Global Listed Real Estate: 2018 Review & 2019 Outlook

Cash flow and dividend growth remain positive drivers for global listed real estate, while the impact of monetary and fiscal policies remains uncertain. The Duff & Phelps Global Real Estate Investment Team takes a look at how the asset class performed in 2018 and shares their expectations for the year ahead.

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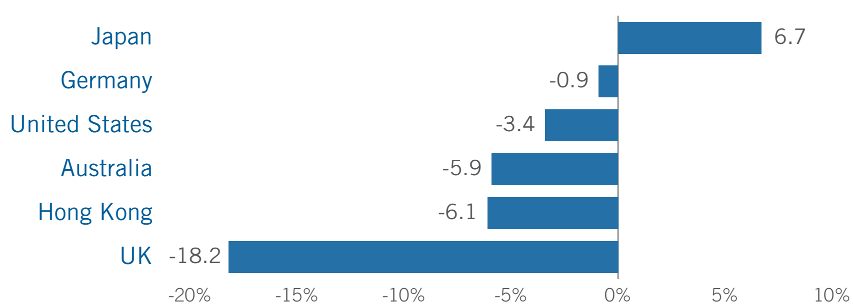
2018 Review

U.S. REITs, as measured by the FTSE Nareit Equity REITs Index, returned -4.6% in 2018, relatively in line with the -4.4% return of the broader U.S. equity market, as measured by the S&P 500® Index. The benefit of lower correlation was visible in all quarters of the year, especially in the fourth quarter, with REITs outperforming U.S. equities by 6.8%.

U.S. REIT returns were anchored by their attractive dividend yield, steady cash flows and dividend growth, a strong private market bid and selective M&A, and attractive valuations in the face of increased economic uncertainty. U.S. tax law changes lifted the economy in the first half to higher rates of growth than the market felt could be sustained. Trade concerns, a modest number of Fed rate increases, and the Fed's balance sheet unwind were top of mind. Global macro-political volatility added to broader market defensiveness and helped more defensive sectors within U.S. REITs outperform, including the less cyclical freestanding retail, manufactured homes, and healthcare property sectors.

International real estate securities underperformed U.S. REITs, hurt by a stronger U.S. dollar. With the exception of Japan, Sweden, and Germany, all of the major international real estate markets underperformed the U.S. on a U.S. dollar basis. A stronger dollar and geopolitical trade and growth concerns were negative drivers of international total return performance.

2018 REIT PERFORMANCE—MAJOR COUNTRIES (%)
Through December 31, 2018



Source: FTSE EPRA Nareit Developed Index (net). **Past performance is not indicative of future results.** Returns are expressed in U.S. dollars and include the reinvestment of dividends. Indexes are gross of fees and are not available for direct investment.

2019 Outlook

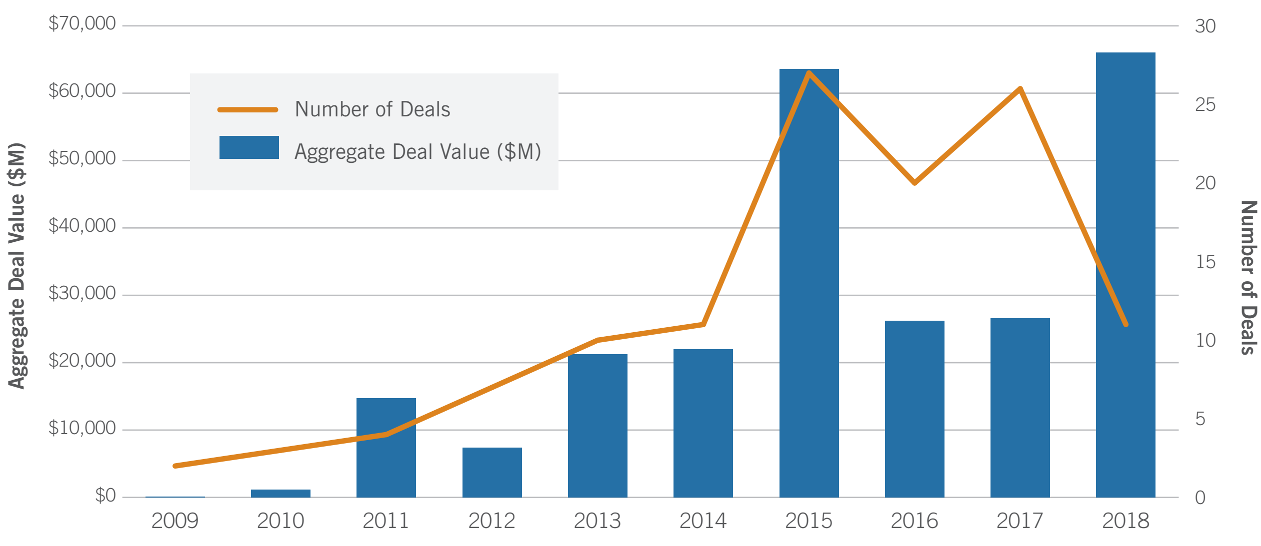
Looking ahead, we expect continued variance in the global economic growth picture and regional real estate fundamentals. Regionally, we are looking to Ireland, Australia, and the U.S. for economic growth leadership. We expect the variance in global growth trajectories to create opportunities for active managers such as ourselves, who are focused on owner-operators of high quality real estate, with solid balance sheets and proven management teams, to deliver outperformance versus the broader REIT market. Overall, we expect cash flow and dividend growth for global real estate securities to be solid once again in 2019.

Key themes we are focusing on include:

- **Rents, not rates:** While there is likely to be upward pressure on interest rates in many markets, rental rate growth—particularly for high quality real estate, will continue to support further cash flow and dividend growth.
- **New supply:** While new supply levels are generally catching up to years of undersupply, selective geographic markets and property sectors will remain impacted by new development.
- **Balance sheet health:** Cash flow and dividend growth rates are converging across many global markets, but U.S. balance sheets are benefiting from more active pruning and remain better positioned with less leverage than most international markets.
- **M&A tailwind:** M&A activity picked up in 2018, driven by healthy discounts to NAV in public real estate security markets, as well as large pools of private equity real estate capital looking to be put to work. We expect this to continue in the year ahead.

M&A TRANSACTION ACTIVITY

As of November 30, 2018



Source: SNL Financial. Completed and pending transaction activity.

Our base case total return drivers for global real estate in 2019 include:

- Attractive estimated cash flow growth of 4-6%.
- Dividend yield of approximately 4%, with above average growth expected in the U.S. given lower payout ratios.
- Healthy demand, increasing rents, and manageable new supply driving cash flow and dividend growth.
- From a global perspective, real estate fundamentals remain more attractive for the industrial/logistics and data center property sectors with secular tailwinds from e-commerce and the cloud.

There are several potential upside catalysts to our base case. A key macro consideration would be greater-than-expected global economic growth, which would drive higher real estate occupancies and rents. Another upside factor would be rotation into real estate securities from bonds and broader equities, as investors embrace asset classes which provide diversification benefits alongside traditional allocations. And the increased potential for M&A and privatizations continues to exist given the listed discounts to private real estate market prices, robust bids, and ongoing appetite for high quality, core real estate among institutional investors.

From a balanced perspective, we also note certain downside risks to our base case assumptions. A key risk would be ongoing waves of macro-political shocks, which could lead to broad-based economic deceleration or a dislocation in global debt markets. Also, interest rates could increase at a faster pace and magnitude than a lift in net operating income growth and replacement costs could absorb. And an acceleration in the pace of new commercial real estate supply would also be a concern.

We will continue to closely monitor broad global macro drivers such as diverging monetary and fiscal policies, potential central bank pausing, and ongoing geopolitical risks. But overall, we believe the global real estate market cycle still has room for further growth against a backdrop of solid catalysts which underpin our base case.

To learn more about Virtus Duff & Phelps Real Estate Funds, please visit virtus.com or call 800-243-4361.

INDEX DEFINITIONS

FTSE Nareit Equity REITs Index: a free-float market capitalization-weighted index measuring equity tax-qualified real estate investment trusts, which meet minimum size and liquidity criteria, that are listed on the New York Stock Exchange, the American Stock Exchange and the NASDAQ National Market System. **FTSE EPRA/Nareit Developed Index (net):** a free-float market capitalization-weighted index measuring publicly traded equity REITs and listed property companies from developed markets, which meet minimum size and liquidity requirements. **S&P 500® Index:** a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The indexes are calculated on a total-return basis with dividends reinvested. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

IMPORTANT RISK CONSIDERATIONS

Equity Securities: The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium sized companies may enhance that risk. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund. **Real Estate:** The fund may be negatively affected by factors specific to the real estate market, including interest rates, leverage, property, and management. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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