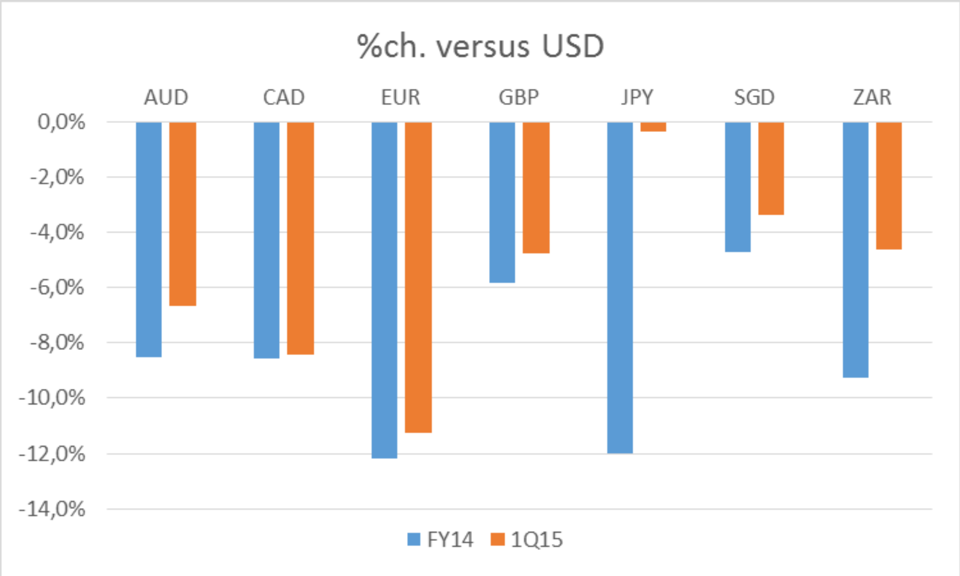
REITWAY GLOBAL
Redefining Listed Property Investing

REITWAY REVIEW – EDITION 8

MARKET OVERVIEW

Entering 2015, the theme was one of divergence of economic performance amongst various regions and countries. Given this, as well as divergent global monetary policies, currencies were also expected to continue to exhibit heightened volatility (particularly weakness against the USD in many cases).

The chart below shows how the respective currencies performed relative to USD in FY14 and 1Q15:



Source: Thomson Eikon

In some regions, currency weakening relative to USD in 1Q15 was almost as great in magnitude as it was for the whole of 2014. This has led some to postulate that the USD is too strong. However, the abovementioned divergent monetary policies may see this situation persist.

As well as respective local fundamentals and risks, currency directional risk and volatility need to be taken into account when selecting regional exposure.

Asia: poor REIT performance in 1Q15

The performance of most global REIT markets has not diverged greatly from their respective broader equity markets in 1Q15 – except in the East. The REIT markets in Singapore, Japan and Hong-Kong underperformed their respective equity markets by 4%, 4.3% and 2.1% on a total return basis in USD during 1Q15. In addition, these three REIT markets ranked 6th, 7th and 9th out of the 9 major global REIT markets we follow on a total return basis in USD.

It remains uncertain how growth in the broader Asian region will develop, with the main growth engine i.e. China exhibiting solid – yet decelerating – growth.

Japan has also remained determined to continue to stimulate its economy through easy money policies.

Canada: unexpected rate cut in January; oil seems to have found a bottom
In January the Bank of Canada unexpectedly reduced the overnight lending rate from 1% to 0.75% due to forecasts of a potentially significant slowdown in the region due to collapsing oil prices at the time. After being almost as high as $110 in June 2014, WTI Crude collapsed to reach the mid-40's in January this year. Year-to-date it has been in a range between $45 - $56.

The IMF's January forecast for 2015 Canadian GDP growth was 2.3%, a slight downgrade from the 2.4% foreseen a few months earlier for 2015. Q4 GDP growth was 0.6% after growth of 0.3%, 0.9% and 0.8% in Q1, Q2 and Q3 respectively. Of course, the effect of lower oil on the economy in the months ahead is yet to be fully determined.

Europe: decreasing inflation and same-asset growth forecasts
On the positive side, European REITs are now able to borrow long-term at yields below 2% - this bodes well for debt servicing costs as well as further accretive acquisitions.

Inflation and same-asset estimates have generally been reduced for European REITs. Notwithstanding this, London Office, UK self-storage and German residential sectors are set to achieve strong same-asset rental growth.

Share prices have surged during 1Q15, and the easy money may already have been made in Europe.

United States: unemployment low at 5.5%, latest jobs data much weaker than expected
As of January 2015 the IMF expected US GDP to exhibit growth of 3.6% for FY15.

Notwithstanding the much weaker-than-expected March non-farm and private payrolls, the upward trend in the rate of employment gains is still intact. It remains to be seen if the March number was the turning point in terms of decelerating job growth. If so, this could mean that the US will not achieve the abovementioned 3.6% growth this year if productivity gains fail to offset a slower rate of job growth.

US economic recoveries have generally been associated with a strong housing market. New home sales have failed to recover significantly since 08/09, but have been trending upwards in the last three months. For February 2015 new home sales were above 500k for the first time since 2008. After years of a near-zero federal funds rate, this could indicate the start of an overdue material recovery in the US housing market.

PORTFOLIO POSITIONING

Asia

Our significant under-exposure to these Eastern markets has been positive for our fund in 1Q15.

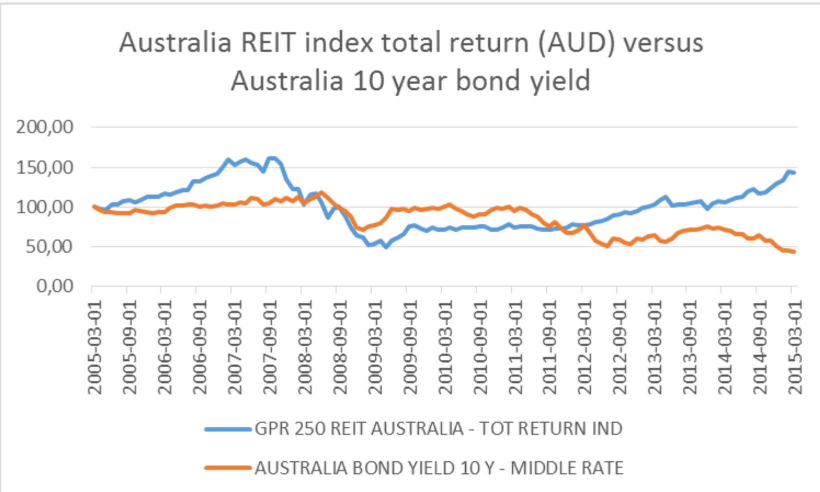
Australia: no direct REIT investments due to dearth of opportunities

Towards the end of 4Q14 we made the decision to eliminate our Australian exposure in terms of our direct REIT investments (excluding exposure via CEFs). We didn't think that any individual opportunities would potentially provide us with acceptable returns over the following 12-18 months. At the time the target prices of individual REITs in the region were largely *below spot market prices.* Overall, the fundamental outlook did not justify investment into the region.

After a mediocre January in USD terms for Australian REITs, in February they exhibited the best total return performance of all REIT markets globally as measured in USD after the Royal Bank of Australia cut its base interest rate, which provided a boost for Australian REITs. In addition, the AUD strengthened versus the USD during February. At the end of February, Australia was the top performing global REIT market in USD terms year-to-date.

However, in a complete about-turn, the month of March saw the Australian REIT market exhibit the worst performance of all global REIT markets in USD terms. In USD terms after 1Q15 the Australian REIT market ranked 5th out of the 9 global REIT markets we follow closely.

The correlation between Australian REIT total returns and the Australian 10 year bond rate was -0.97 from December 2013 to March 2015.



Source: Thomson Eikon

We think that the (low) rate-fuelled free lunch that investors in Australian REITs have been feasting on (despite the lack of a solid fundamental underpin) is largely over, notwithstanding the fact that there may be one (at most two) further interest rate cuts in the region. We see Australian REITs underperforming as investors turn their focus towards fundamentals after a period of easy monetary policy in the region.

Canada: we see significant upside to our holdings

Our decision at the end of 4Q14 to increase our Canadian exposure was significantly due to Canadian REITs exhibiting exceptional value relative to their US peers. We therefore subscribed to the view that C-REITs would outperform US REITs during 2H15. Canadian REITs have in fact outperformed US REITs in local currency terms during 1Q15. However, the weakening CAD during 1Q15 has significantly impaired the performance of C-REITs as measured in USD.

When we elevated our exposure to the Great White North at the end of 4Q14, we were aware of these currency risks. At the time there certainly was further downside risk to CAD given falling oil prices and slowing global growth, but we saw this risk as limited. One of the reasons for our view of limited downside was that we did not foresee a scenario under which CAD would weaken significantly beyond its 08/09 lows. Notwithstanding the grave weakness exhibited by CAD during January 2015 close to its 08/09 lows – sparked by the Bank of Canada surprising the market with an unexpected rate cut – *CAD importantly has not breached the 08/09 lows*.

USDCAD – 10 year history

Source: Yahoo Finance

Given changes year-to-date, from current levels we see potential downside to CAD as significantly less of a threat to our USD-denominated performance compared to our outlook at the end of 4Q14.

Due to our view of limited currency downside (and dare we say it, a potentially stronger CAD over the months ahead) combined with potential further upside to selected REITs in the region in local currency terms, we foresee strong performance in selected Canadian REITs, particularly as measured in USD. If oil has found a bottom and finds a way up further from current levels, the strongest performance in the region may in fact come from REITs that are more highly leveraged to the oil price which were previously hit the hardest due to concerns over the oil price and its potential effects.

United States: strong USD had adverse impact on certain positions, others performed strongly

Some of our US holdings in the timber, lodging and tower sectors suffered in 1Q15 due to the strong USD. Notwithstanding this, we see some of these positions as currently being priced for the worst, with potential for very substantial upside over our investment horizon. Our data centre, life sciences and office holdings were the top performers in this region.

Regards,
The Reitway investment team