# CBRE CLARION SECURITIES

## GLOBAL REAL ESTATE STRATEGY
## STRATEGY COMMENTARY
## MARCH 31, 2021

### MARKET PERFORMANCE REVIEW

**After a very difficult 2020, real estate stocks were up +5.8% for the first quarter of 2021, modestly outpacing the MSCI World Equity Index, which rose +5.0%.** Since the global pandemic arrived approximately one year ago, real estate stocks have lagged the broader stock indices as public market investors discounted a very difficult operating environment for real estate landlords. As we complete the first quarter of 2021, economic conditions are rapidly improving. With COVID vaccine distribution accelerating in most parts of the world, combined with government stimulus and central bank backstops for capital funding markets, investors appear to be pricing in a strong economic bounce in 2021 and a durable economic recovery beginning in 2022. All of these factors are very good news and real estate landlords and real estate stocks will be a beneficiary of this very good news.

#### FTSE EPRA NAREIT DEVELOPED NET INDEX (USD) PERFORMANCE AS OF MARCH 31, 2021

| REGION/COUNTRY | 1 Month | 2021 YTD | 2020 |
|---|---|---|---|
| **World** | **2.9%** | **5.8%** | **-9.0%** |
| **North America** | **4.3%** | **9.2%** | **-10.8%** |
| Canada | 5.6% | 10.5% | -13.9% |
| United States | 4.3% | 9.1% | -10.7% |
| **Europe** | **0.2%** | **-4.4%** | **-2.7%** |
| Cont. Europe | -0.1% | -7.3% | 1.6% |
| United Kingdom | 1.1% | 4.0% | -13.6% |
| **Asia-Pacific** | **1.4%** | **6.2%** | **-9.5%** |
| Australia | 3.4% | 0.3% | -10.1% |
| Hong Kong | -1.7% | 10.7% | -12.2% |
| Japan | 1.6% | 7.8% | -10.3% |
| Singapore | 4.7% | 1.2% | -0.8% |

**CBRE Global Investors' economic forecast calls for improving growth in 2021.** Along with the success of vaccine distribution, we believe the monetary and fiscal measures that were implemented around the globe will help accelerate economic growth out of the recession resulting from the COVID-19 pandemic. We believe the U.S. Federal Reserve is implementing appropriate monetary policy to promote economic recovery and provide liquidity to the credit markets. We believe the Biden Administration will enact economic stimulus packages to help the unemployed, pursue a pro-growth economic agenda, and rebuild America's infrastructure. Assuming the vaccines and health policies are effective and that the global economy can re-open in 2021, we estimate earnings for real estate stocks will grow in excess of 5% in 2021 and 7% in 2022.

We do not believe rising interest rates will disrupt our positive total return outlook for real estate stocks for three primary reasons: 1) CBRE Global Investors' economic forecast projects that market-based interest rates will rise only moderately through the course of 2021, with no central banks raising interest rates during the year; 2) the historically wide yield spreads between real estate stocks and fixed income instruments provide a substantial cushion should interest rates rise above current expectations; and 3) the short-term positive correlation between real estate stocks and interest rates has broken down during this COVID pandemic. In 2020, real estate stocks were negative while interest rates fell. Real estate stocks are acting as an "economic re-opening sector," so it is likely that a measured increase in interest rates as an indicator of economic recovery will be a positive for real estate stock performance.

As we enter the second quarter of 2021, many sectors in the stock market have recovered to or exceeded their pre-pandemic valuations, but not real estate stocks. According to an April 1, 2021 report by Raymond James, over 64% of all U.S. real estate stocks have yet to fully recover to "pre-COVID equity values," the highest percentage of any sector in public markets. On almost any metric we can find, real estate stocks offer investors great value investment opportunities.

As we work through 2021, it is possible that one potential risk for the markets is the direction of the corporate tax rate in the U.S. With U.S. spending programs being passed and budget deficits soaring, the Biden Administration has proposed a plan to increase corporate tax rates in the U.S. The plan proposed will eliminate the corporate tax rate cuts put in place by the Trump Administration back in 2017. It is interesting to note in 2017, real estate stocks materially underperformed the broader stock market as the Trump corporate tax rate cut was being introduced and then passed. Because REITs do not pay taxes at the corporate level, they received no benefit from the Trump corporate tax rate cut, which is presumably why REITs underperformed both the broader market and most sectors which did receive tax rate cut benefits. As an aside, REITs underperformed equities during the entire Trump Administration, which is one reason the stocks are so cheap today. If a corporate tax rate increase is passed in late 2021 or early 2022, there may be no sector better positioned for this rate increase than REITs because the REIT sector will not be affected by corporate tax rate increases.

## MARKET OUTLOOK

**Based on our proprietary valuation dashboard, real estate securities valuations continue to be very compelling relative to the private real estate, fixed income, and broader stock markets.** It is unusual for real estate securities to be "cheap" relative to all three of these broader asset classes at the same time. At March 31, 2021, real estate stocks are trading at a global average 4.5% discount to private market real estate value (i.e., NAV), with an implied unleveraged cash flow yield of 5.5%. In the U.S., the spread between implied cap rates and Baa corporate bonds is +188 basis points versus a long-term average of +98 basis points. Outside the U.S., these spreads are also historically wide. Relative to the broader stock market, REITs look cheap as well. The forward multiple of global REIT earnings is 18.3x versus the 20.3x Price-to-Earnings ratio of the MSCI World Equity Index; normally the multiples are similar and the present gap of 2.0x has not been seen in the recent past. These types of valuation disparities in the past have often been followed by periods of very strong absolute and relative performance of listed real estate.

**We own a well-balanced portfolio of securities that have been screened for their growth prospects in combination with the quality of their business models, assets, balance sheets, and management teams. We are positive on property types, regions, and stocks that offer these qualities at reasonable valuations.** In the U.S., we favor storage, towers, industrial, and quality retail. Since the beginning of the fourth quarter 2020, we have added to the portfolio "over-sold" stocks that represent "great value" in the mall and grocery-anchored shopping center sectors and we have funded these purchases by selling over-valued stocks, particularly in the data center, healthcare and residential sectors.

In Japan, we prefer mid-cap office stocks that are providing earnings resiliency at a very attractive relative valuation, and we continue to overweight select larger diversified real estate companies that have committed to improving their corporate governance. In Hong Kong, we are overweight residential companies, diversified companies with a residential bias, non-discretionary retail, and decentralized office. In Australia, we prefer residential, industrial, and a few select companies where we see compelling value.

In the U.K., we favor the storage, industrial, and residential sectors, and companies with superior balance sheets and the management acumen to create value in times of uncertainty. In Continental Europe, we own the German residential companies, and we continue to prefer property companies in markets with a positive earnings growth profile, which favors mid to small cap stocks in Germany and the Nordics.

**We believe long-term investors have a unique opportunity to invest in high-quality real estate assets at very attractive valuations.** Based on our proprietary analytical tools, we believe that real estate securities are cheap relative to the private real estate market, the fixed income market, and the broader stock market. We believe investors committing capital to listed real estate at this time have the potential to earn above average absolute and relative long-term total returns.

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*The FTSE EPRA/ NAREIT Developed Index is an unmanaged market-weighted index consisting of real estate companies from developed markets, where greater than 75% of their EBITDA (earnings before interest, taxes, depreciation, and amortization) is derived from relevant real estate activities. Investors cannot invest directly in an index.* *PA04292021*