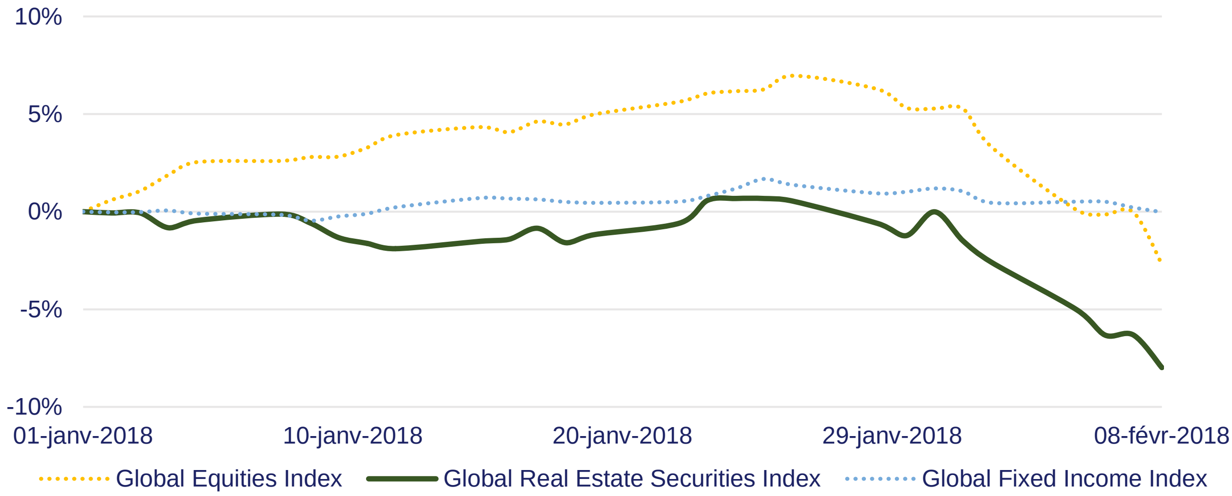
GLOBAL REAL ESTATE SECURITIES MARKETS IN TIMES OF TRADE WAR – CURSE, BLESSING OR SCAPEGOAT?

January 2019 – by Jana Sehnalova, CEO of La Francaise Forum Securities

Around this time in 2018, global real estate securities markets were under serious, short-term pressure, ahead of a series of consecutive interest rate hikes that were expected to occur throughout 2018 and potentially 2019. The anticipatory nature of public markets led to a quick market correction, albeit only in the public domain, resulting in a double-digit gap in valuation as measured by discount to net asset value in comparison to private market valuations. Pricing in the private real estate markets did not adjust for such a risk and remained steady. Publicly traded global real estate markets were thus down sharply, around -8-10%, with the US leading the way in the first two months of 2018. Real estate markets globally screened as one of the worst performing asset classes at that time.

Comparative performance between asset classes January – February 2018

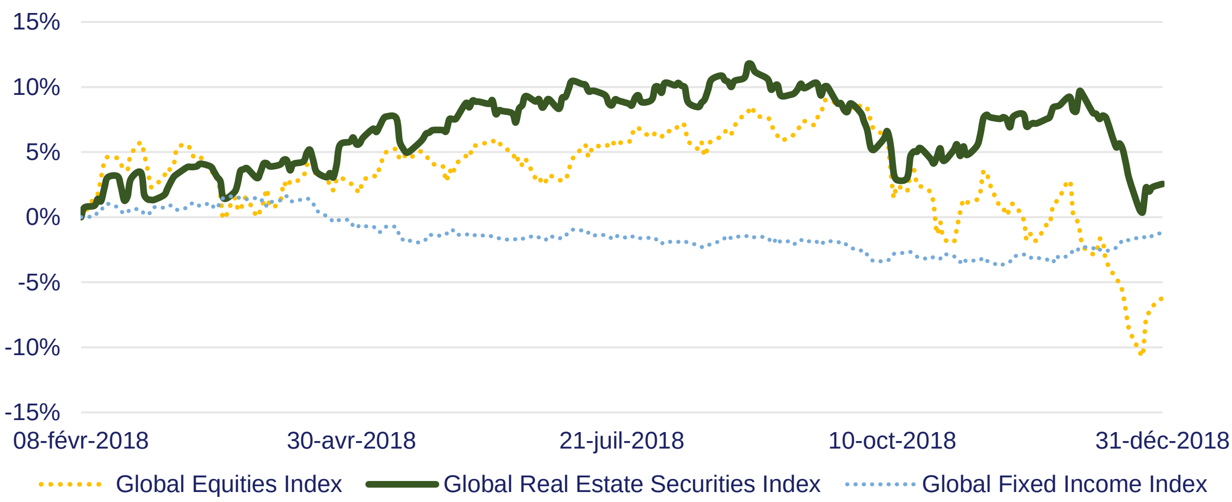


Sources: La Française Forum Securities, Bloomberg
Global Real Estate Securities Index = FTSE EPRA NAREIT Global Developed Index (TRNGLU Index in USD);
Global Equities Index = MSCI World Total return index (NDDUWI Index in USD);
Global Fixed Income Index = Bloomberg Barclays Global Aggregate Index (LEGATRUU Index in USD)

We have cautioned that such severe moves are not unusual in the public real estate domain. However, we added that similar movements in previous years have not derailed the asset class. We also noted that such moments in the cycle were opportune to continue building up exposure to the asset class, in particular when a notable gap exists between the valuation of real estate equities and general equities, as well as public real estate and private real estate markets.

Needless to say, headlines were shortly thereafter dominated by another important theme in 2018: the trade war between the USA and China. Protectionism and the destructive potential of global trade altered the thinking and moods in capital markets starting in early March 2018. The trade war started to be perceived as more detrimental to other global equities sectors exposed to global supply chains, rather than to locally defined property markets. Even though real estate securities markets are not immune to negative consequences linked to the trade war, the defensive characteristics of the property sector, combined with relatively cheap valuations in early March 2018, led to a significant differential in performance between general equities, global fixed income and global real estate securities.

Comparative performance between asset classes February – December 2018



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Observing the trends in 2018, one could conclude that the trade war has become a scapegoat for the listed real estate sector, as the pressures linked to interest rates substantially receded. Fast forward to the fourth quarter of 2018, when the worries about the future growth of the world economy stepped to the forefront and have started to predominate as far as market psychology is concerned. The weakening outlook for themes of global growth, earnings revisions, global tech and the Central Banks' relaxation of monetary tightening have reversed the setup from early 2018.

In early 2019, only twelve months later, global real estate securities are again the *topic du jour*. The attractiveness of yields, combined with an attractive valuation of the sector, has yet again created an opportunity for re-entry into the sector. Considering the persistent valuation gap between private and public real estate, there is good value hidden in many well-run real estate stocks that could continue to be targeted by private equity funds. The balance sheets of publicly listed real estate companies are in good shape (less than 40% levered on average). The cash flows continue to provide high visibility, the assets are professionally managed and portfolios have been continuously rebalanced and adjusted for non-core assets.

Despite the uncertain environment, weakening global growth outlook and psychology of fear, the global real estate sector sparkles again. Without a doubt, markets will continue to be volatile throughout 2019, but this volatility represents an opportunity. While structural issues in the retail sector will continue to be addressed by Darwinian survival mechanisms in the markets, industrial will continue to grow but supply needs to be monitored and valuation taken into account. Office and hotel outlooks will continue to be highly correlated to global GDP numbers and these sectors could prove to be more vulnerable in general. Residential markets in Hong Kong and Singapore will continue to be in a cyclical down cycle, but most of the downside potential might have already been priced in. However, an immediate catalyst may not surface immediately. REITs with modestly rising earnings and covered distributions may be part of the more defensive exposures in investor's portfolios.

Country	Dividend yield (gross p.a.)	10-year sovereign yield	Spread (basis points)	Expected return
United States	4.7%	2.7%	200	11.0%
Canada	5.3%	2.0%	330	4.9%
United Kingdom	5.6%	1.3%	430	13.1%
Western Europe	4.2%	0.2%	400	12.4%
Japan - REITs	3.9%	0.0%	390	2.3%
Japan – REOCs	1.6%	0.0%	160	15.5%
Hong Kong – REITs	4.0%	2.0%	200	10.8%
Hong Kong – REOCs	3.4%	2.0%	140	22.5%
Singapore – REITs	4.2%	2.0%	220	2.5%
Singapore – REOCs	3.3%	2.0%	130	23.4%
Australia	5.1%	2.3%	280	8.7%
Global Real Estate Securities	**4.4%**	**1.6%**	**280**	**11.6%**

As at December 31, 2018.
Source: La Francaise Forum Securities Research, Bloomberg, UBS.

Country	Premium (Discount) to NAV (historical)	Price-to-Book (P/BV)	Current Price-to-CF Ratio
United States	(6.3%)	2.0	14.5
Canada	(5.5%)	1.0	14.6
United Kingdom	(31.7%)	0.7	17.8
Western Europe	(15.1%)	1.0	17.3
Japan – Developers	(51.7%)	1.3	9.3
Japan REITs	7.3%	1.4	12.1
Hong Kong – Developers	(44.4%)	0.6	5.5
Hong Kong REITs	(9.4%)	0.9	23.8
Singapore – Developers	(41.3%)	0.7	9.7
Singapore REITs	1.4%	1.1	22.7
Australia	(1.1%)	1.0	14.3
Global Real Estate Securities	**(16.1%)**	**1.3**	**15.1**

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