COHEN & STEERS
REAL ASSETS. REAL RETURNS.

Rising Rents Matter More to REITs Than Rising Rates

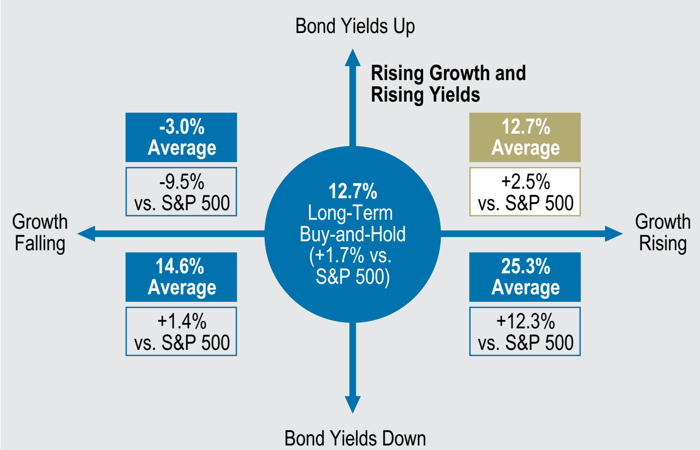
Rate hikes get a lot of attention, but for REITs, they're often not the big story. The big stories today are 77 consecutive months of job growth, a 9-year low in unemployment and a strengthening economy, giving landlords greater ability to raise rents. When rents are rising, history shows that REITs can deliver strong returns—despite higher interest rates.

The perception that REITs always underperform when interest rates are rising is simply not supported by historical data. Higher rates may unsettle markets in the short term, but what tends to matter more for REITs in the long run is the direction of the economy and job growth. Historically, REITs have had strong returns in periods of monetary tightening and rising bond yields, as this is usually a reflection of accelerating inflation and economic growth.

Rising yields with growth have been a positive combination for REITs: The chart below shows annualized returns of the U.S. REIT market since 1981, grouped according to changes in the 10-year Treasury yield and U.S. Leading Economic Indicators over one-month periods. In months when growth was improving and bond yields were rising, REITs outperformed the S&P 500, averaging 12.7%—consistent with their long-term buy-and-hold return.

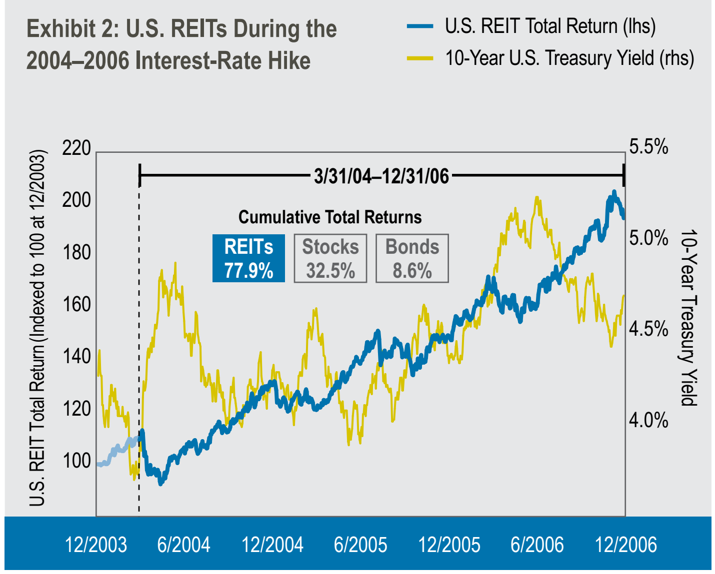
What happened in the last rate-hike cycle? In March 2004, a strong jobs report caused a spike in Treasury yields, causing REITs to sell off and lag the S&P 500 over the next month. As markets digested the data and volatility subsided, REITs recovered. Over the next two years, the Federal Reserve raised interest rates 17 times, from 1.0% to 5.25%. From the 10-year Treasury yield low in March 2004 through the end of 2006, REITs had a cumulative return of 78%, widely outperforming U.S. stocks and bonds.

Exhibit 1: Annualized U.S. REIT Returns in Different Growth/Bond Yield Environments
FTSE NAREIT Equity REIT Index, Since March 1981[a]



At December 31, 2016. Source: NAREIT, Thomson Reuters, Cohen & Steers.

Exhibit 2: U.S. REITs During the 2004–2006 Interest-Rate Hike



Source: Bureau of Labor Statistics and Morningstar.

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(a) The period since March 1981 selected based on the common period of available index and economic data. Bond yields based on the 10-year Treasury. Growth measured by Cohen & Steers' U.S. Leading Economic Indicator (LEI), comprised of six cyclical macro factors that have historically signaled turning points in broad economic growth. Annualized performance based on monthly data, grouped according to positive/negative change in bond yields and rising/falling U.S. LEI. Percent of monthly observations out of 424 total, by quadrant: growth rising/yields down: 22%; growth rising/yields up: 26%; growth falling/yields down: 31%; growth falling, yields up: 21%.

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Opportunity Amid Rate-Driven Volatility

Too often, we see investors focusing on short-term changes in interest rates, yet losing sight of the bigger picture. As investors adjust asset allocations for the shifting market environment, we believe REITs offer attractive characteristics:

- **Attractive yields with growth potential:** As of year-end 2016, real estate was the third-highest-yielding sector in the S&P 500 at 3.5%, compared with the S&P average of 2.1%. The broad U.S. REIT market, represented by the FTSE NAREIT Equity REIT Index, had a dividend yield of 3.9%. REITs have historically provided steady dividend growth along with capital-appreciation potential.
- **Inflation protection:** REITs have historically exhibited a positive association with inflation surprises due to the impact of higher replacement costs on property values, as well as the ability of landlords to raise rents.
- **Potential diversification benefits:** Since 1990, REITs have had a 0.55 correlation with broad equities and a 0.19 correlation with bonds. Combining assets with different performance drivers has the potential to improve risk-adjusted returns.

Investing With Cohen & Steers

Cohen & Steers is one of the world's leading investors in real estate securities, with the largest team of dedicated real estate portfolio managers, analysts and traders in the industry. With 30 years of REIT investing expertise, we have helped investors navigate many market cycles, capitalizing on opportunities through a disciplined investment process. To learn more, visit cohenandsteers.com.

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