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## How short is the memory of the herd?

We are well into 2010 now. Clearly, we all want to forget how terrible last year has been and look into the future with confidence. There is however a eerie feeling that 'confidence' has been taken all too literally – at least in certain pockets of the European property market.

Agents' reports coming out week after week, heralding the recovery. CBRE's most recent pan-European report for the fourth quarter of 2009 quotes a 66% increase in transaction volume compared with the first quarter of the year. And it's not only the number – it's also the size of transactions. CBRE quotes that 24 'big ticket' transactions (over Euro 200m) took place in the second half of the year, compared with eight in the first half (for comparison: 62 such transactions took place at the top of the market – the 3$^{rd}$ quarter of 2007). Liquidity is coming back into the market and yields are coming down. As regards Central & Eastern Europe, activity is concentrating in Poland – perhaps the most resilient market of the region. It has yet to dawn on Eastern Europe.

Let's look at the London market –perhaps the 'barometer' of the European market which leads other markets. A West-end building has just changed hands at a yield of 4.2% while an office in the City is rumoured to be changing hands at sub-5.5%. Perhaps a more dramatic situation is observed in the listed market, where the last few months have generated a full cycle's growth! Is recovery so advanced? Are the boom days back?

Agents have tried to rationalise this behaviour using a number of arguments: the correction had gone too far..the pound is so cheap..there's no better investment alternative..Let's start from the cheap currency: the risk profile of a property is completely different to that of a deposit account. There are much safer ways to take advantage of an undervalued currency – so that's a flawed argument. By the way – other currencies in Europe depreciated even more but that didn't attract many to property. As regards the adage that 'correction has gone too far', the real metric is not 'what it used to cost vs. what it costs now' – it's 'what it costs now vs. what it will cost *tomorrow'.* And this is where it gets complicated.

The economic situation is lagging vastly behind the renewed investment confidence. The recovery of Europe's largest economy, Germany, has ground to a halt. The same concerns resonate in the UK, with growth coming much weaker than expected and confidence falling, accentuating fears that it was the stimulus measures that cranked the engine and their withdrawal might just topple the fragile recovery. New symbols are invoked to describe how the economy will look like, such as the square root and the 'Nike' swoosh –both indicating a long, flattish recovery phase with below-trend growth. The same culprits keeping the breaks on are still with us: jobless recovery, de-leveraging.

All in all, we see another detachment of the investment market from the fundamentals. Another bubble that is. The warning bells are already on. Could investors have such a short memory?

The latest ULI / PwC Emerging Trends survey quotes €35bn held in private vehicles, targeting prime property. Admittedly, this behaviour has so far been observed at the prime end of the market. But there's a real danger that this euphoria spills quickly to other, less prime parts of the market. How composed and disciplined will those 15-20 unsatisfied bidders per transaction remain? When there are 15 boys after a single girl at a party, it's impressive how standards drop if a second, not so attractive girl enters the room!

Sadly, the investment market seems once again to be running ahead of fundamentals. Confidence apart, everything seems to be working against property: the deleveraging of households, the deleveraging of banks -the sector as a whole is reducing its exposure to property –unemployment (which is directly related to vacancy rates) etc. A study by the McKinsey Global Institute last month was a timely reminder that in previous recessions, deleveraging lasted for up to six years, with the economy remaining in recession for two. As this downturn was much more severe for a long time, the impact will be more severe.

Defying gravity always ends up in tears. There's a real risk that as the impact of the above is felt progressively more, we could be seeing prices falling as the economies and the rental markets are recovering!

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