globalmatters

Weekly

momentum global investment management

Safe as houses?

Overall, property warrants a place alongside equities within our basket of growth assets

Richard Stutley, CFA
Portfolio Manager

12 June 2023

Contrary to that saying, property has been anything but a safe bet so far this year: the S&P Global Property Index is up 1.9%[1], positive yes but lagging far behind the MSCI All Countries World [equity] Index, up 10.4%. That is despite dividend forecasts for 2023 being revised up by 3.2%, better than the 1.4% upward revision in equity dividends – in other words the outlook for property companies has improved relative to equities so far this year, and for that investors have been rewarded with a swing of almost minus 9% in performance. Counterintuitive to say the least.

To help explain this disparity between fundamental performance and share price performance, I've paraphrased one of my colleagues:

> *'The market is worried about write-downs to the value of assets, which poses a risk to businesses looking to refinance: higher loan-to-values (LTVs) compound the impact of an already higher base rate.'*

They go on to offer some encouragement however:

> *'In 2008/09, many REITs were forced to recapitalise. Since then, average LTVs have come down significantly, hence comparisons to that time are overstated. While companies in many industries are affected by the current tough economic environment, long leases (typically 3-5 years) mean property is better insulated than other sectors and hence general equities.'*

A related risk preoccupying investors is funding risk. While property companies are looking less creditworthy due to the higher base rate and higher LTVs, the banks that traditionally lend to them are having problems of their own, as highlighted recently by several high-profile collapses. Here, however, I agree with our active property manager Catalyst Fund Managers, that a distinction needs to be drawn between private property companies and publicly listed ones, in which we invest. According to data compiled by National Association of Real Estate Investment Trusts[2], publicly listed property companies have less than a quarter of the exposure to the office sector (which remains under pressure) of their private counterparts, at just over 5%. They are also less highly indebted on average and have more diversified sources of funding beyond the banking sector, according to Catalyst.

While all that sounds positive, we need to bear in mind that listed property companies don't operate within a vacuum, and hence contagion from the private sector remains a risk.

Fundamentals for listed property companies are still intact. Rental growth remains high across most sectors, with the exception of offices, and even the sharp slowdown in the apartment sector (following a swift supply response) only brings rental growth back in line with its pre-pandemic norm[3]. With respect to balance sheets, companies are less indebted than pre 2008/09, and they have taken advantage of low interest rates to lock in cheap debt out to 2030 on average[4].

The continued derating so far this year has pushed dividend yields above historic averages, implying that either something is different this time, or else current prices are attractive. One thing that is clearly different is the interest rate environment, and we note that property only looks roughly fair value when compared to the yields on offer from US Treasuries and Treasury Inflation Protected Securities (TIPS)[5], although considerably better than equities.

Looking at analysts' expectations on Bloomberg, it is striking how much growth they expect from the sector over the next 12 months. Part of this is clearly to do with higher inflation but looking at the pricing of 12-month Treasuries and TIPS, forward-looking inflation is in fact expected to be benign. Estimates ranging between 6 and 8% growth for the next 12 months, and in excess of 4% annualised for the next 4 years[6], are in stark contrast to the outcome over the past 10 years or so (dating back to April 2013). Since that time, the S&P Global Property Index has delivered dividend growth of only ~2% per annum[7]. Where is this higher growth going to come from? The increased proportion of high growth subsectors in the index is obviously key – areas such as laboratory space and retail parks, which we specifically target in our portfolios. We also expect to see the lagged effects of inflation coming through, plus the strong rental growth catalysed by the aftermath of the pandemic, when a boom in demand met constrained supply at the time.

Adding all this together: fundamentals look good, in particular balance sheets which are in better shape compared to 2008/09 on average. Valuations have improved year to date but are not yet super compelling and there is likely to be an overhang from private markets. Overall, property is still not that attractive compared to certain areas of the fixed income markets in our assessment, but it warrants a place alongside equities within our basket of growth assets.

Source: [1] Bloomberg Finance L.P. (index closing levels between 30/12/2022 - 07/06/2023). [2] Reit.com REITs Offer Diversification and Timeliness, *30 March 2023.* [3] *Reit.com* Core Property Sector Fundamentals Generally Solid in 4Q22, Some Evidence of Softening, *20 March 2023.* [4] *Reit.com* In 2023, REITs Are Likely to Remain Resilient to Higher Interest Rates, *15 December 2022.* [5] *Treasury Inflation Protected Securities.* [6] *Forecasts from Bloomberg Finance L.P. and Catalyst Fund Managers.* [7] *Bloomberg Finance L.P. (SPBMGPTU Index; trailing 12 months dividend per share; April 2013 to May 2023).*

Market Focus - 12 June 2023

- **Global equities returned 0.4% last week**
- **The World Bank's latest global outlook points to a 2.1% growth for 2023, and a revised down figure of 2.4% for 2024. The OECD's latest outlook points to growth of 2.7% this year and 2.9% in 2024**
- **Brent crude fell by 1.8% to $74.79 per barrel**
- **Gold rose by 0.7% to $1961.19 per ounce**

US

- US equities rose by 0.4% last week
- Weekly jobless claims saw a large increase to 261k over the week ending 3 June, ahead of consensus estimates of 235k, coming in at their highest level since October 2021
- The Institute for Supply Management Services Purchasing Managers' Index (PMI) for May came in at 50.3, the second lowest level since the pandemic

UK

- UK equities fell 0.4% last week
- The composite PMI for May came in at 54.0, ahead of expectations and up from 53.9 the month prior

Europe

- European equities fell 0.6% last week
- Euro Area growth data was revised to confirm that the economy experienced a winter recession having contracted by 0.1% in both Q4 2022 and Q1 2023
- The Euro Area composite PMI for May came in at 52.8 (vs. the flash reading of 53.3)
- Producer Price Index inflation in the Euro Area fell to its lowest level since January 2021 to just 1.0% in April

Rest of the World/Asia

- Global emerging market equities returned 1.9% last week
- Chinese equities rose by 1.8% last week
- China's Caixin services PMI rose for a fifth consecutive month, coming in at 57.1 in May from 56.4 in April
- Producer deflation in China continued in May for the eighth consecutive month with the producer price index declining 4.6% year-on-year in May. Meanwhile, Consumer Price Index rose 0.2% year-on-year, in line with market expectations
- Japan's Q1 Gross Domestic Product growth was revised up to an annualised rate of 2.7%, above the initial 1.6% estimate

Market Summary

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 9 June**	**Month to date**	**YTD 2023**	**12 months**
Developed Markets Equities					
United States	USD	0.4%	2.9%	12.6%	8.3%
United Kingdom	GBP	-0.4%	1.8%	3.1%	4.6%
Continental Europe	EUR	-0.6%	1.6%	11.5%	10.8%
Japan	JPY	1.9%	4.4%	19.1%	16.1%
Asia Pacific (ex Japan)	USD	1.5%	4.1%	4.0%	-3.7%
Australia	AUD	-0.3%	0.4%	3.2%	6.2%
Global	USD	0.4%	3.1%	11.9%	7.8%
Emerging Markets Equities					
Emerging Europe	USD	2.6%	7.7%	13.7%	31.4%
Emerging Asia	USD	1.3%	3.9%	5.2%	-4.8%
Emerging Latin America	USD	4.9%	10.9%	17.3%	13.7%
BRICs	USD	1.7%	5.4%	-0.3%	-6.7%
China	USD	1.8%	6.3%	-3.3%	-13.3%
MENA countries	USD	2.2%	2.4%	2.2%	-11.8%
South Africa	USD	7.1%	12.0%	-3.3%	-7.5%
India	USD	0.2%	0.6%	3.4%	7.7%
Global emerging markets	USD	1.9%	4.7%	5.8%	-3.3%
Bonds					
US Treasuries	USD	-0.2%	-0.4%	2.0%	-1.6%
US Treasuries (inflation protected)	USD	0.0%	-0.3%	2.0%	-4.6%
US Corporate (investment grade)	USD	-0.2%	-0.4%	2.6%	-0.5%
US High Yield	USD	0.3%	1.1%	4.9%	2.7%
UK Gilts	GBP	-0.4%	0.0%	-3.2%	-15.0%
UK Corporate (investment grade)	GBP	-0.2%	0.0%	0.2%	-7.9%
Euro Government Bonds	EUR	-0.3%	-0.3%	2.5%	-4.2%
Euro Corporate (investment grade)	EUR	-0.1%	-0.2%	2.3%	-1.7%
Euro High Yield	EUR	0.6%	0.8%	4.7%	2.3%
Japanese Government	JPY	0.0%	0.0%	2.6%	-1.0%
Australian Government	AUD	-1.7%	-1.9%	1.6%	1.2%
Global Government Bonds	USD	0.0%	0.1%	1.3%	-3.4%
Global Bonds	USD	0.0%	0.1%	2.1%	-2.5%
Global Convertible Bonds	USD	0.9%	2.4%	3.8%	0.3%
Emerging Market Bonds	USD	0.6%	1.1%	2.2%	0.3%

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 9 June**	**Month to date**	**YTD 2023**	**12 months**
Property					
US Property Securities	USD	1.1%	3.5%	3.4%	-5.4%
Australian Property Securities	AUD	-2.9%	-1.8%	1.4%	-3.2%
Asia Property Securities	USD	2.0%	4.8%	-4.3%	-9.6%
Global Property Securities	USD	1.3%	3.8%	1.4%	-7.9%
Currencies					
Euro	USD	0.4%	1.0%	0.3%	0.9%
UK Pound Sterling	USD	1.1%	1.6%	4.0%	0.5%
Japanese Yen	USD	0.4%	0.3%	-6.0%	-3.7%
Australian Dollar	USD	2.0%	4.3%	-1.1%	-5.3%
South African Rand	USD	4.3%	5.6%	-9.0%	-17.5%
Swiss Franc	USD	0.6%	1.3%	2.1%	8.3%
Chinese Yuan	USD	-0.6%	-0.3%	-3.3%	-6.2%
Commodities & Alternatives					
Commodities	USD	0.6%	3.2%	-8.3%	-21.8%
Agricultural Commodities	USD	1.7%	4.3%	-0.9%	-11.9%
Oil	USD	-1.8%	2.9%	-12.9%	-39.2%
Gold	USD	0.7%	-0.2%	7.5%	6.1%
Hedge funds	USD	0.2%	0.5%	0.4%	-1.1%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

For more information, please contact:

Distribution Services

E: distributionservices@momentum.co.uk

T: T: +44 (0)207 618 1803