BearBull
Global Investments Group

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Securitised real estate will benefit from the exceptional convergence of business cycles in 2021

Economic stimulus plans also favourable to real estate. The health crisis will not have a profound effect on yields. Real estate remains an effective hedge against a resumption of inflation. Time to invest

Key points

- Volatility in January did not spare international securitised real estate
- Alignment of regional and national economic cycles favourable to real estate in 2021
- Incipient awareness that inflation may make a significant comeback in 2021
- Real estate: a natural hedge against inflation
- Continued popularity in Q4
- Collapse in demand not so dramatic
- Stimulus plans favourable to real estate
- International securitised real estate is a prime source of diversification

Volatility in January did not spare international securitised real estate

The return of uncertainty in the second half of January was enough to plunge all risky assets back into a profit-taking phase, which for the moment still seems relatively controlled and temporary. With the exception of commodities, which benefited from the rise in crude oil prices in a stronger overall economic context, most assets ended the month in negative territory. International real estate also slid slightly by -0.51% in a general context of profit-taking. However, as we shall see below, we believe that fundamentals remain broadly in favour of international real estate in 2021. We therefore believe that the current weakness still represents an opportunity for medium-term positioning in this asset class, which is essential in terms of diversification.

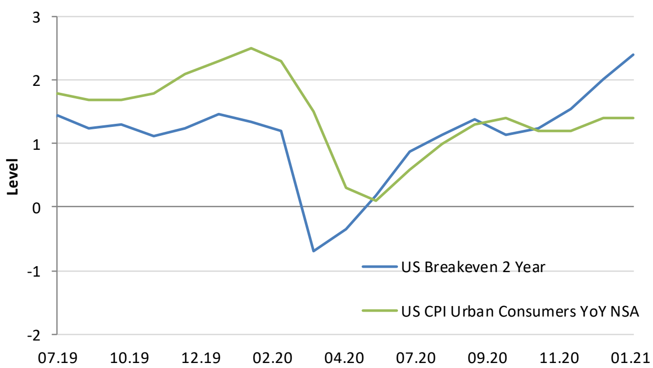
Alignment of regional and national economic cycles favourable to real estate in 2021

Nevertheless, the overall macroeconomic context is not worrying and is likely to be considered favourable by the vast majority of observers. The economic recovery is underway in 2021 and will be supported by a combination of stimulus policies in all regions of the developed and emerging world. The only reason 2021 is thus not off to an excellent start in the very short term is because of the lockdowns still in place for a few weeks in European countries in particular, but the coming quarters offer strong hopes of a generalised economic recovery throughout the world. In 2021 the national and regional economic cycles will align and probably cause much more intense tensions than currently expected in global production and distribution chains. A generalised global demand boost when all countries emerge from their respective lockdowns will have effects on global demand and on the supply of products and services that are as yet unsuspected. The persistent fear of Covid-19's negative impact on growth is undoubtedly affecting the assessment of the possible effects of perfectly aligned and durably competing national business cycles, particularly with regard to the supply of commodities and inflation. However, the vaccination campaigns currently underway will make it possible in a few weeks' time to see how quickly a return to normal could occur and begin to have the effects mentioned.

Incipient awareness that inflation may make a significant comeback in 2021

Capital markets may have begun in January to become aware of the growing risks of a rise in inflation by the end of 2021. Ten-year US Treasury bond yields have risen to nearly 1.2% in conjunction with expected US inflation. The theoretical inflation rate incorporated in TIPS (10-year) bonds is already at its highest level since 2014 (2.2%), after reaching a low of a mere 0.55% in March 2020. Most developed countries capable of developing economic recovery strategies experienced similar trends at the beginning of the year. The resumption of inflation in 2021 would have a clearly negative impact on bond markets, but it could also have a favourable impact on real estate.

Expected inflation and index CPI - USA



Sources: Bloomberg, BearBull

Real estate is a natural hedge against inflation

Although falling interest rates have been one of the main factors behind the appreciation of property values and real estate shares in recent years, recall that in times of rising inflation, the asset class is one of the few to retain its value, second only to commodities. Indeed, real estate is a natural hedge against the erosion of purchasing power and value caused by rising inflation. In the current context, it is worth recalling this historical and statistical reality at a time when a resurgence in inflation seems increasingly likely.

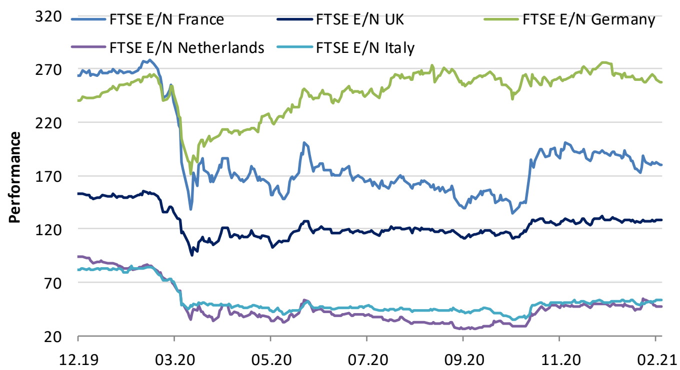
Diversification more attractive than ever in 2021

Securitised real estate therefore appears to be a particularly attractive source of diversification, as disappearing bond yields will soon lead to capital losses that are increasingly likely over the coming quarters and years. The weakness of the sector is still too deeply informed by the increasingly irrational fears of rent losses and falling property values, particularly in the commercial sector. Yields may well suffer for some time yet due to the difficulties of certain lessors including possible bankruptcies, but overall we believe that at current prices listed REITs (real estate investment trusts) still offer good opportunities for repositioning in the medium and long term.

Continued popularity in Q4

At the beginning of Q4 2020 we believed that arbitrage and repositioning opportunities in the medium term were still attractive with regard to international securitised real estate, which had not yet benefited like the equity markets from the positive change in the macroeconomic outlook for the second half of the year. In the vast majority of countries, securitised real estate was still suffering from the negative sentiment of investors worried about the medium-term risks that the pandemic posed to the stability of rent payments and therefore also to the expected returns on real estate investments. The last months of 2020 were ultimately very favourable for international REITs, which ended up jumping by +12.6% at the end of the year. All regions benefited from this positive trend reversal in the sector. In Europe, REITs progressed by +11.7%, achieving a performance similar to that of Asian REITs, up +11.1%. The US (+13.1%) and UK (+13.7%) markets both performed slightly better. Emerging markets, however, lagged behind in the last quarter with only a small increase of 2.8%.

European real estate markets in local currencies

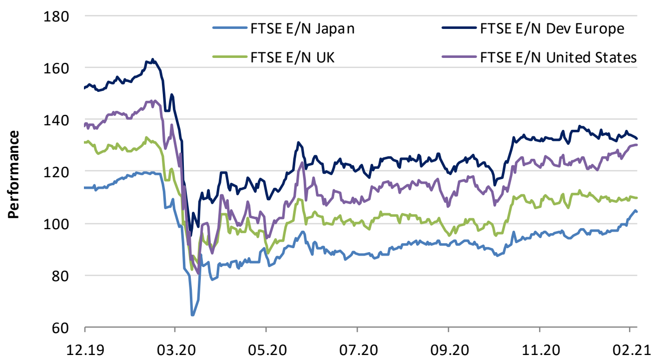


Sources: Bloomberg, BearBull

International securitised real estate thus finally benefited from the renewed optimism observed at the end of the year, which owes much to the appearance on the market of Covid-19 vaccines that rapidly changed, at least in part, investors' risk perceptions with regard to growth.

The adjustment of expectations observed in recent months in this asset class is promising and encouraging. However, the rebounds observed are still far from erasing the fall in prices in Q1 2020. Over 2020 as a whole, securitised real estate is still down -10% overall. The European market has fared best with a result of -7%. Real estate in the UK is still suffering from the consequences of the dramatic spread of the Covid-19 epidemic and the increased risks of a marked weakening of the economic outlook. Down -15.9%, British real estate remains less attractive in international comparison. The underperformance of emerging market securitised real estate, down -23.9% in 2020, may not last in 2021. Vaccination campaigns will still take several months to show their effectiveness, but 2021 will be a year of global economic recovery, and this positive new environment will certainly attract new investment in emerging securitised real estate as well. At the beginning of this year, international real estate appears to be one of the best asset classes in terms of risk/expected return ratios. The revaluation of international real estate markets is underway and still offers significant opportunities for capital gains.

Real estate markets in local currencies



Sources: Bloomberg, BearBull

Collapse in demand not as dramatic as expected

The pandemic will not have as significant and lasting effects on real estate markets as is sometimes imagined in connection with the development of teleworking, which intensified in 2020. Of course, we do foresee a lasting impact on companies resulting from the forced teleworking experience during lockdown. Many companies were undoubtedly seduced by this new form of collaboration and work organisation, and a very large number of employees appreciated the freedom in their personal organisation resulting from this new form of work. It is therefore likely that employee workspaces will now be viewed differently by companies. Commercial and office space development needs will certainly be affected, probably lowering the prospects for new construction in the coming years. As far as residential real estate is concerned, this trend is likely to have a more positive impact on the floorplans of private dwellings. The need for an additional room for example will certainly be essential for the sustainability of teleworking in a comfortable environment. Otherwise, it is also likely that employees themselves will prefer the comfort of their professional workspace to the constraints of trying to organise a permanent workspace within their private living space. The development of teleworking will not be so simple and will only involve a much smaller proportion of employees than has been the case in times of forced lockdowns. Therefore, while it is indeed likely that demand for office space will weaken, we do not believe that the outlook for international real estate will be impacted in 2021 as dramatically as share prices suggest.

Stimulus plans are also favourable to real estate

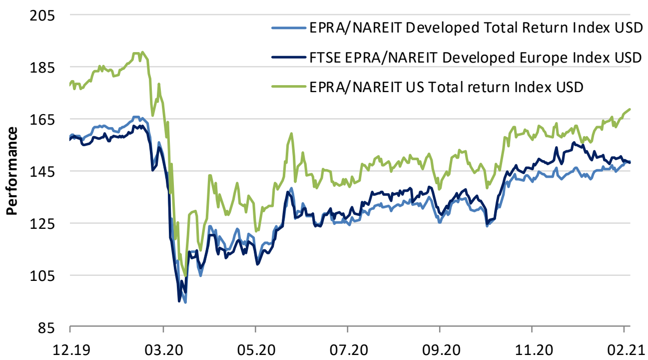
International real estate will also benefit from the economic stimulus plans implemented by governments. We noted above the risks affecting demand for office space stemming from the impact of the teleworking experience on the changing habits of decision-makers and businesses. It is also important to note that, in parallel with this likely trend, economic stimulus packages will significantly alter the outlook for global economic growth. Global growth is expected to be up by almost +5.5% in 2021. This particularly positive macroeconomic context will certainly create favourable conditions for many sectors, including real estate. An increase in demand will therefore also be induced by this overall growth and will compensate for the medium-term decline expected due to the increase in teleworking. Such a strong economic recovery will also have positive consequences on expectations regarding the sustainability of revenues and rents collected by landlords. In this context, fears of vacancies or non-payment of rents, which could reduce real estate profitability, are certainly overestimated.

In addition, massive liquidity injections by central banks and the availability of credit will continue to support the real estate sector and asset valuations. Eventually, a rise in long-term rates will have a negative effect on the latter, but for the time being we still believe that securitised real estate remains unjustly penalised by overly pessimistic expectations.

International securitised real estate is a prime source of diversification

The overall return on international real estate is still particularly attractive at the beginning of the year, both in absolute and relative terms. In the Eurozone, the yield on the Nareits EPRA indices was 4.45% in 2020 with an expected increase of almost 5% over the next two years. In the United States, yields for 2021 are slightly lower, averaging 3.9%, which is roughly the same as those expected for Asia. Yields in the UK are even lower and are estimated at around 3.7%. Thus, the yields on securitised real estate in emerging markets logically appear to be the highest in our investment universe with an expected average yield of 5.5% for 2021 and 6.3% for 2022.

Nareits EPRA indice - USA, Europe, World (in USD)

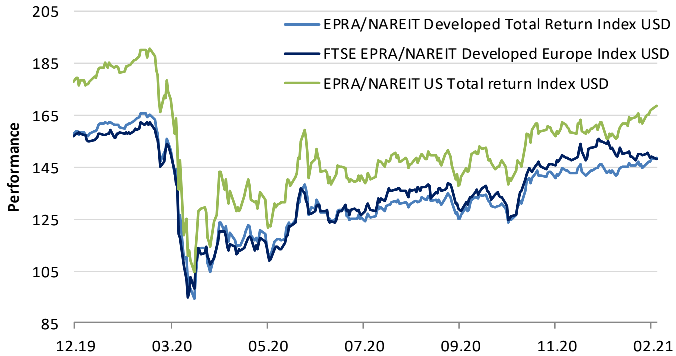


Sources: Bloomberg, BearBull

International securitised real estate has clearly fallen victim to the process of reallocating assets to risky investments such as equities, whose earnings prospects in the economic recovery phase seemed more constructive and predictable. However, we believe that this asset class remains undervalued and is likely to see renewed investor interest in 2021, as it benefits more broadly from the improved investment climate.

The risks of an increase in interest rates in the coming months could possibly be viewed as a negative factor for the sector in the short term, but we expect that this would occur in a context of undervaluation of real estate shares and therefore would not have any real immediate consequences. Competition from slightly better bond yields should also not be overestimated, as the yield spread in favour of real estate would remain significant. At current price levels, we maintain our positive outlook for international securitised real estate and suggest an overweight investment policy and tactical allocation following what we believe to be unjustified price corrections in indirect real estate investments and given the delay in the ongoing process of revaluing opportunities to take advantage of still attractive valuation levels. The return on real estate investments will not be affected as much by the Covid-19 crisis, and the global economic recovery reinforces the attractiveness of the asset class. An improved investment climate and reduced uncertainty will support the shift in investment away from bonds and towards securitised real estate. In terms of tactical positioning, we favour real estate markets in countries or regions that can expect a stronger economic recovery in 2021. Our regional allocation is diversified in the current context, but overweight the Eurozone, Asia and emerging markets.

Nareits EPRA indice - Eurozone, UK, Emerging (in USD)



Sources: Bloomberg, BearBull

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