Cohen & Steers Global Real Estate Securities Strategy

The global real estate market, as represented by the FTSE EPRA/NAREIT Developed Real Estate Index, had a 9.1% total return in the second quarter (in Australian dollars, net of dividend withholding taxes), bringing the year-to-date return to 6.2%.

Investment Review

Global real estate stocks had a solid gain in the second quarter and outperformed the broader equity market, although performance varied by region. The U.S. led the advance, rebounding from a decline in the first quarter, aided by a favorable economic and jobs backdrop and amid valuations that appeared attractive compared with S&P 500 companies as a whole.

Visible M&A Activity

The period saw a continuation of real estate M&A activity in the U.S. and elsewhere, a trend that has highlighted the potential for value opportunities in the asset class. Merger news in the quarter included private companies targeting listed real estate; in June, an affiliate of Greystar Real Estate Partners announced that it would acquire student housing REIT Education Realty Trust (EDR) in a $4.6 billion privatization, at a 26% premium to EDR's 90-day volume-weighted average share price. There were also mergers among public entities, including Prologis' bid for its smaller industrial peer DCT Industrial Trust at a 15% premium. In the U.S. hotel sector, listed Pebblebrook and private Blackstone made competing offers to acquire LaSalle Hotel Properties.

Elsewhere of note, Blackstone made a bid for Australia's Investa Office Fund, an AUD$3 billion all-cash offer at a 13% premium to Investa's previous-close share price. Unibail-Rodamco completed its acquisition of Australia's Westfield (which only owns malls in the U.S. and the U.K.). Starwood Capital made a bid to acquire Sweden's residential landlord Victoria Park at an 8% premium to its share price.

In monetary policy news, the U.S. Federal Reserve, as expected, raised short-term interest rates by 0.25%, to the 1.75% to 2.0% range. The Fed's statement cited continued improvements in the U.S. economy and employment and an inflation rate that was nearing its 2% target. The European Central Bank announced it would end its bond-buying QE program by the end of 2018, with tapering set to start in the fall, although it said interest rates will likely remain unchanged at low levels until at least mid-2019.

Country Highlights

- U.S. REITs (10.3% total return[1]) had solid performance. All sectors advanced. One of the largest gains was made by hotels (14.1%[2]), a highly cyclical group that benefited from economic optimism and positive sentiment regarding actual and possible M&A activity. At the same time, the

Index Performance (A$)

	Linked Index[(1)]
Q2 2018	9.13%
YTD	6.24%
1 Year	9.68%
3 Year	7.11%
5 Year	10.61%
10 Year	7.67%

(1) Linked Index: FTSE EPRA/NAREIT Developed Real Estate Index. Prior to 12/31/06, the returns for the index are from the S&P Developed Property Index.

Data quoted represents past performance, which is no guarantee of future results.

This information is not representative of any Cohen & Steers account and no such account will seek to replicate an index. You cannot invest directly in an index and index performance does not reflect the deduction of fees, expenses or taxes.

Periods greater than 12 months are annualized.

Index Characteristics

	FTSE EPRA/NAREIT Developed Real Estate Index (Net)
Premium or Discount to NAV	0.7%
Premium or Discount to DDM	5.2%
Dividend Yield	4.0%
Price/Cash Flow (2018E)	17.5x
Cash Flow Growth (2018E vs. 2017)	5.5%
Cash Flow Growth (2019E vs. 2018E)	5.3%
5-Year Cash Flow Growth	4.5%
Total Market Capitalization	A$2,366.1B
Weighted Average Market Cap.	A$18.8B
Number of Holdings	338

Source: Cohen & Steers.

Characteristics are market capitalization-weighted averages of estimates for companies in the FTSE EPRA/NAREIT Developed Real Estate Index (Net) and are subject to change over time.

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less-cyclical health care sector (14.2%) outperformed as well, benefiting from a view that health care property owners were resolving key tenant concerns with renegotiated leases.

- In the U.K. (5.0%), most real estate stocks had gains, although there was a wide dispersion of returns amid ongoing economic and Brexit uncertainty. Certain less-cyclical names like self storage company Safestore Holdings and industrial REIT Segro outperformed. At the same time, office landlord Great Portland Estates also performed well, amid signs of surprising resilience in London offices. Retail landlords were among the poorer performers on concerns about continued retailer bankruptcies. Intu Properties, which has more exposure to failing tenants than its peers, was particularly weak.
- Germany (8.1%) benefited as investors favored countries perceived to have less political risk. Apartment landlord Deutsche Wohnen, which was among the better performers, reported strong cash flows driven by same-property rental growth, with indications for continued upward rent momentum.
- Most companies in France (4.4%) had gains, although retail landlord Mercialys had a flat return, restrained by its largest shareholder selling a 10% stake in the company.
- Spain (2.8%) underperformed but finished the period on a strong note, as the overhang of Italy political risk on peripheral markets faded and as Spain's economic recovery remained on track.
- Australia (9.9%) was the top performer in Asia Pacific, aided in part as some investors moved money from mall owner Westfield (which was acquired by France's Unibail-Rodamco and de-listed at the end of May) to other property companies listed in the country. Goodman Group had a sizable gain, benefiting from a favorable logistics backdrop in all markets in which it operates. Investa Office Fund rallied after the company received an AUD$3 billion all-cash buyout offer from Blackstone at a 13% premium to its previous-close share price.
- Hong Kong (0.2%) was slightly positive as a group, although returns varied widely. Wharf Real Estate Investment and Link REIT were positive outliers, aided by their relatively defensive properties at a time of increasing market uncertainty. Developers, on the other hand, were generally hindered by concerns about global trade, China growth and rising local interest rates, despite a resumption in property market activity after a quiet first quarter that suggested strong pent-up demand.
- Singapore (–5.4%), which tends to be sensitive to global trade news, was adversely affected by the weakness in ASEAN markets due to trade tensions, in addition to higher oil costs and concerns of an economic slowdown in China. Developers were also pressured by a significant increase in pre-sales residential supply.
- In Japan (4.6%), REITs generally performed well, displaying their defensive qualities. Sentiment toward developers turned negative on concerns that President Trump's threat of tariffs on the steel and automobile sectors would hurt the Japanese economy, which is particularly dependent on exports. Still, developers generally guided positively, commenting on the strong office market.

Portfolio Performance

The portfolio had a positive total return in the quarter, although it underperformed its benchmark. Stock selection in the U.S. detracted from relative performance, in part due to our underweight in outperforming health care REITs. Our out-of-index allocation to Brazil also detracted from relative returns; Brazilian stocks in general were pressured by signs of economic deceleration, election uncertainty, and rising oil prices. In addition to hampering the consumer, higher fuel costs sparked a crippling truckers' strike in the period. Stock selection in Hong Kong and Japan hindered performance as well.

Factors that helped relative returns included our non-allocation to Singapore, a market we believe has limited growth potential and generally expensive valuations. Stock selection in the U.K. also aided performance, in part due to our overweight in self storage company Big Yellow, which had a significant gain, and non-investment in retail landlords Hammerson and Intu Properties, which struggled.

Investment Outlook

Over the past five years, global real estate securities have experienced generally strong cash flow growth but have widely trailed the stock market's performance. As a result, REITs today are trading at earnings multiples near the low end of their five-year range while broad equity valuations are at cycle highs, representing attractive relative value, in our view.

Although volatility in real estate stocks may continue in the short run as investors seem focused on interest rates, bond yields are rising because of stronger growth and signs of higher inflation, both in the U.S. and abroad. We believe commercial real estate should continue to see improving operating fundamentals in most global markets amid solid

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economic growth, steady job creation, reasonable new supply levels, and monetary conditions that should remain relatively accommodative even as stimulus is gradually withdrawn. We therefore generally favor pro-cyclical real estate sectors over the more interest-rate-sensitive sectors.

Potential Opportunities

U.S. office, residential and data centers. We anticipate that real estate demand in the U.S. will moderately outpace new supply across most sectors in the coming months, but cyclical and secular changes to some sectors will result in widely divergent operating results. West Coast central business district offices should continue to benefit from strong job creation and low speculative supply, while New York and other East Coast office markets are decelerating due to substantial supply and weaker demand. We favor data centers and cell towers because of their strong cyclical and structural growth drivers and still moderate valuations, and residential sectors (particularly single-family rentals and manufactured housing) due to strong job growth, low home ownership trends, and demand for affordable rental options.

Continental Europe. Property markets on the continent are likely to continue to benefit from strong fundamentals, even as economic growth appears to be decelerating. We favor residential property owners in most markets—Spain and Germany in particular. Economic growth is likely to remain robust in Spain and Sweden, with office landlords being a primary beneficiary. Offices in France also appear attractive given the sector's improving fundamentals and moderate supply growth.

U.K. less-cyclical sectors. In light of our relatively negative view of economic prospects for the U.K., we favor companies that we believe feature more defensive or structural growth characteristics and that will likely remain relatively insulated from an economic deceleration. These include logistics warehouses, student housing and health care landlords. While these sectors remain our focus in the U.K., certain office landlords appear attractive based on improving valuations.

Japan and Australia offer select areas of opportunity. In Japan, we remain positive on developers given attractive valuations and solid fundamentals. We maintain our preference for certain J-REITs that offer the ability to deliver relatively stronger dividend yields and/or earnings growth. In Australia, the Sydney office market is expected to experience net demand growth, boosting property occupancy and rental rates. We also favor logistics landlords, which are experiencing strong demand from the rapid growth in e-commerce, while the traditional brick-and-mortar retail shopping centers and malls are beginning to suffer its effects.

Approaching With Caution

U.S. retail, health care and industrial landlords. We remain moderately underweight the U.S. due to what we believe are more attractive opportunities elsewhere. We are most notably underweight malls and health care in light of the secular headwinds facing both sectors, but we are beginning to identify undervalued companies that may have worked through the worst of their problems. For example, certain retail landlords appear to be in a healthier competitive position as several national retailers have seen better-than-expected growth, demonstrating they have been able to defend more effectively against e-commerce competitors, at least for now. We remain underweight industrial properties despite their strong organic growth, as valuations have become excessive relative to growth, in our opinion.

U.K. retail. We remain negative toward the U.K. retail sector due to the damaging effects of Brexit, e-commerce, and our negative macroeconomic outlook for the country. High occupancy costs may also prove to be a headwind for the profitability of retailers and department stores.

Singapore and Australian retail. While the Singapore economy is improving, we see limited market upside, given global trade tensions that threaten the region coupled with stretched valuations. Suburban malls face growth challenges with supply accelerating and e-commerce penetration still low. We expect pressure on capital values over time, especially if the monetary backdrop tightens. In Australia, retail spending trends at traditional shopping centers are weakening following the continued push by online retail offerings (such as the arrival of Amazon), which is disrupting the Australian market in the same way it has in the U.S.

Keeping Watch

Hong Kong. Hong Kong interest rates are primarily influenced by the U.S., so a tighter Federal Reserve policy could weigh on real estate securities there. Even so, we believe the impact of higher rates on residential mortgages should be limited, given healthy housing demand supported by strong domestic consumption sentiment and capital inflows from mainland China. However, increasing trade tensions between the U.S. and China could hinder economic growth and investor confidence in coming months, and more cyclically oriented property companies may be relatively more volatile despite the solid underlying property market.

(1) All country returns in this commentary are in local currencies.
(2) All sector returns in this commentary are in USD.

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Index Performance by Country

	Q2 2018		YTD 2018	
	Local	**USD**	**Local**	**USD**
North America	**9.92%**	**9.80%**	**1.89%**	**1.61%**
United States	10.25%	10.25%	1.67%	1.67%
Canada	4.10%	2.02%	5.07%	0.08%
Asia Pacific	**3.26%**	**0.53%**	**1.11%**	**0.34%**
Japan	4.63%	0.46%	6.01%	7.81%
Australia	9.90%	5.86%	3.04%	-2.66%
Hong Kong	0.19%	0.22%	-3.06%	-3.38%
New Zealand	3.24%	-3.10%	-1.53%	-6.26%
Singapore	-5.41%	-9.03%	-7.25%	-9.10%
Europe	**5.87%**	**0.23%**	**2.66%**	**-0.51%**
Spain	2.77%	-2.43%	12.61%	9.49%
Austria	5.58%	0.23%	9.97%	6.92%
Germany	8.05%	2.58%	7.21%	4.24%
Belgium	7.53%	2.08%	6.59%	3.64%
Switzerland	2.47%	-1.17%	2.84%	0.93%
United Kingdom	4.96%	-1.21%	0.95%	-1.47%
Sweden	9.10%	2.13%	7.07%	-2.01%
Ireland	0.48%	-4.61%	-2.84%	-5.53%
France	4.36%	-0.92%	-3.33%	-6.01%
Norway	6.14%	2.24%	-7.09%	-6.76%
Italy	9.46%	3.92%	-4.37%	-7.02%
Netherlands	5.07%	-0.48%	-4.72%	-7.57%
Finland	5.14%	-0.19%	-6.94%	-9.51%
Middle East - Africa	**10.65%**	**6.13%**	**-4.27%**	**-9.21%**
Israel	10.65%	6.13%	-4.27%	-9.21%

Source: Cohen & Steers.

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The FTSE EPRA/NAREIT Developed Real Estate Index - net is an unmanaged market-capitalization-weighted total-return index, which consists of publicly traded equity REITs and listed property companies from developed markets and is net of dividend withholding taxes.

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