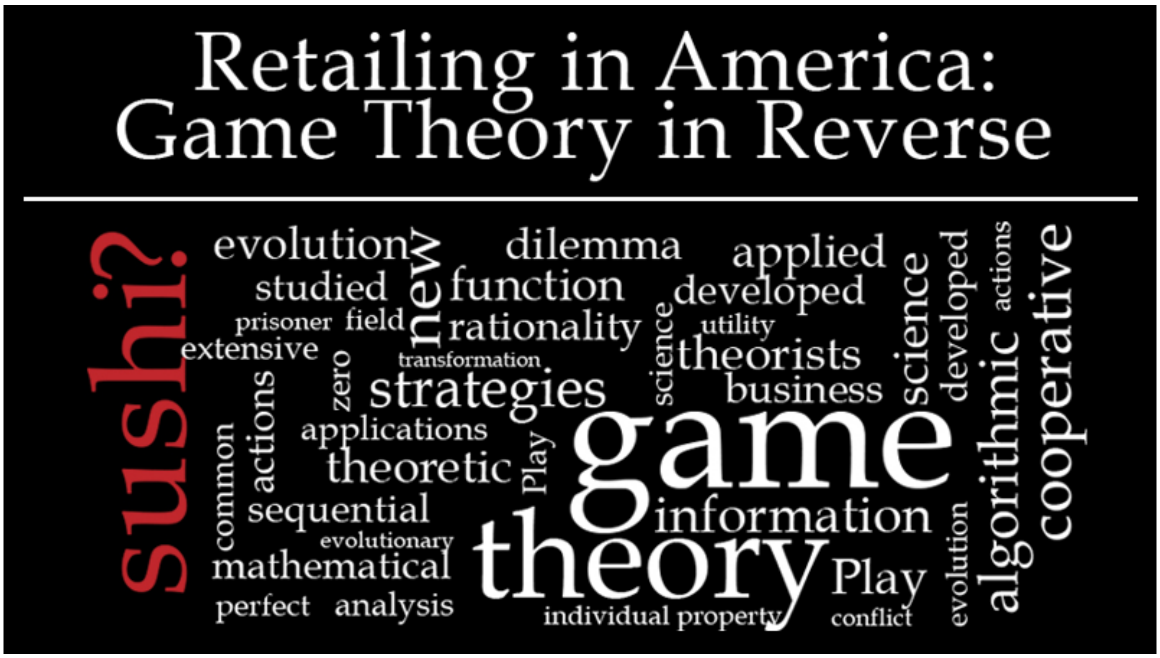

Toro, toro? Hankering for Hamachi?

Have an urge for uni? In Midtown? Well then, head west, to 8th Avenue to be precise. And keep walking, west that is. But go easy on the sake if you've got a sushi crawl in mind. No fewer than six fine purveyors of some of the best raw fish on the isle of Manhattan await you. Clearly the law of **game theory** applies to more than just clusters of gas stations.

Not sure you'd agree, but game theory made the study of economics engaging. The brain teaser's roots date back to the 1920s with the work of John von Neumann. His work culminated in a book he co-wrote with **Oskar Morgenstern** which delves into the oxymoronic theory in its most straightforward form – a 'zero-sum' game wherein the interests of two players are strictly opposed.

But it was **John Nash** who elevated the theory to fame. The eminent **Nash Equilibrium** added practicality to the theory and opened the door to nuance. The 'players' were numerous and shared both common interests and rivalries. Hence six sushi spots in one square block and a handful more a few steps in either direction.

But what happens when game theory hits reverse gear? Is such a thing possible? The answer may be coming soon to a mall near you, maybe even one with its theatre and Sears still standing. Huh?

Developed in 1973, Valley View Mall rose to be a retail darling on the 1980s Dallas shopping scene. Even its name worked well with an iconic mall-era film (Why **Valley Girl**, of course! **(Retailing in America: Valley Girl (Interrupted)** Foley's, Macy's Bloomingdale's anyone? All of these icons anchored Valley View at one point or another.

But that was then, in a pre-Amazon world, when people clearly got out more and discretionary spending was more discrete. In December 2016, the mall literally began to be bulldozed, albeit with two tenants still operating amidst the dust storm – Sears and AMC Theatres. On March 21st, the world learned that it could soon be just the theater left standing.

Though the Valley View Sears will still be open today from 11 am to 8 pm, odds are the retailer will not be with us in a year's time. On March 21st, Sears Holding Corporation submitted a filing with its regulators that it has "substantial doubt" it can continue as a "going concern."

Don't recall companies being charged with making their own death throes' announcements from your Accounting coursework? You are correct. Meet the new and improved U.S. accounting rules that have just come into effect for public companies reporting annual periods that ended after December 15, 2016, Sears included. The change shifted the onus to disclose from a given company's auditors to its management.

It was telling that the Sears news fell on the very same day discount retailer Payless announced it could soon file for bankruptcy protection. That same day, the less ubiquitous Bebe female fashion chain said it too was 'exploring strategic options,' typically code for that same ill-fated Chapter in the court system.

Did Sears strategically time its disclosure? Not in the least according to the retailer's **CFO Jason Hollar.** The day after the disastrous disclosure, he blogged out that the 'going concern' reference simply complied with regulators' requirements that investors be apprised of any risks looming over the horizon. Hollar went so far as to say that Sears is a, "viable business that can meet its financial and other obligations for the foreseeable future." Don't shoot the messenger, but selling Craftsman, the last valuable jewel in the once encrusted crown, certainly doesn't suggest that much of a 'future."

Unless, that is, the reassurances come down to **CEO Edward Lampert** trying his level best to play game theory in reverse. That would entail capitalizing on the dying chain's real estate holdings before the rest of the players on life support clue in to just how dire the situation will soon be across the full commercial real estate spectrum. Lampert does, after all, run a hedge fund that happens to be the retailer's second-largest shareholder. You would agree, the best managers excel at games.

One does have to marvel at the degree of denial among retailers when websites such as deadmalls.com actively track shuttering structures.

At the opposite end of the denial spectrum sits **Boston Fed President Eric Rosengren**, who is and has been publicly worried about an entirely different sort of challenge facing the real estate market.

It's no secret that apartment prices are soaring. Over the past year, prices have risen 11 percent, leading the broad market. While that increase may seem benign in and of itself, consider how the sector has fared over the course of the recovery: prices have recouped an eye-watering 240 percent of their peak-to-trough losses. In sharp contrast, retail has performed the worst; it's only recovered 96 percent of its losses.

Rosengren is rightly worried that the "sharp" increase in apartment prices could catalyze financial instability. He went on to say that, "Because real estate holdings are widespread, and the monetary and macro-prudential tools for handling valuation concerns are somewhat limited, I believe we must acknowledge that the commercial real estate sector has the potential to amplify whatever problems may emerge when we at some point face an economic downturn."

If you would indulge a translation: The bubble in commercial real estate (CRE) could trigger systemic risk, which of course, no central bank can contain.

The 'macro-prudential' tools to which Rosengren refers include rules and caps on banks' exposure to CRE. Odds are, however, that the horse has already fled the barn. Over the past five years, CRE lending has been running at roughly double economic growth, a dangerous dynamic. The result: banks' exposure to CRE has reached record levels. Last year alone, bank holdings of CRE and multifamily mortgages rose nine and 12 percent, respectively.

More worrisome yet is that the most concentrated cohort – those with more than 300 percent of their risk-based capital at risk – is banks with less than $50 billion in assets; most have assets south of $10 billion. How exactly will small banks confront a systemic risk conflagration? That pesky potential presumably is what's robbing Rosengren of sleep at night. He might just remember that small German lenders called Landesbanks were where subprime bombs detonated unexpectedly way back when.

Beginning to connect the dots? All of this lending has led to massive amounts of building. After troughing at an annualized rate of 82,000 units in late 2009, multifamily starts hit a 387,000-annualized rate last year – a neat 372 percent rebound. Permits data suggest 2017 will push an equal number of units onto the market while 2018 looks to be about three percent below these lofty decade-high levels. There are similar supply stories in the hotel sector, which has led to the beginning of the end for lodging. Indeed, prices across the full CRE market have begun to fall for the first time since 2009.

Take all of these moving pieces into account and ask yourself, is it any wonder retailers are rushing the exits, all but falling over one another to accelerate announcements of thousands of store closures? As ugly as the situation is today, if widespread panic promises to present itself, prospects for retailers will get that much nastier. Demolition specialists will soon forget what it was to have down time and headlines screaming about malls sold for $1 will lose their novelty.

Is Sears' Lampert craftily capitalizing on a trend he saw coming first, giving new meaning to 'first mover advantage'? Is retail on the receiving end of reverse game theory? John Nash would be so proud.