moves.

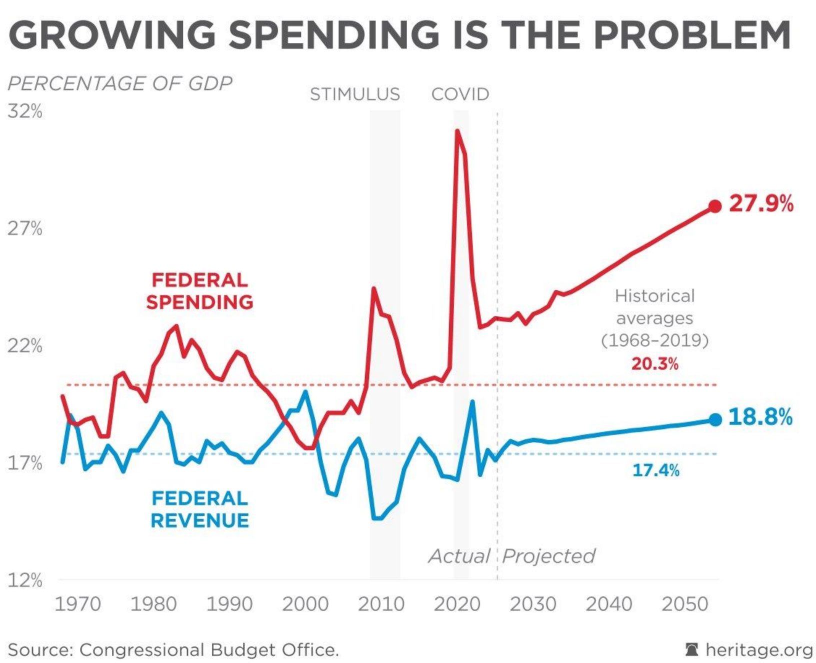


Finally, I will mention that the bond market continues to suffer in the wake of inflation and higher interest rates, suffering the longest bear market in history, with Bloomberg's U.S. Bond Index down for 44 straight months. Ouch.

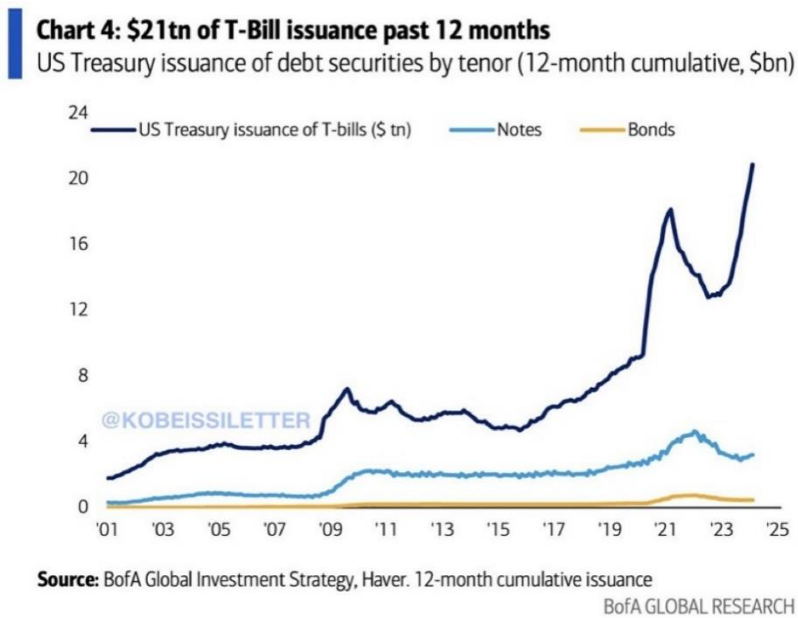
Bloomberg US Aggregate Bond Index: Longest Drawdowns (Monthly Data, 1976 - 2024)			
Start of Drawdown	End of Drawdown	# Months	Max Drawdown During Period (Monthly)
Aug-20	?	44	-17.2%
Jul-80	Oct-81	16	-9.0%
May-13	Apr-14	12	-3.7%
Aug-16	Jul-17	12	-3.3%
Feb-94	Jan-95	12	-5.1%
Mar-87	Nov-87	9	-4.9%
Aug-79	Apr-80	9	-12.7%
Apr-08	Nov-08	8	-3.8%
Feb-96	Sep-96	8	-3.2%
Jun-03	Nov-03	6	-3.6%
Feb-84	Jun-84	5	-4.9%
May-83	Aug-83	4	-3.5%
CREATIVE PLANNING	@CharlieBilello	(As of 3/31/24)	

While the U.S. consumer continues to borrow and spend, they have absolutely nothing on the U.S. government, who show us how it is really done

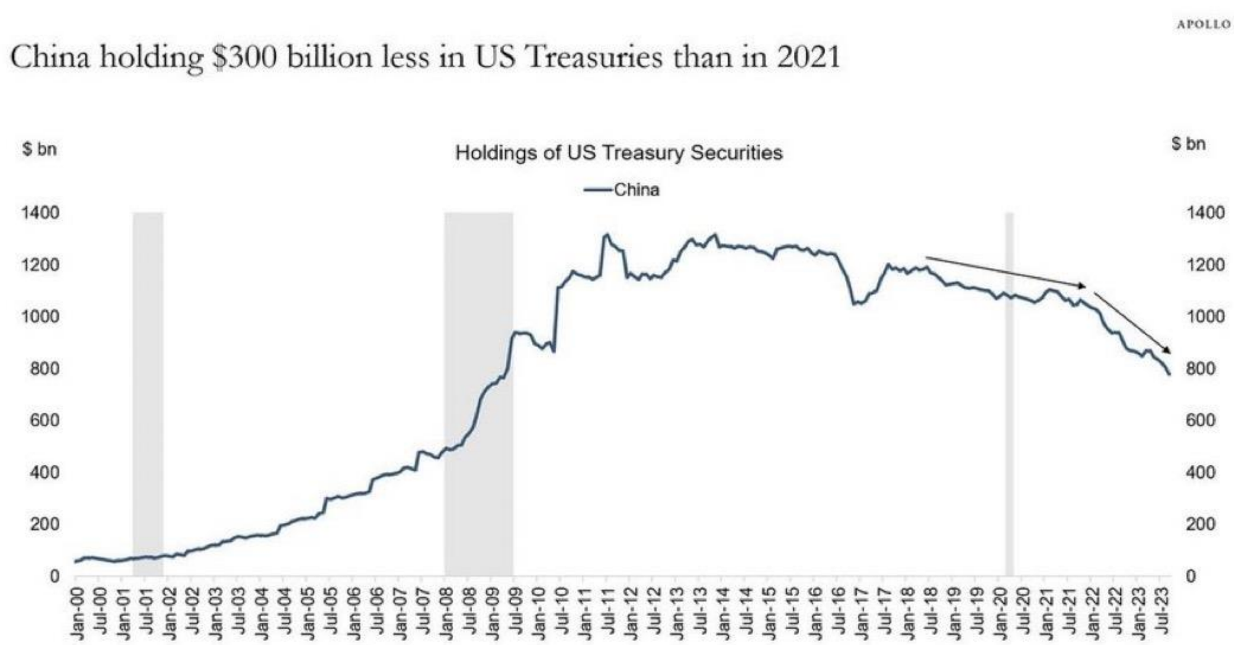
I honestly don't know when the levels of U.S. debt become problematic, but common sense tells us that at some point borrowing and spending reach a breaking point. At some point, Congress has to get its fiscal house in order, reducing spending and/or (gulp) increasing taxes.



At some point, will there be enough demand for the debt we issue? After all, in just the last year, our spendthrift ways have necessitated the mind-boggling issuance of $21 trillion of Treasury Bills. That is not a typo. $21 trillion, all yielding more than 5%.



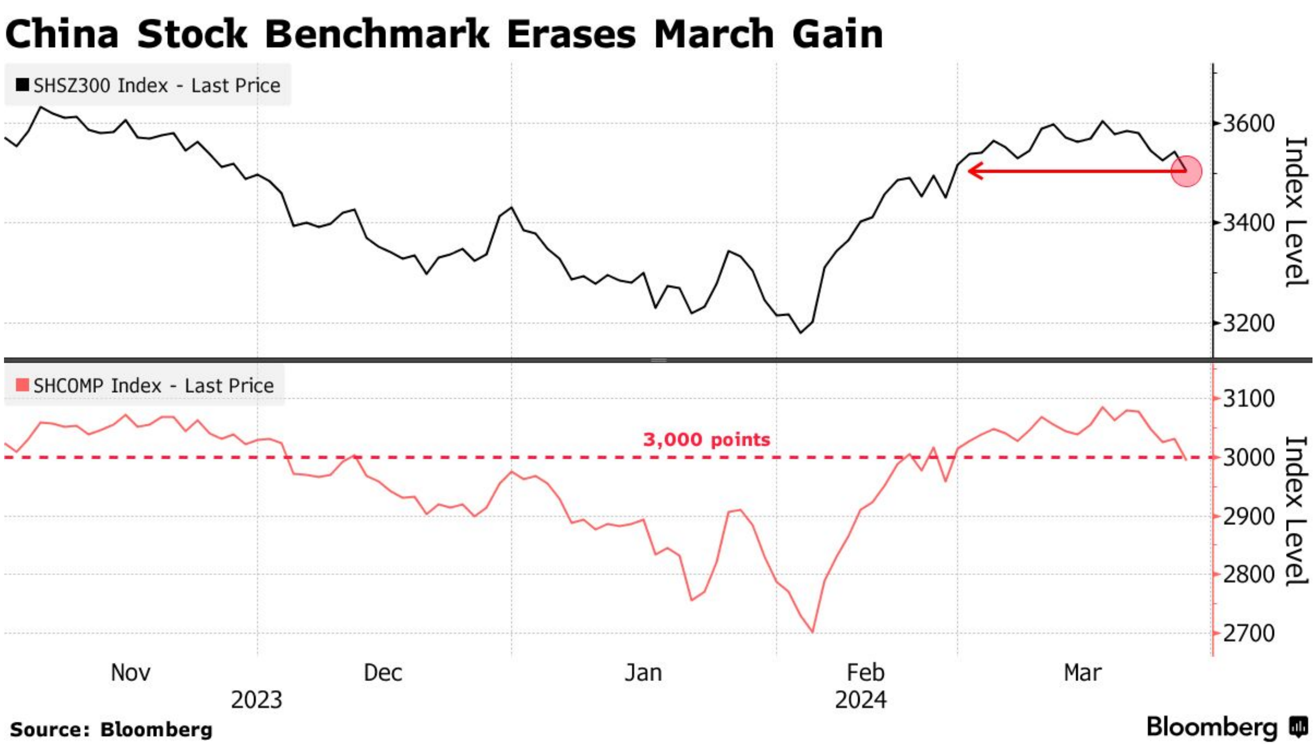
When does the market begin to choke on this increased volume of issuances? As I discussed in a memo last year, the Chinese, Saudis, and Japanese have reduced their Treasury Bond holdings of late, perhaps necessitating the need to issue shorter-term T-Bills. This deficit spending and borrowing also makes the Fed's job that much more difficult, as it seeks to lighten up its security holdings and its bloated balance sheet.

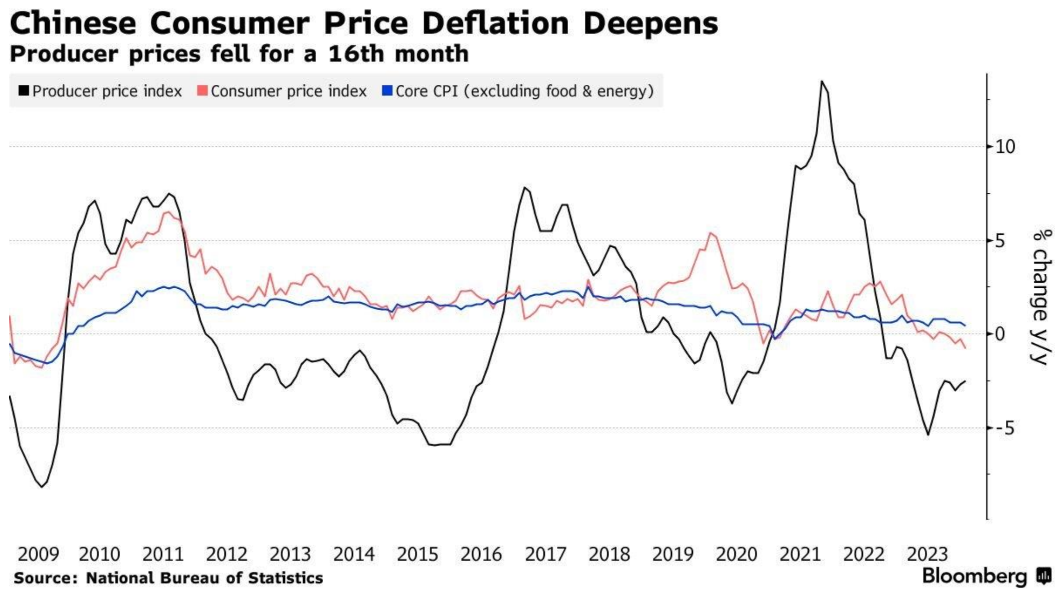


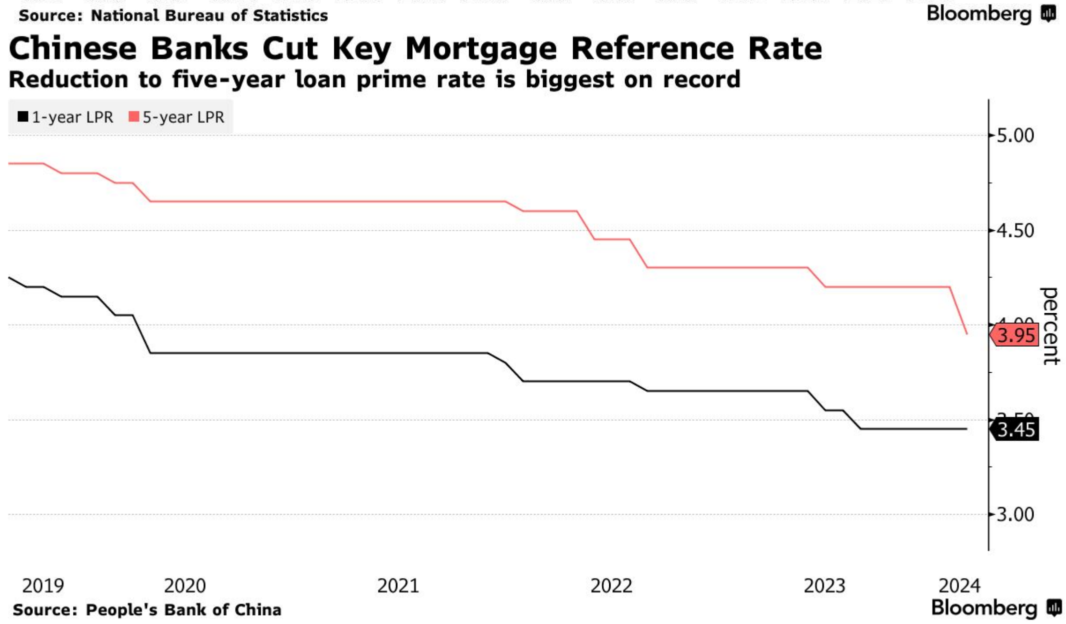
And finally, here are a few other newsworthy tidbits worth mentioning

- ***Increased Regulations:*** As I have mentioned repeatedly, it can come as no surprise that issues in housing affordability place extensive pressure on policy makers who feel they must "do something" in response, usually extending rent control, expanding tenant rights, and/or making evictions more difficult. Here in California, which leads the nation in these sorts of band-aid policies, the "Justice for Renters Act," set to appear on a California ballot near you, proposes to eliminate the statewide ban on rent control, allowing local governments to enact their own rent restrictions. I am sure that will go well and absolutely reduce rents broadly and improve the state's housing stock (#sarcasm). Meanwhile, the U.S. Supreme Court rejected another challenge out of New York regarding its extensive rent control/stabilization endeavors.

- ***China's Continued Struggles:*** When I was last in China (2017), all we heard was bullishness, that China's GDP would exceed that of the U.S. in time, as it expanded the old Silk Road, encouraged entrepreneurship and technology start-ups, and invested in infrastructure. However, under the adage that the "only constant is change," we see a very different China in 2024, characterized by an economic slowdown, deflation, a rapidly aging demographic, population declines, and several high-profile corporate failures (e.g., Evergrande, China's largest property developer, China Garden, Zhongzhi Enterprise Group). Three graphs from our friends at Bloomberg tell the story.







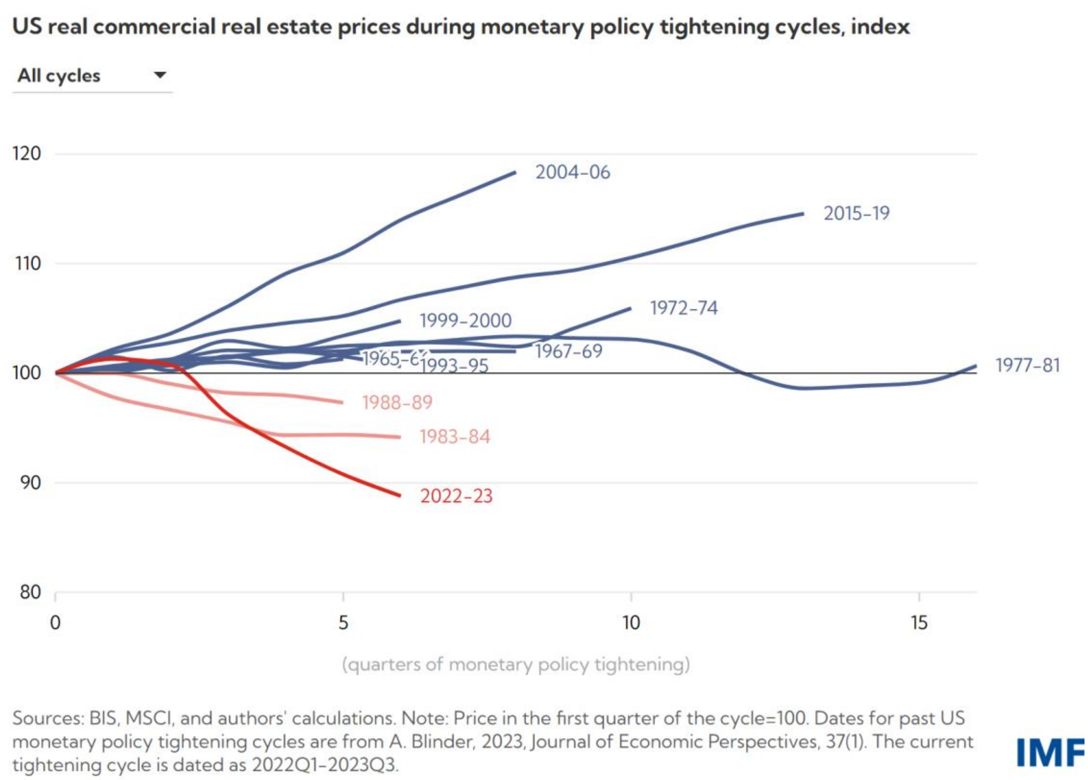
In short, China is hurting, though they are hardly alone. The EU is not faring much better, hobbled by challenges in Germany, Italy, and the U.K., and the ongoing Russia-Ukraine conflict.

- ***Japan's Noteworthy Comeback***: On December 29, 1989, a mere 35 years ago, Japan's benchmark Nikkei Index hit an all-time high of 38,915.87, before its bubble burst and Japan entered a multi decade-long slump, facing a myriad of familiar challenges, namely unfavorable demographics and significant competition from China and the rest of Southeast Asia. It took all those 35 years before the Nikkei was finally able to recapture that record high in February. At last glance, the Nikkei is up 17 percent since the start of the year.

In closing, the next year or two will be very challenging for commercial real estate and the markets, but brighter days lay ahead

In closing, the U.S. economy continues to surprise, a sort of Cinderella during March Madness, so to speak. Despite predictions of moderating economic growth, lower inflation, and reduced interest rates, the U.S. economy continues to hum along, experiencing enviable economic growth, which unfortunately comes with a dose of sticky inflation and higher interest rates. In fact, later this week, the U.S. will publish first quarter GDP data, and assuming the economy grew more than 2.0%, a foregone conclusion at this point, it would represent the seventh consecutive quarter of GDP growth in excess of 2.0%, the longest streak since 2003 to 2004.

However, commercial real estate is another story, and it will be a challenging trough, especially for those assets with floating-rate debt, which has been widely used by virtually all value-add sponsors and investors. That debt will need to be hedged until it matures, and at a significant cost. Once that debt matures, it will need to be extended or restructured unless interest rates drop significantly over the next year or two. There is simply no escaping this economic reality and once you consider the additional headwinds facing the industry, those unescapable "I's," the bear market will persist. This trend has occurred many times in history, all during periods when the Federal Reserve tightens monetary policy.



As detailed above, history indicates just how important it is to hang on, to make it through the tumult. Does that mean investors should meet capital calls? The only candid answer I can offer is "it depends." Is the call required or optional? Are investors penalized or diluted for not contributing capital? What return does any capital contributed via the call receive and in what preference? Are the sponsors putting in capital and if so, how much? What other support, financial or otherwise, has the sponsor provided to troubled assets? Has the sponsor executed on its business plan, notwithstanding the higher interest rates and other industry headwinds? How closely are they managing expenses and controllable costs? Answers to these questions should provide necessary guidance.

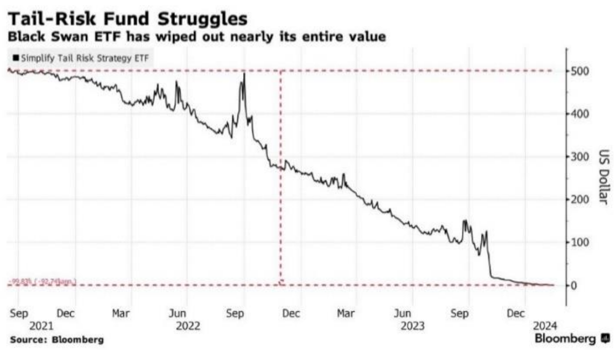
However, while I anticipate that the multifamily market will recover by 2026, if not earlier, predictions are not easy, as this single graph makes clear. Those that predicted that the U.S. economy would tank and invested in "Black Swan ETFs" have lost virtually everything. Talk about irony.

Black-Swan ETFs Are Facing Their Own Doomsday After a 99% Plunge

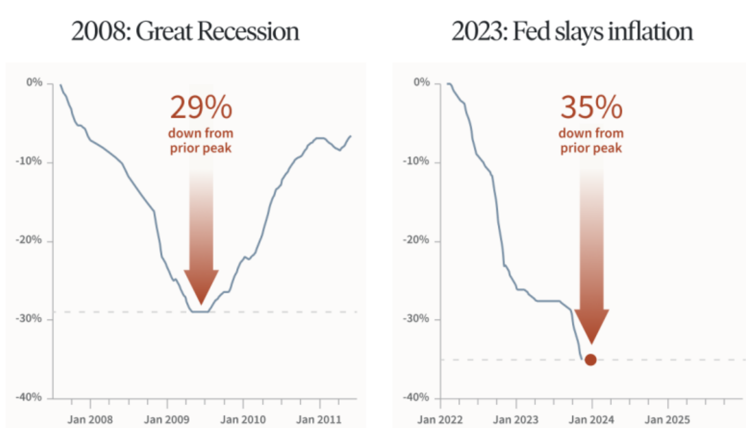
- Stock rebound deals hit to funds set up to profit on calamity
- Big losses pile up as economy, markets defy once-dour outlook

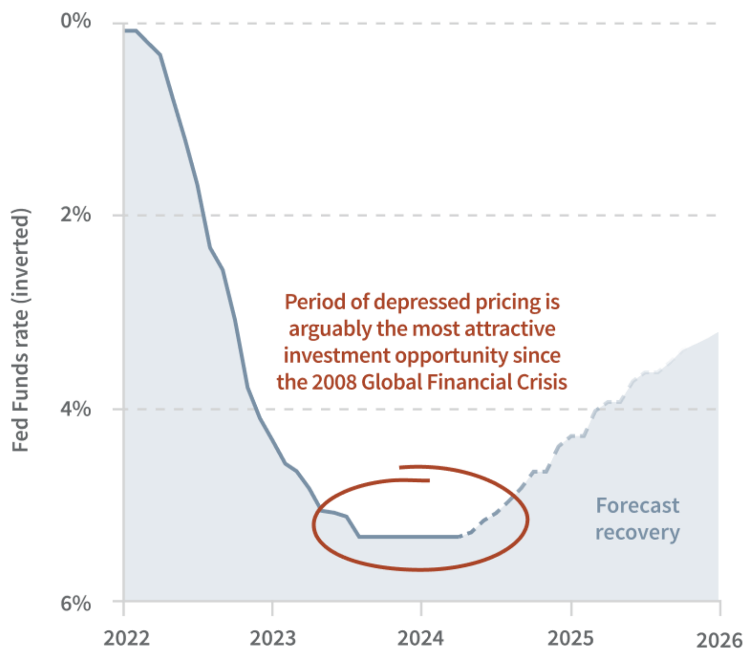
By Denitsa Tsekova

February 16, 2024 at 3:53 PM CST



A couple other data points give me hope and optimism. Just a couple of weeks ago, Blackstone announced that it is acquiring Apartment Income REIT in a $10 billion transaction, with plans to invest another $400 million in acquired assets, consisting of over 27,000 units in 10 states and the District of Columbia. The firm remains bullish on rental housing and is betting that we are at or near a cyclical bottom. As Blackstone CEO, Jonathan Grey, said, "We believe the best investments are made during times of uncertainty." Meantime, Green Street Advisors issued a report with a few telling graphs, which I present without comment.





With that, thank you for your ongoing support, for which I and the Clear Capital team remain appreciative and grateful. Please don't hesitate to reach out to anyone on our team, including yours truly, if you need anything or have any questions or comments.

Best,

Eric Sussman
Managing Partner