LA FRANÇAISE FORUM SECURITIES

Market & Strategy Update

June 2017 – By Jana Sehnalova, Portfolio Manager

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Dear Investors and Prospects,

Five months into the year, now is a good time to reflect on the performance of the global real estate securities sector, and to provide you with an update on our product development and market outlook.

How would we sum up the current macroeconomic environment?

From a **macroeconomic perspective**, the world is gradually improving; public markets have fared well under Mr. Trump, a trend that should continue. However, one should note that the world has been feeling somewhat complacent recently and that markets do not necessarily provide for a margin of error on either the macroeconomic or geopolitical front. Currently, U.S. government yields are lower than they were when Mr. Trump entered into office. His reforms have yet to be negotiated or approved by the House and the Senate. Markets may have priced in the optimism associated with these reforms; without these reforms, reality could come short of expectations priced in by equity market valuations. While equity markets rallied, real estate securities markets lagged, despite falling rates. The EUR has been strengthening whereas the USD has been weakening.

While we have seen increased geopolitical tensions – in Syria and North Korea – these events have had little, if any, impact on the market. Volatility is hovering around all-time lows, supporting the complacency argument mentioned earlier. The monetary policy toolbox is running out of options and the current U.S. administration is very focused on moving the world out of a zero nominal / negative real interest rate context. The consensus expectation is for two interest rate hikes in the U.S. in the remainder of 2017, with the first one likely to occur in June 2017. The major central banks (U.S., European and Japanese) are expected to announce tapering of their monetary policies. There is still uncertainty about when by how much and how exactly this will impact bond yields. Clearly, the focus is shifting from monetary to fiscal policy, as the next driver of global growth and of potential market volatility.

Market Performance in EUR

	Global Real Estate Securities (RNGL Index)	Global Equities (MSERWI Index)	Global Bonds (GMXAG Index)	Global Hedge Fund Index (HFRXGLE Index)
Year to Date 2017 (in EUR)	(1.4%)	2.6%	(2.4%)	1.4%
Volatility (annualized)	9.6%	9.1%	5.3%	2.5%

As at May 24, 2017. Past performance does not guarantee future results.
Source: Bloomberg daily data in EUR

Market Performance in USD

	Global Real Estate Securities (RUGL Index)	Global Equities (NDDUWI Index)	Global Bonds (GMUAG Index)	Global Hedge Fund Index (HFRXGL Index)
Year to Date 2017 (in USD)	4.5%	9.8%	4.4%	2.2%
Volatility (annualized)	8.2%	6.4%	6.0%	2.5%

As at May 24, 2017. Past performance does not guarantee future results.
Source: Bloomberg daily data in USD

How has the activity been in the public real estate space?

A few examples and anecdotes from public & private real estate markets around the world:

- We have just seen historically high prices paid for land by Henderson Land in Hong Kong and a Chinese consortium in Singapore in the past few days; increasingly, there is a feeling that the residential market in Singapore could be near a bottom after 4 years of decline.
- In Hong Kong and China, governments are intervening in order to control the markets and prevent price escalations beyond the current levels.
- Residential prices in Toronto, Vancouver, Sydney, Melbourne, Shanghai, Paris and Munich are through the roof, questioning sustainability and affordability.
- Foreign capital, in particular Chinese, has been very active in purchasing overseas commercial assets, in major gateway cities.
- Cap rates are low by historical standards and so are interest rates.
- Supply is largely under control due to the lack of availability of speculative development financing. The wild card is the changing nature of demand across the majority of the real estate sector and the impact of disruptive technologies on the future form, shape and structure of demand.
- Bankruptcies in the retail space have been omnipresent, in particular in fashion and household goods. The department store concept is proving more obsolete day by day; fashion retailers are being replaced by life-style concepts. The U.S. retail space has been under a lot of pressure, leading to tarnished valuations for mall and strip center owners.
- On the other hand, disruptive technologies seem to have had an ongoing positive effect on industrial demand and the demand for co-working / flexible workspace (i.e. WeWork model and similar). Industrial companies around the world have witnessed a significant structural change in cap rates (where often industrial cap rates are below the level of retail cap rates and rental growth is superior to the one achieved in either office or retail).
- Access to capital is abundant - in the private real estate market it is currently easier to raise capital than to place it. While we are witnessing the selling of non-core assets by listed companies, a few companies have been actively promoting themselves as net sellers
- The market has not been complacent on the M&A front either: Vonovia in Germany has been focused on the completion of the takeover of Conwert. In the U.S. healthcare sector, Sabra is attempting to acquire Capital Care Properties, and, in the U.S. hotel space, FelCor Lodging Trust is considering a sale. In Australia, Cromwell has been attempting to merge with IOF. In Japan, we keep hearing about potential announcements on corporate share buy-backs as developers are now trading at 50% discount to NAV and represent the cheapest value

proposition globally. The press has also been spreading the news that Japan Post would like to acquire Nomura Real Estate Holdings. This could potentially also improve the pipeline of assets for Nomura Real Estate Master Fund J-REIT, should such change in sponsorship materialize. Lonestar is attempting to privatize Saizen REIT, listed in Singapore. Some of the J-REITs have been merging and given the decline in valuation and the emergence of discounts among the smaller cap, less well run J-REITs, we could see further corporate action. Sabana REIT in Singapore is attempting to restructure and internalize its management. Global Logistics Properties in Singapore is looking for a strategic partner to help unlock value for shareholders. Kennedy Wilson has announced the privatization of its European listed entity. A few new IPOs have occurred – a $6 Bn IPO of Invitation Homes, a single family residential rental business in the U.S., and Neinor Homes, the first public entry in the homebuilding market after the crisis in Spain. Hispania REIT, a successful hotel REIT in Spain, has announced its liquidation in lieu and place of a change from an externally managed structure to an internally managed structure.

- As far as corporate balance sheets are concerned, corporates have been renegotiating their debt structure, extending tenure and bringing down their cost of capital. The overall level of indebtedness in the system today is significantly lower (and less risky) than in the period prior to the Global Financial crisis.

- As far as the evolution of REITs regimes is concerned, REITs legislation has been approved in India in 2017, paving the way for infrastructure vehicles and real estate commercial trusts in particular. The same debate is ongoing in China, where the government is attempting to create an infrastructure REITs legislation. Potentially, we could see infrastructure REITs also emerge in Belgium and the U.S. Infrastructure remains the next focus for us and an area where we would want to play a role.

Market Performance by Country

Country	2016 performance (EUR)	2016 performance (USD)	YTD 2017 performance (EUR)	YTD 2017 performance (USD)
United States	9.7%	7.6%	(5.7%)	0.0%
Canada	23.4%	21.3%	(2.4%)	3.4%
United Kingdom	(20.8%)	(23.4%)	4.7%	11.0%
Western Europe	1.2%	1.0%	7.9%	14.3%
Japan – Developers	(2.4%)	(5.3%)	(4.0%)	(1.5%)
Japan REITs	17.5%	14.0%	(7.1%)	1.8%
Hong Kong – Developers	7.1%	3.9%	13.7%	20.5%
Hong Kong REITs	17.2%	13.8%	9.5%	16.1%
Singapore – Developers	(6.9%)	(9.6%)	18.3%	25.4%
Singapore REITs	11.0%	7.8%	12.3%	19.0%
Australia	7.3%	13.4%	(2.8%)	3.1%
Global Real Estate Securities	**8.1%**	**5.0%**	**(1.3%)**	**4.6%**

As at May 24, 2017. Past performance does not guarantee future results.
Source: La Française Forum Securities Research, Bloomberg.

Good Entry Point?

Real estate securities, as an asset class, have seen outflows this year and have lagged behind general equities when considered on a global level. The sector is currently trading at a discount of ca 9% and at a PE ratio of 16x, which is about 10% below its historical average. In other words, with a few exceptions, the public market is currently offering a cheaper entry to real estate than the private market. The dividend yield of 4.0% gross p.a. on the global benchmark is interesting when compared to other alternatives with similar credit profile.

The most commonly asked question is – are higher interest rates going to hurt real estate performance? Should we be entering into the asset class at this point?

A negative correlation to interest rates is typically a short-term phenomenon. We tend to see this correlation 3-6 months prior to interest rates hikes, leading typically to around 5-15% declines in performance. However, at the moment of the hike itself, we tend to see a relief rally. An important cause of this behavior is economic growth: if rates are rising, because markets are seeing a recovery, this economic growth rate is likely to have a positive impact on the top line of real estate companies through higher rents, thus offsetting any negative impact of higher interest rates. The mid to long-term correlation to interest rates tends to oscillate around zero, thus making the performance of the asset class less dependent on the level / movement of headline interest rates. A particularly risky situation would be one in which inflation and interest rates rise, unaccompanied by higher economic growth. This scenario would most likely lead to negative asset repricing.

We believe that the recent volatility and polarization amongst sectors is creating a good repositioning opportunity and/or entry opportunity for the real estate securities sector. Should the current phase of complacency lead to more volatility, this could be used as an entry point or an opportunity for portfolio repositioning.

Current Valuation Estimates

Country	Premium (Discount) to NAV (historical)	Price-to-Book (P/BV)	Current Price-to-CF Ratio
United States	(4.1%)	2.3	15.5
Canada	(4.8%)	1.1	15.1
United Kingdom	(14.6%)	0.9	24.5
Western Europe	(0.1%)	1.2	20.8
Japan – Developers	(45.4%)	1.4	18.3
Japan REITs	16.2%	1.5	14.8
Hong Kong – Developers	(30.6%)	0.7	9.7
Hong Kong REITs	(8.6%)	0.9	23.0
Singapore – Developers	(12.6%)	0.9	7.3
Singapore REITs	5.7%	1.0	17.2
Australia	(2.0%)	1.3	18.0
Global Real Estate Securities	**(8.9%)**	**1.5**	**15.6**

As at April 28, 2017. Based on current market conditions and subject to change without notice.
Source: La Francaise Forum Securities Research, Bloomberg, UBS.

What themes are we pursuing today?

Despite the recent re-rating in Europe, we still see investment opportunities in European real estate securities, backed by high single digit expected returns. The focus is on the ownership of specific stocks, with currently a preference for Continental Europe and thereafter the UK.

In Asia, we see deep value opportunities in Japanese developers. We are less bullish on Japanese REITs in the absence of growth and in light of the diminishing purchases of J-REITs by the Bank of Japan. HK/SG REITs are still well positioned to deliver above average yields with valuations in neutral territory. The Australian REITs market currently appears to be more expensive and to have limited opportunities for immediate capital deployment.

For a period of time, we have been quite negative on valuations in the U.S.; this has now changed, in particular in sectors like malls/strips/storage. We are looking for high quality companies in these sectors to include in the portfolio and we have started to reduce our underweight to this market. We still like selective exposure in Canada given its strong yield support and an economy free of immediate interest rate changes.

Currently, we are less active in emerging markets, with the exception of the Mexican logistics sector. Globally, we struggle to find value in logistics as the sector seems priced to perfection. Deep value opportunities are emerging in global retail, in particular in the U.S.

Current Valuation Estimates

Country	Dividend yield (gross p.a.)	10-year sovereign yield	Spread (basis points)	Expected returns
United States	4.2%	2.3%	190	7.6%
Canada	5.4%	1.6%	380	4.9%
United Kingdom	3.5%	1.1%	240	3.9%
Western Europe	3.6%	0.3%	330	9.1%
Japan	2.4%	0.0%	240	5.4%
Hong Kong	3.3%	1.5%	180	12.2%
Singapore	4.0%	2.1%	190	4.8%
Australia	4.5%	2.6%	190	3.6%
Global Real Estate Securities	**3.9%**	**1.4%**	**250**	**6.4%**

As at April 28, 2017. Based on current market conditions and subject to change without notice.
Source: La Francaise Forum Securities Research, Bloomberg, UBS.

What types of strategies?

During the past 5 months, we have extended our strategy range in order to address the diversity of client demand in the real estate space. Investors have asked for a skillset that we possess with La Française Group and that we have been developing for some time.

Long-Only Strategies

Our current strategies include long-only real estate portfolios (be it diversified ones or portfolios focused on higher income generation on a global basis). Such strategies tend to deliver above average risk adjusted returns when compared to the benchmark, as a result of concentration, stock selection and, in the case of income portfolios, robust yields (above 5% p.a. dividend yield on gross basis). Long-only strategies tend to provide access to the asset class, exhibit double digit volatility and offer liquid access to real estate.

Volatility Controlled Strategies

Volatility controlled strategies have been developed in order to manage the volatility of the asset class while still participating in the strategy's upside. Such volatility reduction can be done in two ways:

- Deployment of hedging instruments in the portfolio (options, real estate basket shorts, currency hedging, cash management) in order to lower volatility, within the single digit territory
- Combination of equity and listed debt instruments issued by publicly listed companies in order to lower volatility and enhance diversification

We offer clients either a global volatility controlled solution or a European equity/debt real estate allocation, which can be used as a listed liquid bucket within private equity real estate funds.

Sharia Strategies

We have undertaken significant research and worked jointly with other counterparties in order to launch a real estate securities global strategy for the Middle East and South East Asia. These markets are showing a growing demand for sharia strategies, and we believe that there is a market opportunity waiting to be filled. We would like to introduce this strategy to the market in the second half of 2017. Sharia strategies are typically invested in halal activities and their leverage is limited to a maximum of 1/3.

Green / Sustainable Strategies

The strength of the franchise that La Française Group has built is demonstrated by its ability to develop and launch new innovative strategies that call upon a broader collective knowledge and experience in order to address new client' preferences and demand. In Europe in particular, we have identified a growing demand for sustainable / ESG strategies. This demand is not exclusively driven by institutional commitments to sustainability but also by the new preferences of retail/private banking clients in some European countries. This is associated with greater global awareness and willingness to make a difference. Jointly with Inflection Point Capital Management (IPCM), a subsidiary of La Française Group, and with the support of La Française Group and its shareholders, we are introducing a green real estate securities strategy to the market. This offering is qualitatively focused on the ownership of companies with high ESG scoring (undertaken by IPCM) backed by above average risk adjusted returns (selected on the basis of company analysis of risk and return undertaken by La Française Forum Securities). The thesis behind this strategy offer is based on the back test evidence that companies with high ESG scores tend to generate strong environmental dividends in the form of stronger performance.

Conclusion

In summary, we consider that real estate securities should continue to form part of portfolio allocations, even today, in times of potentially rising interest rates. Access to the best in class public, liquid real estate is not replicable in private real estate markets. The movement of share prices offers the opportunity to exploit pricing inefficiency and to seek allocation to the asset class. We continue to work with clients and prospects to best meet their demand via investments in funds or mandates where individual preferences can be best addressed via a tailored approach. The asset class offers high single digit returns, and the polarization in performance has generated new investment ideas and rotation opportunities, in particular geared towards Continental Europe, the U.S., Japanese developers and selected global REITs. With our skill set and knowledge, we want to make a difference to your portfolios, as well as the world of public real estate securities investing.

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