

ALTERNATIVE INVESTMENT UPDATE

How REITs can weather a slowdown

The late market cycle and increased uncertainty are less of a concern for global REITs than equities



The performance of equities compared to real estate investment trusts in 2018 had a bit of a hare-and-tortoise dynamic. Synchronized global growth initially drove equities to new highs while real estate lagged. But as trade tensions, Brexit fears, rising interest rates in North America and other hints of economic slowdown surfaced, the optimism that fuelled global stock markets collapsed and gave way to volatility in the last quarter.

Amidst all this, global real estate securities emerged less battered than other sectors. In its 2019 outlook for the space, Timbercreek

Investment Management noted that global REITs outperformed global equities by 785 basis points in Q4, registering returns of -5.5% compared to -13.3% for equities.

"While we are cognizant of the fact that the global growth trajectory is changing, we believe this sets the stage for REITs to outperform broad equities by generating an attractive total return balanced between yield and growth," said Timbercreek's Corrado Russo. "REITs and their more predictable recurring income streams have proven to be a powerful solution in slowing GDP environments."

Acknowledging the lateness of the cycle and increased macroeconomic uncertainty in 2019, Timbercreek's outlook suggests global REITs could achieve "a positive total return in 2019 in the range of 9% to 10%." That prediction includes 5% cash-flow yield and 4% to 5% earnings growth driven by annual contractual rent bumps, positive releasing spreads, and completion of redevelopment and development projects currently underway.

"REITs ... have proven to be a powerful solution in slowing GDP environments"

The firm also believes REITs will continue to outperform broad equities thanks to their resilience, attractive valuations and historical outperformance in economic slowdowns. Timbercreek said it also expects an increase in institutional allocations to real estate in 2019, which will further drive global REIT growth.

As for the Canadian market, Timbercreek's analysis highlighted bright prospects for both industrial REITs and senior housing. "Although we acknowledge that the [senior housing sector] could be vulnerable to short-term headline risks in brief periods when elevated amounts of supply disrupts rental growth," the report said, "we think Canada will struggle to construct enough beds over the long term in order to meet the needs of an aging population."



Dennis Mitchell
CEO and CIO
STARLIGHT CAPITAL

Years in the industry
15+

Fast fact
The Starlight Hybrid Global Real Assets Trust was launched on the Aequitas NEO Exchange in December under the symbol SCHG.UN

Q&A

Seeking real returns and stability

What are the advantages of the Starlight Hybrid Global Real Assets Trust over other real asset investment vehicles in Canada?

The Starlight Global Real Assets Trust is a unique investment vehicle in the marketplace because it brings institutional assets to retail investors. It pays a 5% yield on a monthly basis by combining not just real estate and infrastructure, but also listed securities as well as direct investments, which should provide uncorrelated returns.

What opportunities are there for global real asset investment, given the near-term outlook in the markets?

The markets were very volatile in 2018, particularly in the fourth quarter; I think a lot of investors were disappointed with their returns. But both real estate and infrastructure outperformed the broader equity markets in Canada and the US. Canadian REITs delivered returns of 6.3%, which includes around a 5% distribution yield paid on a monthly basis and capital appreciation. Meanwhile, the broader TSX actually went down about 9%, as its yields of between 2% and 2.5% were eclipsed by capital losses.

The opportunities in the near term revolve around the strong total return potential for real estate and infrastructure, which both generate tax-efficient income. Infrastructure investments are known for growing their dividends and distributions on a regular basis. Real estate is known for having very tax-efficient

distributions; REIT distributions aren't subject to the double taxation that corporate dividends face. Both sectors are also trading in and around their long-term averages from a multiples standpoint, and they do well in rising-rate environments where economic activity is picking up. That all adds up to high-single-digit to low-double-digit potential returns.

On top of that, a lot of the returns are contractual. Real assets like toll roads, pipelines, office towers and industrial facilities have long-term leases. That creates a lot of predictability around the cash flows and total returns from real estate and infrastructure.

What's the biggest obstacle for Canadian investors in terms of infrastructure and real estate investing?

When you look at the Canadian investment landscape, you'll find retail investors have about \$1.5 trillion in mutual funds and ETFs, and less than 5% of that is in real estate and infrastructure mutual funds. But the top 100 pension plans in Canada control around \$2.1 trillion in assets, over 18% of which is in real estate and infrastructure.

So there's a dearth of supply of mutual funds focused on these two sectors, which results in a lack of opportunity and, in turn, a lack of awareness among retail investors. We're doing our best to help people understand the opportunities in the real estate and infrastructure space, and we're providing new funds and solutions they can take advantage of.

NEWS BRIEFS



Mortgage-based fund joins NEO Connect

CMI Mortgage Investment Corporation has launched NEO Connect's first mortgage-based fund, offering investors a new option for investing in private mortgages. "The market is showing an increase demand for secure investment options when it comes to investing in real estate," said CMI's Bryan Jaskolka. "Launching on NEO Connect makes CMI MIC more accessible to Canadians and offers an alternative PTF for advisors and their clients to ... create an alternative fixed-income investment that yields significant value."



US alternative firm makes Canadian debut

Regal Assets, an American alternative investment firm that specializes in providing investments such as cryptocurrency and precious metals for retirement account holders, has expanded to Canada. Tyler Gallagher, the company's Canadian CEO, noted that many investors in Canada are unaware that they can own assets like physical gold and silver as part of their RRSP or TFSA. Regal Assets handles the entire investment process, including communication with account custodians and filling out the required paperwork.



Pender reopens Small Cap Opportunities Fund

Management is reopening two classes of the Pender Small Cap Opportunities Fund, which was capped in 2015 so the fund could better maintain its focus on investing. Citing current market circumstances that have opened up investment opportunities in the small- and micro-cap tech markets in the US and Canada, Pender launched Class B and Class G units of the fund through prospectus via Fundserv on January 11; the classes will remain open until the fund has raised \$50 million of additional capacity.



AGF makes investment in infrastructure fund

AGF Management has announced a \$75 million commitment to a closed-end fund that invests in North American middle-market infrastructure and is managed by its subsidiary, InstarAGF. "AGF has a strategic priority to develop an alternatives platform, including infrastructure, with an aim to further diversify our business," said AGF CEO and chief investment officer Kevin McCreadie. "The attractiveness of this business stems from the fact that underlying assets are uncorrelated to our core business."



Has the hedge fund heyday come to an end?

A Preqin poll of fund managers and institutional investors found that 79% of private equity investors expected to increase their allocations in that space by 2023, while only 27% of hedge fund investors planned to raise their hedge fund allocations. According to Amy Bensted, head of Preqin's data products team, the firm predicts just 31% growth for the hedge fund industry in the next five years – the smallest percentage increase among all the alternative asset classes tracked by Preqin.