CBRE CLARION SECURITIES

GLOBAL REAL ESTATE STRATEGY
STRATEGY COMMENTARY
Q2 2021

MARKET PERFORMANCE REVIEW

Real estate stocks were up +9.2% for the second quarter of 2021. On a year-to-date basis, real estate stocks are up +15.5%, outpacing the MSCI World Equity Index (+13.3%) and the Barclays Global Bond Index (-3.2%). After several years of relative underperformance, real estate stocks are among the best performing asset classes in 2021. The economic recovery is accelerating, driven by the rapid distribution of COVID vaccines, consumers with substantial savings and a desire to spend, businesses eager to hire, and there remains material policy support from governments and central banks. These factors all are very good news for the economic outlook and real estate landlords, and we believe real estate stocks will be beneficiaries of these trends.

FTSE EPRA NAREIT DEVELOPED NET INDEX (USD) PERFORMANCE AS OF JUNE 30, 2021

REGION/COUNTRY	3 Month	YTD	1 Year
World	**9.2%**	**15.5%**	**33.6%**
North America	**11.1%**	**21.4%**	**37.8%**
Canada	13.0%	24.8%	47.0%
United States	11.0%	21.2%	37.4%
Europe	**10.6%**	**5.7%**	**30.9%**
Cont. Europe	11.8%	3.6%	28.9%
United Kingdom	7.3%	11.6%	36.5%
Asia-Pacific	**3.4%**	**9.8%**	**25.4%**
Australia	4.3%	4.6%	37.0%
Hong Kong	4.4%	15.6%	21.1%
Japan	3.7%	11.8%	28.0%
Singapore	-0.3%	0.9%	14.9%

MARKET OUTLOOK

We believe that real estate securities are attractively priced relative to the private real estate market, the fixed income market, and the broader stock market and that investors committing capital to listed real estate at this time have the potential to earn attractive absolute and relative long-term total. Based on our proprietary valuation dashboard, real estate securities valuations are attractive relative to the private real estate, fixed income, and broader stock markets. At June 30, 2021, real estate stocks are trading at a global average 2.8% 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 +167 basis points versus a long-term average of +99 basis points. Outside the U.S., these spreads are wide as well. Relative to the broader stock market, REITs look cheap as well. The forward multiple of global REIT earnings is 19.2x versus the 19.8x Price-to-Earnings ratio of the MSCI World Equity Index; normally the multiples are similar. These types of valuation disparities in the past have often been followed by periods of attractive absolute and relative performance of listed real estate.

Well-respected real estate research firm Green Street Advisors agrees with our assessment of the total return outlook for real estate stocks. In Green Street's July 1, 2021 Real Estate Securities Monthly, the firm's proprietary valuation methodology rates real estate securities as "inexpensive" and sees upside of up to +30% above current levels before the sector would be considered "pricey". We agree with Green Street that despite the strong performance over the last 12 months, an allocation to real estate securities now still offers double-digit total return potential from current levels.

In addition to attractive valuation metrics, there are additional thematic reasons to be positive about real estate stocks at mid-year 2021, including: 1) real estate stocks are outperforming broader stock market indices for the first time in the last five years, which suggests a change in stock market leadership; 2) real estate clearly benefits from a re-opening economy; 3) short lease duration sectors can quickly re-price rental rates in an inflationary environment, thus offering an inflation hedge; and 4) funds flows to dedicated real estate mutual funds and ETFs have turned positive in 2021 after several years of anemic funds flows signaling improving investor interest in the sector.

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.

The proposed increase in U.S. corporate tax rates could be a risk for the broader market, but a boost to U.S. REIT relative return prospects. With U.S. spending programs being passed and budget deficits soaring, the Biden Administration has proposed to increase corporate tax rates in the U.S. It is interesting to note in 2017 when the previous administration reduced U.S. corporate tax rates that real estate stocks materially underperformed the broader stock market. REITs do not pay corporate taxes and so received no benefit from the corporate tax rate cut, which is presumably why REITs underperformed the broader market in 2017. 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.

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 are overweight towers, industrial, retail, apartments, and storage. In Japan, we prefer industrial, residential, and mid-cap office J-REITs that are providing earnings resiliency at a very attractive relative valuation, and we continue to own select Japanese REOCs that have exposure to office, retail, and residential and 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 diversified companies.

In the U.K., we favor the storage, industrial, and residential sectors, and select larger cap diversified companies that trade at material discounts and may see earnings acceleration as the U.K. economy re-opens. 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 active management has the ability to offer significant relative return potential at this time when investors have a unique opportunity to invest in listed real estate assets at attractive valuations. Based on our "information advantage" and the disciplined use of our proprietary analytical tools, we have been able to outperform a passive investment strategy and believe the portfolio is well-positioned to deliver continued relative outperformance.

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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. *PA07202021*