CBRE CLARION SECURITIES

U.S. REAL ESTATE STRATEGY
STRATEGY COMMENTARY
Q2 2021

MARKET PERFORMANCE REVIEW

Real estate stocks were up +12.0% for the second quarter of 2021. On a year-to-date basis, real estate stocks are up +21.8%, outpacing the S&P 500 Equity Index (+15.3%) and the Barclays U.S. Bond Index (-1.6%). 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.

MSCI U.S. REIT INDEX
PERFORMANCE AS OF JUNE 30, 2021

SECTOR	3 Month	YTD	1 Year
MSCI US REIT	**12.0%**	**21.8%**	**38.1%**
Storage	23.6%	36.3%	70.0%
Malls	17.6%	56.4%	103.1%
Technology Real Estate	14.2%	12.3%	15.1%
Shopping Centers	14.1%	41.3%	60.7%
Residential	14.1%	27.5%	38.6%
Industrial	12.0%	18.7%	32.3%
Net Lease	10.1%	17.9%	36.6%
Office	7.3%	19.4%	26.1%
Healthcare	7.0%	11.4%	32.6%
Hotels	-0.4%	16.4%	74.1%

MARKET OUTLOOK

We believe that real estate securities are attractively priced and that investors committing capital to listed real estate at this time have the potential to earn attractive absolute and relative long-term total returns. At June 30, 2021, real estate stocks are trading roughly in line with private market real estate values (i.e., NAV) with some material variation across property sectors. This relationship stands in contrast to a more significant premium that is typical coming out of prior recessions as values and growth recovers. The spread between implied cap rates and Baa corporate bonds is +167 basis points versus a long-term average of +99 basis points, which is indicative for the potential for further cap rate compression (value increases). Relative to the broader stock market, REITs look cheap as well. The forward multiple of U.S. REIT earnings is 20.4x versus the 21.5x Price-to-Earnings ratio of the S&P 500 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 +12% above current levels before the sector would reach "fair" value. 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) fund flows to dedicated real estate mutual funds and ETFs have turned are 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. We are overweight storage, cell towers, industrial, retail, and residential and have increased our position within lodging in the more recent selloff.

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.