Global Property Securities

Quarterly Review and Outlook

As at September 2016

Key Highlights

- Global property securities continued to rise in the September quarter. The FTSE EPRA/NAREIT Global Developed Index (USD) registered a gain of 1.5%.
- We still think the stock is capable of delivering above-average earnings growth over the next two years, and believe that its recent decline represents an attractive entry point.
- We remain sharply focused on required real estate returns, and on the preservation and growth of invested capital.

Market Insights

Global property securities continued to rise in the September quarter. The FTSE EPRA/NAREIT Global Developed Index (USD) registered a gain of 1.5%.

Hong Kong property securities continued to rally from February lows as well-positioned residential projects recorded strong sales rates during the month; while recent transactions indicated firm demand for office property assets.

The month saw REITs move out of the Financials sector into their own Global Industry Classification Standard (GICS) sector.

Strategy Performance

The Strategy rose in value by 1.8% in the quarter, 30 basis points ahead of its benchmark index. YTD the Strategy has returned 4.4% to investors.

Drivers of relative outperformance included overweight holdings in Hong Kong property developer Sun Hung Kai Properties; and Singapore-listed Hongkong Land, whose assets include a large portfolio of high quality Hong Kong office properties. Both companies were buoyed by higher book values per share; consistently low vacancy rates; and ongoing rental growth for Hong Kong Central grade-A offices.

UK retail REIT Hammerson also contributed positively to relative performance as it recovered from oversold levels on lower UK interest rates, stable fundamentals, and demand for its portfolio of high quality retail property assets. A listing on the Johannesburg stock exchange saw trading volumes in the stock increase sharply.

Detractors from relative performance included US data storage company Equinix, which dipped following a sustained period of outperformance.

Strategy Activity

In the strategy's U.S. data centre exposure was increased following a broad pull-back in the sector's valuations by initiating a position in CyrusOne. A number of strong secular growth trends, including the growth of cloud computing and rising internet and mobile computing, are driving demand for the services offered by large specialist data center operators.

The strategy also invested in Cubesmart, the third largest US self-storage REIT, following significant YTD underperformance as a result of slowing sector momentum and additional supply coming on-stream in some markets. Cubesmart benefits from significant New York City exposure, and is relatively insulated from many of the markets with new supply. While revenue growth may slow in 2017, we still think the stock is capable of delivering above-average earnings growth over the next two years, and believe that its recent decline represents an attractive entry point.

In Japan, positions in Kenedix Residential Investment Corp and Kenedix Retail REIT were sold. The strategy's Japanese exposure is focussed primarily on high quality central Tokyo office buildings, through holdings in Mitsui Fudosan and Mitsubishi Estate.

Market Outlook and Strategy Positioning

Property securities continue to trade in line with elevated private property market values, as fundamentals remain overshadowed by expansionary central bank policies. We remain sharply focused on required real estate returns, and on the preservation and growth of invested capital.

U.S. REIT valuations remain close to all-time record high levels, on close-to-peak occupancy levels and rental rates. Fundamentals are now decelerating for most property sectors, due to new supply and moderating real GDP growth. However, the current slow GDP growth and low interest rate environment remains highly supportive of U.S. REITs, given the sectors' attractive dividend yield and relatively healthy earnings growth outlook for this year.

In the UK, Brexit-related uncertainty may impact London office rental rates. However we believe that share prices already reflect this. The portfolio's UK exposure is primarily focussed on high quality REITs in the retail, diversified and residential (student accommodation) sub-sectors.

We are more concerned about Continental Europe, where supportive central bank measures have not yet had their hoped-for impact on economic growth rates. The political situation is at risk of deteriorating. The strategy's European exposures are focussed on the retail sector.

The strategy's Japanese holdings consist of large property developers with exposure to Tokyo's healthy office market; and smaller J-REITs with appealing investment cases. The strategy has maintained its exposure to Singapore retail REITs due to their relatively attractive valuations and defensive, recurring cash flows.