REITWAY REVIEW – EDITION 18

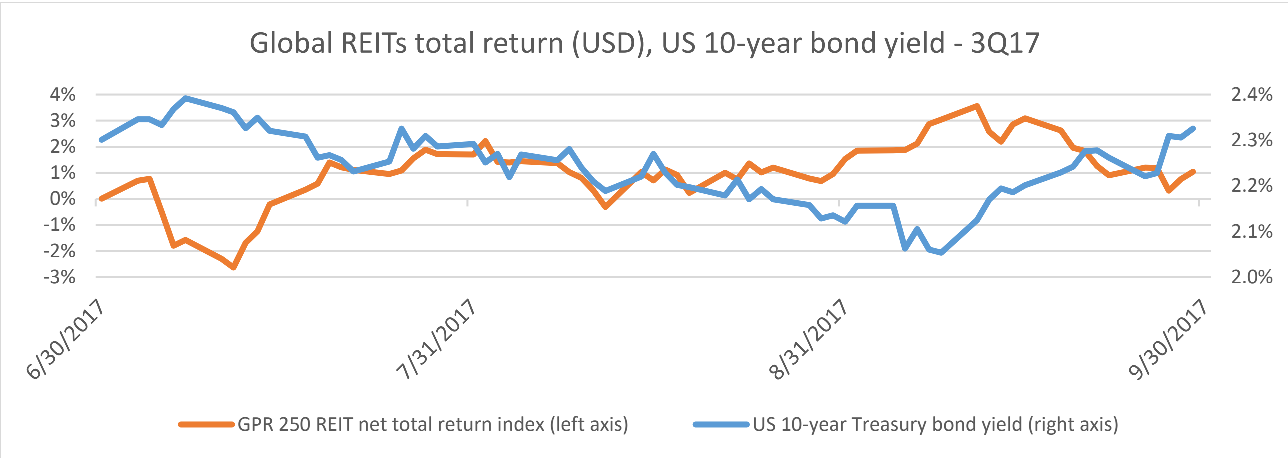
For the quarter ended 30 September 2017

MARKET PERFORMANCE AND COMMENTARY – 3Q17

Global REIT market

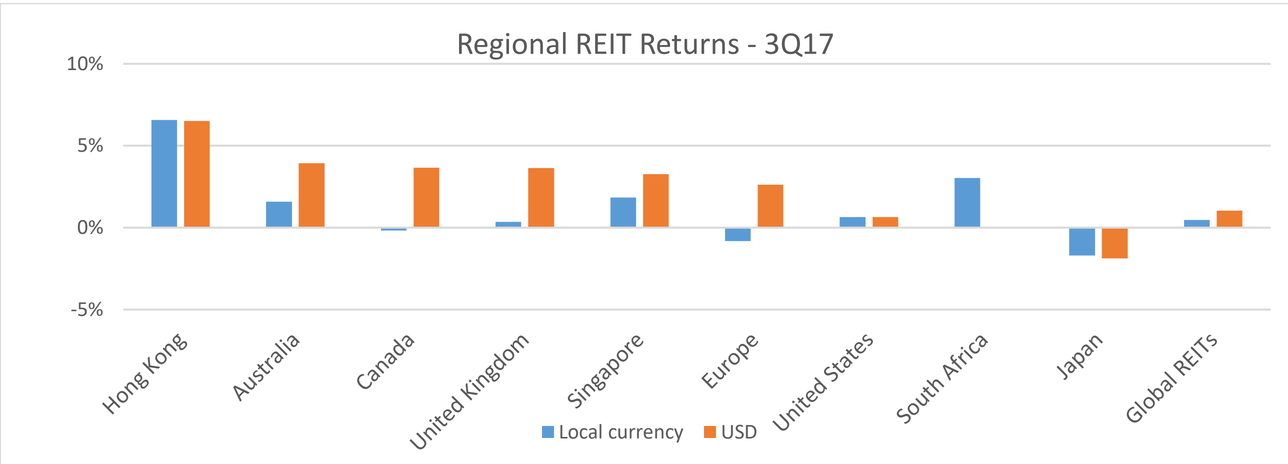
The GPR 250 REIT World Index exhibited a US Dollar (USD) total return of 1.04% during 3Q17. As the quarter progressed, persistently low inflation (and inflation expectations) saw the US 10-year bond yield dip below 2.1% during August 2017. Towards the end of the quarter, as US and other DM economic data proved resilient, the market pushed up bond yields. This can be seen below.

GPR 250 REIT net total return index (USD) vs US 10-year Treasury yield – 3Q17



Source: Thomson Reuters Eikon, Reitway calculations

The graphic below shows the total return for the respective regional global REIT markets during 3Q17.



Source: Global Property Research, Reitway calculations

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Highlights

Sharply declining bond yields as well as a moderate improvement in fundamentals saw the Hong Kong REIT market appreciate noticeably during 3Q17.

Over and above positive locally denominated returns for Australian REITs (A-REITs), the appreciation of the Australian Dollar (AUD) versus the USD boosted the USD-denominated returns of A-REITs during the quarter.

The abovementioned currency appreciation versus USD was also prevalent in Canada, the UK, Singapore and Europe. Conversely, the USD-denominated returns on South African REITs were negatively impacted by the weakening Rand (ZAR) during the quarter.

PORTFOLIO PERFORMANCE REVIEW – 3Q17

The Reitway BCI Global Property Fund underperformed its benchmark by 3.33% in 3Q17.

Our performance relative to peers can be seen below.

Peer Group comparison

Reitway BCI Global Property Fund vs Peer Group Average (ZAR)					
	1yr	2yrs	3yrs	4yrs	5yrs
Reitway BCI Global Property Fund	(1.81%)	6.10%	12.25%	13.20%	16.06%
Peer Group Average	0.36%	4.28%	11.07%	12.87%	15.23%
Excess Return	*(2.17%)*	*1.82%*	*1.19%*	*0.33%*	*0.84%*
Peer Group Rank	*10/14*	*3/10*	*1/7*	*2/7*	*1/6*

All periods greater than one year are annualised. There may be rounding errors.
Source: MoneyMate. As at 04/10/2017.

In terms of country positioning, overweight positions to the UK and Europe were rewarded, whereas an underweight to Hong Kong, Australia and Canada detracted from performance.

Our underweight in industrial REITs detracted from relative performance over the quarter. While we have found opportunities to make select investments in the sector (Prologis), the group's valuations generally remained less attractive to us. Conversely, our overweight to data centre REITs and underweight to health care REITs boosted results.

Despite healthy results and steady diversification progress, Uniti Group shares were down dramatically over the third quarter. We believe it is tied to larger fears in the credit market over Windstream (Uniti's largest tenant), following its dividend cut.

Windstream's dividend cut was not as much fundamental as it was a change in their capital allocation philosophy. While the dividend elimination was not overly surprising according to Cowen and Company, it still caused a 36% drop in the Windstream share price as the very large yield-mandated investor base were forced to rotate out and find a new home.

Our research associates maintain that the dividend cut increases Windstream's credit quality and the assurance of the UNIT lease payments. Uniti Group management agrees with their view, noting "we applaud their decision to cut" and remain "highly confident" in the assurance of lease payments.

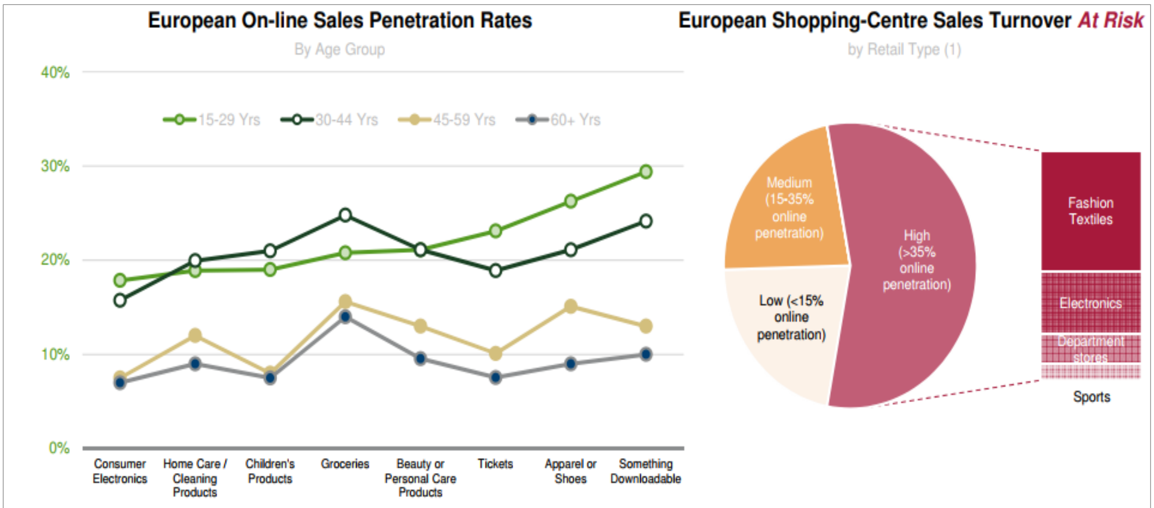
We understand the close relationship with Windstream, but we believe the UNIT stock pullback was unjustified.

REIT MARKET OUTLOOK

According to Macquarie, one of the most important structural factors playing a role in the Japanese REIT (J-REIT) market is a shift in investment from individual REITs to REIT ETFs by regional banks. This supplements what we have noted before, which is the fact that the J-REIT market is inhabited by numerous REITs that are very homogenous in terms of market behaviour and correlated to the bond market, as opposed to being driven by unsystematic fundamentals.

Over the latest Australian REIT (A-REIT) reporting season, cash flow generation relative to distributions remains a key theme. According to Macquarie, nearly half of the A-REIT sector declared distributions that exceeded free cash flow – this implies that distributions are being partly debt or equity funded. For much of the A-REIT sector, this is a negative and unsustainable situation over the long term.

In Europe, Green Street Advisors' (GSA) latest retail REIT research states that the seemingly widely held view – that online penetration rates on the Continent are set to top out at 20% – seems arbitrarily low. GSA sees this 20% "end point" as having little basis, and ignores the behaviour of younger people, as well as the fact that the mix of retail categories in European shopping centres indicates that the online saturation point is probably higher than 25%. This is illustrated below.



(1) Typical shopping-centre portfolio breakdown, by retailer type, on the Continent (based on sales turnover share). *At Risk* of migrating online, based on GfK analysis.

Source: GfK, JLL, Ecommerce Europe, Statista, Green Street Advisors.

However, the usual caveat applies: higher quality malls will be less affected, and there remains much uncertainty around the ultimate "end point."

GSA's latest Global Property Allocator lists their five top sectors as follows (for clarity, this is within the context of expected return premium relative to their respective 10-year government bonds):

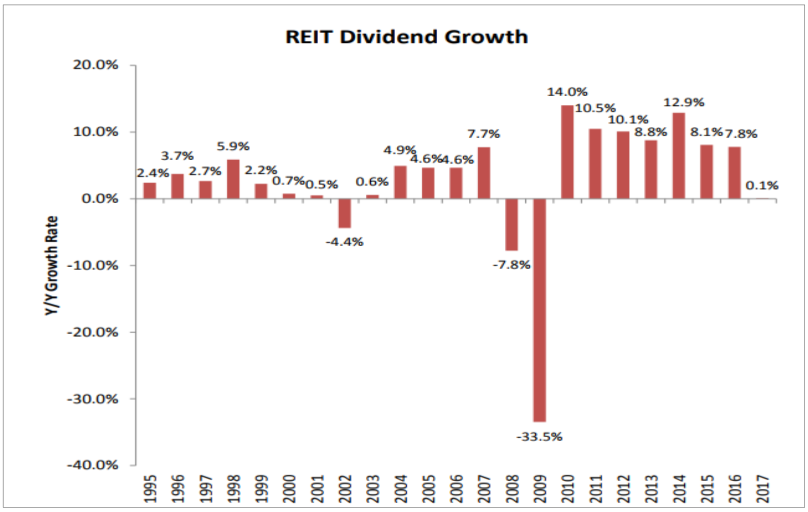
1) UK Self-Storage
2) US Mall
3) London Specialists
4) Continental Retail
5) German Residential

Therefore, notwithstanding GSA's reservations on online penetration in Continental retail, this sector is still ranked highly. Of course, this is in part due to public market pricing being depressed (i.e. higher public market yields/ expected returns), reflecting some of the abovementioned doubts. In addition, these yields only mean anything if there is the explicit expectation that absolute or relative mean reversion is expected to result in potential upside or outperformance.

Some of the "UK majors" appear cheap – however, there seems to be a lack of a catalyst to unlock value in some cases. This does not mean, however, that prospects generally for the UK property market are bleak. London Specialists, Great Portland and Derwent London, remain fundamentally sound, i.e. continue to exhibit a runway for strong cash flow growth, despite the Brexit overhang. The Self-Storage sector also remains attractive, with robust organic and external growth prospects.

Commercial real estate fundamentals in the US continue to be underpinned by low financing costs and high construction cost inflation, which generally limits supply. According to Raymond James & Associates (RJ), replacement cost inflation for commercial real estate is tracking 4-6% per year, a significant factor set to drive FFO growth. Notwithstanding the above, some supply pressure is mounting in certain sectors.

As per RJ, US REIT dividend and FFO growth expectations can be seen below.



Note: 1995-2016 dividend growth data based on the NAREIT All Equity REIT Index.
Source: NAREIT, SNL Financial, Raymond James research

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The strongest fundamental themes in the US REIT market are the industrial, data centre and single-family rental sectors.

In the *industrial* space, particularly logistics, macro tailwinds are expected to continue to contribute towards robust earnings growth over time. Prologis (ticker: PLD), for example, notes that market rent growth is 8%, up from previous expectations of 4%. These outcomes are largely being driven by operations in high barrier coastal markets. The latest strong results as well as compressing private market cap rates are supportive of persistently increasing justified valuations and target prices.

Most recently, according to RBC, financial results in the *data centre* sector generally exceeded or matched expectations. 2017 guidance was maintained or increased amongst sector incumbents.

M&A activity in the *single-family rental* sector serves to increase the size of asset bases (housing stock) and, importantly, the associated efficiencies of scale. The merger of Invitation Homes (ticker: INVH) and Starwood Waypoint (ticker: SFR), into an entity by the latter name, further demonstrates how the single-family rental sector continues with its forward momentum.

Conclusion

Our approach to investing in a benchmark agnostic, growth at a reasonable price manner leads us to remain invested in strong themes including German Apartments, Single-Family Rentals, and Data Centres.

REITWAY NEWS

- **Malta**
  The Reitway Leveraged Global Property Portfolio (MLT) has been approved by the Malta Financial Services authority (MFSA) and is now available for investment.
- **Australia**
  Lonsec Research has awarded our Australian domiciled fund (Reitway Global Property Portfolio) an Investment Grade status.
- **Allan Gray Voting List 2017**
  The Reitway BCI Global Property Fund has been included on the Allan Gray voting list for 2017. To this end, we appeal to the Financial Advisors using the Allan Gray platform to vote for our fund (See pg 5 of the voting form). The fund is currently available through restricted access however, we would like to upgrade the status to the open platform.

Regards,
The REITWAY team
For more information about the performance of our funds and investment methodology, please visit our website at www.reitwayglobal.com.