Global property securities market total returns

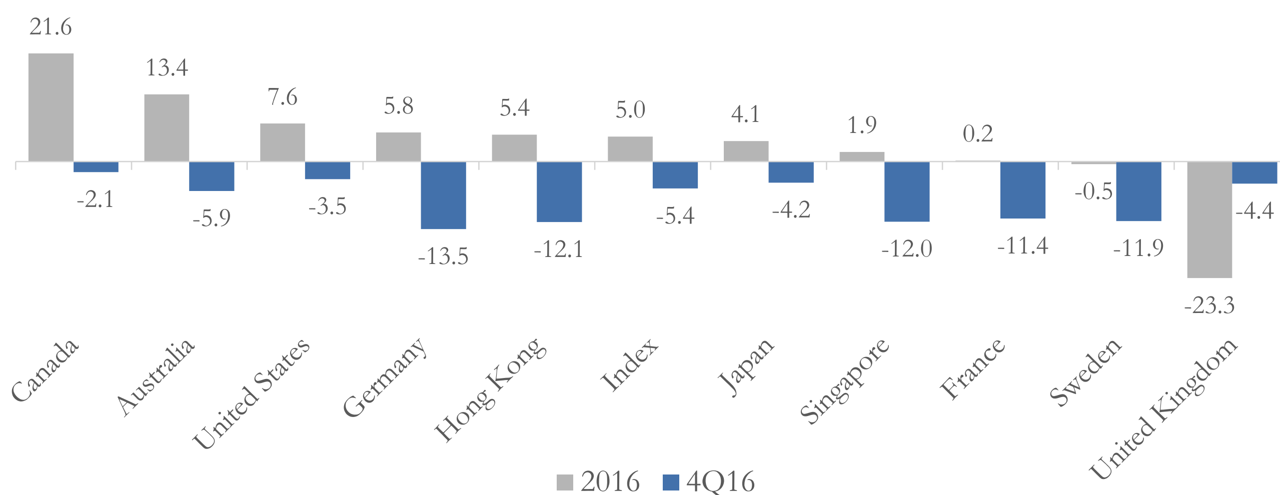
Index/region	4Q16	2016
FTSE EPRA/NAREIT Developed Index ("Index")	-5.4%	5.0%
Asia-Pacific	-7.5	6.1
Europe	-8.9	-7.1
North America	-3.4	8.2
FTSE All World Developed Index	1.9	8.2
JP Morgan Global Aggregate Bond Index	-6.6	2.2

Source: Bloomberg, FTSE EPRA/NAREIT, and FactSet in USD.

Global property securities produced a 5.0% total return in 2016 despite the fourth quarter pullback as bond yields rose globally. US Interest rates had been gradually rising since late summer, but spiked in November following Donald Trump's surprise Presidential win. His victory, together with a unified Republican Congress, has lifted optimism as now seen in the NFIB Index. The Trump administration has an agenda that includes tax reform/cuts, regulatory reforms and fiscal stimulus. Independently, the Federal Reserve has signaled that interest rates are likely to rise in 2017. With the post-election surge in bond yields spread across the globe, a rotation away from yield/defensive investments to cyclicals is underway. The strength of the USD negatively impacted returns during the quarter. While real estate securities outperformed bonds, they lagged equities by a wide margin for the quarter and full year. **Looking ahead to 2017, uncertainty and caution have become consistent themes in developed markets around the globe.**

Performance by Country (% in USD)

FTSE EPRA/NAREIT Developed Index



Source: FTSE EPRA/NAREIT and FactSet in USD for countries representing at least 1.0% of Index weight.

North America (58.2 % of the Index)	4Q16 Total Return North America	U.S.	Canada
Index Weight	58.2%	55.3%	2.9%
Local Currency	-3.3	-3.5	-0.1
USD	-3.4	-3.5	-2.1

Source: FTSE EPRA/NAREIT and FactSet.

North America was the best performing region globally, both for the quarter and full year. While the region was not immune from the negative impact of rising bond yields in the quarter**,** both the U.S. and Canada delivered solid returns for the full year with Canada's 21.6% return for 2016 the highest among major developed countries. **Property stocks in both Canada and the U.S. lagged their respective broader equity indices.**

More surprising than Trump's victory in the election was the subsequent shift in reaction of the capital markets. Huge losses in the futures markets on the night of the election once the result seemed inevitable were quickly reversed and all facets of a "reflation" trade were in full display with small caps, cyclical and financial stocks up, bond prices down and yields up, together with a strengthening USD. An FOMC rate hike in December became a near certainty, along with potential further increases in 2017, and the trend of rising bond yields went global.

The performance of REITs in the U.S. showed quite a bit of dispersion in the quarter, demonstrating that not all REITs are created equal in a reflationary world. **The duration of the underlying leases and sensitively to an improved growth outlook were the most important variables in determining relative performance by property type in the quarter.** Additionally, small cap companies generally outperformed large cap companies, both in the quarter and for the year.

Hotels were clear beneficiaries of renewed optimism with a total return of close to 20% in the quarter. Investors bid up the stocks despite signs of deteriorating fundamentals with third quarter results and concerns in two major REIT markets (New York and San Francisco) in 2017.

Not all short duration sectors enjoyed the same level of euphoria from investors as Hotels. While the **Apartment and Self-Storage sectors managed to outperform U.S. REITs overall in the quarter and deliver modestly positive total returns, their performance was more muted** as investors remained concerned over pockets of supply and decelerating fundamentals.

Among the weaker performing property sectors in the quarter were long lease duration assets such as Health Care and Net Lease. Both woefully underperformed in the quarter as investors fled sectors most sensitive to rising interest rates.

Performance within the Office sector was mixed in the quarter with some dispersion as well. REITs with exposure to NYC benefitted from improved sentiment towards financial services tenants driven by the potential for less regulation and higher rates, while those with exposure to the Washington D.C. region got a slight lift on speculation of improved post-election tenant demand.

The Retail sector continued to suffer in performance in the quarter. Historically, retail landlords have been beneficiaries of a better economy and higher retail sales, generally outperforming during periods of good GDP growth. However, fears of a secular decline vis a vis internet retail and obsolescence of the anchor store, as exemplified by problems at department stores such as Sears and Macys, has scared investors away. **Regional malls have experienced weak investor sentiment most of the year**, but the weakness in the quarter was broader across the retail spectrum.

The rebound of Canadian REITs in the quarter and for the year was notable. After a difficult year in 2015 as a result of a weaker Canadian economy that was battered by falling energy prices, sentiment has improved as energy prices have rebounded despite what is still a mixed economic outlook.

Asia-Pacific (26.3% of the Index)	4Q16 Total Return				
	Asia-Pacific	Japan	Hong Kong	Australia	Singapore
Index Weight	26.2%	11.1%	7.1%	5.9%	2.1%
Local Currency	-0.2	10.3	-12.2	-0.5	-6.7
USD	-7.5	-4.2	-12.1	-5.9	-12.0

Source: FTSE EPRA/NAREIT and FactSet.

The Asia-Pacific region was the second weakest performing region in the quarter. While local currency returns were relatively flat for the quarter, the strengthening of the USD following the rise in rates after the U.S. election negatively impacted USD total returns across most of the region. Despite a difficult quarter, Asia provided the second best absolute total returns for the full year with a USD total return of 6.1% slightly exceeding the local currency return of 4.9%.

Hong Kong was the worst performing region in the quarter. In early November the government unexpectedly raised the Double Stamp Duty to 15% for second homebuyers from the previous range of 1.5% to 8.5% range. **The move was in response to concerns over rising residential property prices and negatively impacted prices for Hong Kong property companies with residential development exposure.** Governance questions also impacted Cheung Kong Properties (CKP), which was the worst performing security in the quarter with a total return of -16.0%. CKP announced the sale of a partial interest in a large mixed-use project in Shanghai for RMB10 bn (USD1.4 bn), but disappointed investors with the decision to redeploy the proceeds into the purchase of a business (aircraft leasing company) unrelated to property from a related party (CKH Holdings).

Japanese real estate stocks fared well in the quarter in local terms, the only country in the region to produce a positive local currency total return. The strength was largely in response to the Bank of Japan's decision in late September to peg its 10-year government bond yield near 0%, limiting the rise in yields relative to that experienced in other regions. The move resulted in a 13% decline in the Yen versus the USD in the quarter, a positive for Japan's export oriented economy. The improved outlook was an even bigger boost to Japanese Developers versus the JREITs since they are viewed as more cyclical beneficiaries of an improved growth outlook. **Japanese Developers outperformed the JREITs in the quarter, delivering a local currency total return of 21.8% versus 2.1%.** However, Japanese Developers lagged for the full year, with a local currency total return of -7.9% versus 11.1% for the JREITs.

A-REITs had a relatively benign quarter despite an 85 bps increase in the Aussie 10 year government bond yield in the quarter to end at 2.76%. While the rise in yield was large, interest rates remain low from a long-term perspective**.** The performance of A-REITs in the quarter provided some positive proof that REITs can generate acceptable returns during rising interest rate environments provided cash flows are growing, balance sheets are appropriately structured and physical supply remains in check. **During the quarter, A-REITs with significant exposure to the Sydney office market performed particularly well.** The market continues to benefit from low vacancy, evidence of strong effective rent growth and a medium term outlook of limited new supply.

The prospect of rising bond yields weighed on Singapore's yield focused REITs, which had a local currency total return of -6.7%. Meanwhile, Singapore based Global Logistic Properties (GLP) announced it is undertaking an independent strategic review of options available for its business, in line with its commitment to enhance shareholder value. The move followed a request from its largest shareholder, GIC Real Estate. GLP has traded at a discount to peers in part due to governance concerns and its exposure to over supplied secondary markets in mainland China. Speculation surrounding the outcome of the process helped GLP produce a local currency total return of 17.7%.

Europe (15.6% of the Index)	4Q16 Total Return					
	Europe	U.K.	Germany	Sweden	France	Europe (ex U.K.)
Index Weight	15.6%	4.7%	3.1%	1.2%	3.3%	10.9%
Local Currency	-3.5	0.6	-7.9	-6.6	-5.6	-5.1
USD	-8.9	-4.4	-13.5	-11.9	-11.4	-10.8

Source: FTSE EPRA/NAREIT and FactSet.

Europe was the worst performing region globally, both for the quarter and for the full year. In addition the rise in bond yields that affected other regions, weaker currencies negatively impacted USD total returns. Despite a challenging second half of the year following the U.K.'s Brexit referendum vote, local currency total returns for the full year in Europe held up well, coming in at 0.35%. However, the USD total return for the full year was -7.1%.

After lagging each of the first three quarters of the year, U.K. property securities outperformed Europe (ex U.K.) in the quarter. The deeply discounted London office specialists, whose shares sold off most severely post referendum vote, rebounded in the quarter with Derwent London and Great Portland Estates each having a local currency total return over 6%. While modestly encouraging for U.K. property securities, a significant level of uncertainty remains regarding Brexit that is unlikely to be resolved in 2017. Prime Minister Theresa May indicated plans to trigger Article 50 of the Lisbon Treaty in March 2017, triggering the start of what will be at least a two year process of negotiating the terms of its exit from the European Union.

For the full year, the U.K was the clear laggard both in the region and globally. The U.K. had a local currency total return of -8.5% versus 5.6% for Europe (ex U.K.) with the post Brexit plunge in the Sterling versus the USD magnifying the difference in USD total returns with the U.K at -23.3% versus Europe (ex U.K.) at 2.2%. While U.K. economic data post Brexit has generally held up better than expected, U.K. property stocks have lagged the broader U.K. markets as measured by the FTSE 250, which had a local currency total return of 6.7% in 2016.

For most of the remainder of Europe (ex U.K.), the impact on property stocks from rising bond yields was more significant in the quarter. Bond yields moved up considerably in October, affected by hints of "tapering" by the ECB in their minutes, as well as broader political uncertainty across Europe as investors began to look ahead to Brexit negotiations and upcoming elections in 2017 in France, Germany and the Netherlands. The surprise outcome of the U.S. election pushed yields up further in November. At their December meeting, the ECB announced plans to extend its QE program until the end of 2017, albeit at a reduced monthly level of €60 bn versus €80 bn. Although it created some initial fears of the "taper" tantrum that occurred in the U.S. in 2013, concerns eased and yields stabilized in December to end the year on a more positive note.

German residential companies were notably weak in the quarter. Although property fundamentals remain favorable and the investment market continued to provide good support for underlying values, the more than doubling of the 10 year Bund yield in the quarter created some panic for yield sensitive investors. The yield increased 32 bps to end at 0.20%. **Similarly, Swedish property stocks were also weak in the quarter.** While the Swedish economy and property markets have done well, Swedish property companies remain sensitive rising interest rates given higher leverage levels.

Elsewhere within Europe, the weakness within France was also driven by the upward move in bond yields. With the yield on French 10 year bonds also more than doubling in the quarter to end the year at 0.68%, many of the large cap French companies such as Unibail and Klepierre that serve as bond proxies for some investors experienced downward price pressure. Although Italy's December constitutional referendum resulted in their prime minister stepping down and the appointment of a caretaker government until likely new elections in 2017, the outcome was largely expected and did not result in any panic across the region.