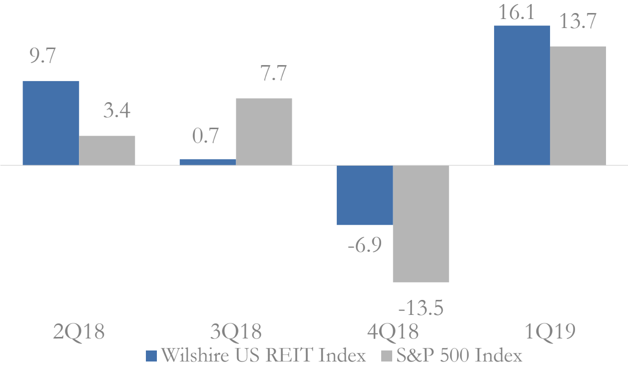
A 50 bps cut couldn't hurt… The US economy is still expanding, albeit at a slower rate. The third estimate of Fourth Quarter GDP growth was 2.2% and the Federal Reserve Bank of Atlanta projects First Quarter GDP growth to be 2.3%. According to the Bureau of Labor Statistics, changes in total nonfarm payroll in the past three months were 196,000, 33,000 and 312,000, respectively, an average of 180,333 and a definite deceleration from 223,250 for the 12 months prior**.** Despite the positive GDP and job growth, the long end of the yield curve continues to decline as the yield on the 10-Year Treasury Note went from 2.686% on December 31 to 2.414% on March 31; the yield curve flattened with the spread between the 3 Month Treasury Bill and the 10 Year Treasury Note ("3M-10Yr") tightening in First Quarter from 31 bps to only 1 bps (after turning negative for five days prior to quarter-end).

The Wilshire US REIT Index ("Index") was up 16.1% in First Quarter, besting both the S&P 500 and Russell 2000 Indices which advanced 13.7% and 14.6%, respectively; since the sharp sell-off in First Quarter 2018 (based on false expectations of a steep rise in interest rates), REITs have handedly outperformed the broader equity indices delivering 19.3% total returns for the year ending March 31, 2018 versus 9.5% and 2.0% for the S&P 500 and Russell 2000 Indices, respectively. In First Quarter, out of the 109 constituents of the Index, only one, CBL & Associates Properties ("CBL"), produced a negative total return, falling 15.4%; the best performing stock was TIER REIT, a Sun Belt office company whose acquisition by a larger peer was announced during the quarter propelling the stock 39.9%.

REITs vs. S&P 500 Index (%)

Total Return



Source: Bloomberg and Wilshire Associates.

Sector Performance of the Wilshire US REIT Index

Ranked by First Quarter 2019 Performance

Sector	1Q19	Trailing 1-Year	Current Yield
Diversified	21.0%	20.8%	4.1%
Industrial	20.8	21.0	3.0
Industrial Mixed	20.1	15.6	3.4
Retail-Local	18.8	19.6	4.7
Office	18.5	10.5	3.2
Mfd. Housing	18.0	33.3	2.0
Apartments	16.1	26.7	3.1
Wilshire US REIT	**16.1**	**19.3**	**3.8**
Hotels	14.8	4.0	5.5
Health Care	12.0	35.9	5.2
Storage	9.9	15.9	3.7
Retail-Regional	9.8	14.7	5.0
Factory Outlets	5.3	1.3	6.8

Source: Wilshire Associates.

A reversion to the mean. The First Quarter rally for REITs was broad based; even a woebegone sector like Factory Outlets managed to eke out positive total returns for the quarter. Some of the outperformers were (i) sectors that were down about 14% in 2018, Office and Retail-Local (a questionable narrative seems to be developing that store closures are going to disproportionately affect mall based landlords), and (ii) secular growth stories like Industrial and Data Centers (particularly those not overly exposed to hyper-scale leasing). Shelter companies also outperformed once again suggesting that they are threading the needle between economic optimism and pessimism; demand/job growth is good in many of the markets where REITs have ownership and supply seems tolerable to investors.

As for laggards, Retail real estate in general is straining under the weight of secular decline; recent news about CBL's settlement of a class action lawsuit for overcharging utility bills resulting in $88 million of additional liability for the company (CBL's bonds are trading ~ $0.75/$1 and its equity market capitalization is below $400 million) just added to the gloom. As for the Health Care sector, despite its quarterly underperformance, unless REIT investors are willing to bet on a prolonged upturn in interest rates, an undue shortening of the duration of their portfolios is probably unwarranted.

Insider sales. On March 19, Invitation Homes Inc. announced that stockholders affiliated with Blackstone and Starwood Capital Group (Barry Sternlich, Chairman and CEO) were selling 43 million shares of their common stock. Form 4s revealed that Starwood/Sternlich had liquidated their entire position while the Blackstone Group still owns 180 million shares representing 34.5% of shares outstanding. Despite the Blackstone overhang, the deal was well received and Invitation shares have outperformed the REIT market into quarter-end. Perhaps more of a negative, the Invitation management team eschewed issuing primary shares alongside (as they had suggested in the past) in order to reduce their meaningful 8.6x Debt/EBITDA ratio; thus far, the management team seems comfortable bearing both operational and financial leverage.

On February 27, Americold Realty Trust (not in the Index), the largest global and US based REIT focused on the ownership and operations of temperature-controlled warehouses, announced that stockholders affiliated with The Yucaipa Companies and Goldman Sachs were selling 40 million shares of their common stock. This sale completely removes the overhang of sponsor ownership and shares outperformed the Index by 603 bps through March 31. It is promising that the REIT market was able to absorb these two ~$1 billion deals plus another $1 billion issuance from Equinix (to fund its IBX data center expansion projects) during the quarter.

M&A. On March 25, Cousins Properties announced that it has entered into a definitive merger agreement with TIER REIT in a 100% stock-for-stock transaction. The merger will create one of the largest Sun Belt office REITs (alongside Highwood Properties) with a portfolio totaling more than 21 million sq. ft. The transaction will diversify Cousins away from its 41% concentration in Atlanta by increasing its exposure to Austin, Charlotte, Dallas and Houston; synergies from greater scale in a number of core markets are expected as there is 81% overlap within the two portfolios. The combined companies will have an attractive development pipeline totaling 1.9 million sq. ft. which is 77% preleased. Additionally, the new company will have a land bank which represents an additional 3.5 million sq. ft. of future development. Admittedly, Cousins did pay a rich price for the combination and the deal will be dilutive in 2019 despite projected G&A savings of $18.5 million. However, like the Pebblebrook/LaSalle Hotels deal last year, this is a rare public to public combination that was made possible by a discrepancy in the cost of capital; if the cost of capital advantage was made possible by a history of sound management and capital allocation, both deals should prove fruitful in the long run.

Observations from the Field – Jeung Hyun

In March, we attended Citi's 24th Annual Global Property CEO Conference in Florida. As we approach the Silver Anniversary of this confab, there was record attendance again with almost 1,300 registered attendees from around the globe comprising both investors (interestingly, less hedge funds this year) and representatives from 185 companies. Citi is always the first industry-wide conference for the year, a good venue to gauge investor and company sentiment following fourth quarter earnings. The spread was excellent (think ice sculptures) and the mood was, if not ebullient, positive. As we enter the tail end of the economic/real estate cycle, management teams expressed confidence with their balance sheets (lowest levels of debt on record according to NAREIT) and portfolio quality (10 years of pruning the lowest quality assets); having closed their gap to NAV, numerous companies now have the cost of capital to explore avenues for external growth.

Michael Bilerman, head of Citi's REIT research, conducts three surveys during the Conference, one targeted to CEOs and two to the broad audience (during lunches). This year, CEOs expected same-store NOI to be up 2.6% in 2019 compared to 3.1% last year. However, CEOs have moderated their expectations of higher interest rates, an 18 bps increase in 10-Year Treasury Note yield in 12 months compared to ~ 30 – 50 bps in years past. And CEOs on average felt that the US would enter a recession in 2021, which feels like an eternity away. Lastly, there were some expectations that M&A would continue in the sector as 43% of the CEO thought that there would be fewer companies at next year's conference compared to 48% expecting the same number; most likely, the CEOs were forecasting privatization, not public to public combination, but the first deal of the year has turned out to the latter.

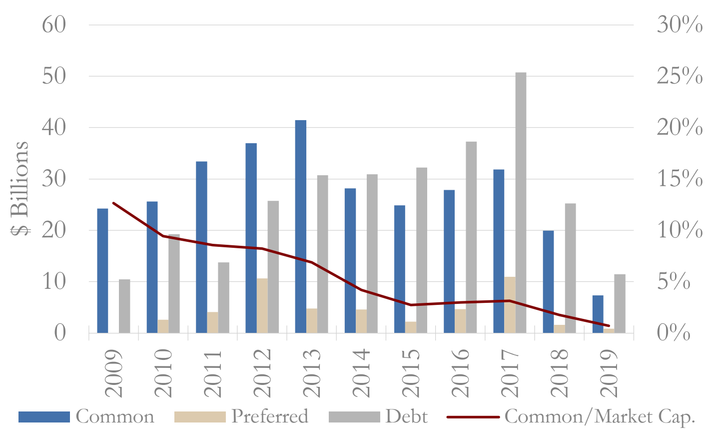
Despite slowing internal growth, attendees were more optimistic about REIT returns as their interest rate outlook has softened; 74% expected positive returns for REITs compared to 64% in 2018. Once again, they believed that the best performing sectors will be data centers, industrial and shelter while the worst performing sectors will be retail, healthcare and office; net lease has dropped off the prospective losers list, not altogether surprising given the consensus view on rates. The vast majority of the attendees thought that we were in the later innings of the real estate cycle, both public and private (with private being a little bit longer in the tooth than public) but we have been stuck in the seventh inning for a number of years now (insert extra-inning ball game/rain delay quip here).

Happy days are here again. According to NAREIT, $19.6 billion in capital was raised in First Quarter 2019, significantly more than the $8.3 billion raised in the prior quarter and the $15.9 billion raised a year ago in First Quarter 2018. More than half the capital activity took place in the issuance of unsecured bonds (there were 28 offerings totaling $11.4 billion during the quarter, way more than the $4.5 billion issued in the prior quarter and the $8.8 billion issued a year ago). There were 23 secondary equity offerings totaling $7.3 billion during the quarter, significantly more than the $3.7 billion issued in the prior quarter and the $3.5 billion issued a year ago. There were six small offering of preferred equity totaling $0.8 billion and no IPOs.

Note that the NAREIT data does not take into account equity issuance by at-the-market ("ATM") programs, a low cost alternative; now that more REITs are trading above NAV, expect heightened activity on that front.

Historical Offering of Securities

2009 – 2019YTD



Source: S&P Global Market Intelligence, NAREIT 2019.

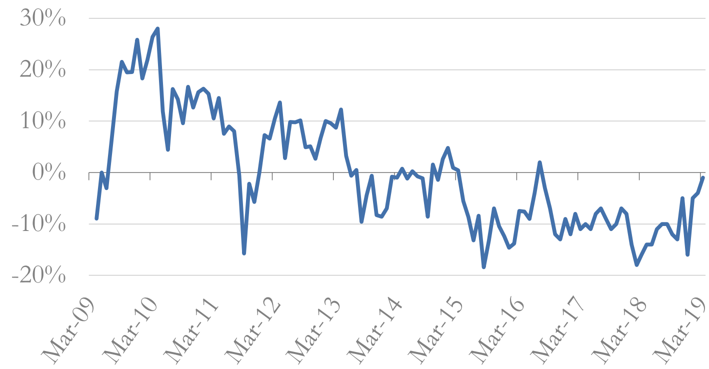
Got REITs? According to AMG Data Services, net flows out of dedicated real estate funds, excluding ETFs, totaled $0.9 billion in First Quarter 2019, significantly less than the outflows in excess of $2.2 billion in First Quarters 2018 and 2017. Interestingly, REIT ETFs saw inflows of $3.0 billion in First Quarter 2019 compared to outflows of $2.7 billion in First Quarter 2018; there may be some performance chasing going on as REITs proved more defensive during the Fourth Quarter 2018 downturn and outrebounded the broad equity indices during the recovery in First Quarter 2019.

Flows out of US and Global mutual funds registered in Japan also slowed to $1.0 billion in First Quarter 2019 compared to outflows of $2.7 billion in First Quarter 2018.

Premium/Discount to Net Asset Value

REIT Universe

March 31, 2009 to March 31, 2019



Source: Adelante Capital Management and Green Street Advisors.

Risk premium on par with the ten-year average. The risk premium for owning commercial real estate, as represented by the spread between REIT cash flow yields and the riskless rate of return, trades on par with the 10-year average of 238 bps. While the cash flow yield for REITs remained constant, the yield on the 10-Year Treasury Note decreased another 27 bps and, as a consequence, the spread between REIT cash flow yields and the 10-Year Treasury Note yield increased 22 bps to 204 bps.

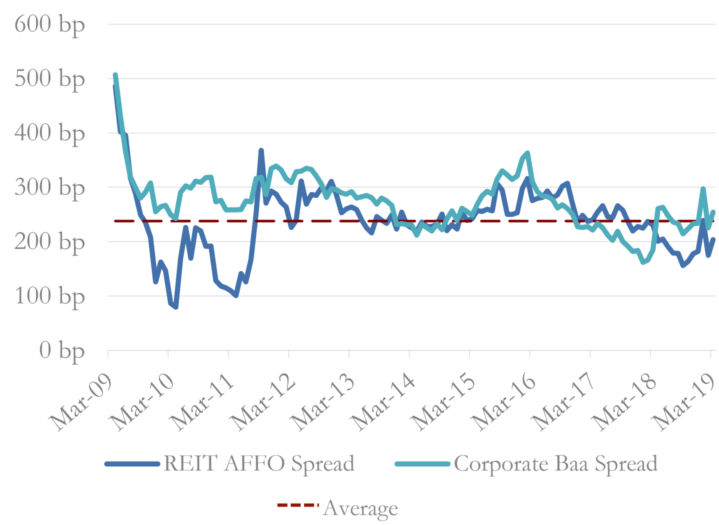
In First Quarter, the Corporate Baa spread increased 21 bps to 254 bps, also on par with the 10-year average of 273 bps.

Spread Comparison

REIT Cash Flow and Corporate Baa Yields vs.

10-Year Treasury Note Yield

March 31, 2009 to March 31, 2019



Source: Adelante Capital Management and Green Street Advisors.

Outlook

The term spread – the difference between long-term and short-term rates – is a strikingly accurate predictor of future economic activity. Every US recession in the past 60 years was preceded by a negative term spread, that is, an inverted yield curve. Furthermore, a negative term spread was always followed by an economic slowdown and, except for one time, by a recession… A simple rule of thumb that predicts a recession within two years when the term spread is negative has correctly signaled all nine recessions since 1955 and had only one false positive, in the mid-1960s, when an inversion was followed by an economic slowdown but not an official recession. The delay between the term spread turning negative and the beginning of a recession has ranged between 6 and 24 months.

While historical circumstances differed for these episodes, the patterns of past yield-curve inversions were remarkably similar: The decline in the term spread was generally driven by a pronounced increase in short-term interest rates. Long-term rates, on the other hand, typically moved much more gradually and either increased slightly over those periods or even declined. This pattern suggests some possible explanations why inversions are typically followed by a recession. During an economic expansion, the Fed normally tightens its monetary policy stance by gradually raising short-term interest rates. The central feature of the business cycle is that expansions are at some point followed by recessions. Long-term rates reflect expectations of future economic conditions and, while they move up with short-term rates during the early part of an expansion, they tend to stop doing so once investors' economic outlook becomes increasingly pessimistic.

Economic Forecasts with the Yield Curve
Michael D. Bauer and Thomas M. Mertens
FRBSF Economic Letter – March 5, 2018

But what about quantitative easing (QE)? One might argue that long-term yields, particularly the term premium component, are significantly depressed due to QE programs by central banks around the world and the large balance sheet of the Federal Reserve… If long-term yields are still low because of QE, and if these effects contribute to the yield curve flattening but do not increase recession risk, then some part of that flattening may not be worrisome at all.

While this reasoning is plausible, these are, however, two big ifs. First, there is a lot of uncertainty around the effects of QE on interest rates… Second, while a lower term premium contributes to easier financial conditions and therefore stimulates economic activity, this was also the case in the past and at times may have contributed to economic overheating, heightened financial stability risk, and ultimately higher recession risk. There is no clear evidence in the data that "this time is different" or that forecasters should ignore part of the current yield curve flattening because of the presumed macro-financial effects of QE.

Information in the Yield Curve about Future Recessions
Michael D. Bauer and Thomas M. Mertens
FRBSF Economic Letter - August 27, 2018

Isn't the old adage "a watched curve never inverts?" Well, it did. The spread between the 3 Month Treasury Bill and the 10 Year Treasury Note yields (identified by recent research from the Federal Reserve Bank of San Francisco as the "best summary measure" of the potential for a recession in the US economy) turned negative for the first time since 2006. When investors started to worry about the potential inversion of the spread between the 2 Year and 10 Year Treasury Notes yields in 2018, pundits suggested that investors focus on the 3M-10Yr spread instead. Now that the 3M-10Yr spread has turned negative, bull market apologist are saying (i) the yield has to stay inverted for a while, (ii) the inversion is less meaningful when term premiums are so low and (iii) there is always a lag between the inversion and a recession anyway.

While the bond market was taking its cue from the steady stream of underwhelming global economic data, the equity market was all bulled up by the dovish turn (no more "loco") by Jerome Powell and the Federal Reserve resulting in the afore-mentioned 13.7% total returns for the S&P 500 Index, the best quarterly start to the year since 1998. It is a strange market indeed when global investors are buying both bonds and equities hand over fist. The biggest question going forward is whether the abrupt cessation of both balance sheet reduction and rate normalization by the FOMC is enough to get US/global growth going again. Is or is not US monetary policy too tight; do we need an immediate 50 bps cut by the FOMC as the Trump administration so clearly wants?

For REITs, low interest rates will always be preferable to surging growth so the current situation seems favorable (assuming that there is some correlation between the economic growth and the natural rate of interest). As a simple example to illustrate potential changes in real estate valuations in differing economic conditions, assume that an office building is producing $1 million in Net Operating Income ("NOI"). With a rollicking economy, assume 3% growth for next year's NOI, a 3.5% yield on the 10 Year Treasury Note and a 6.0% cap rate on the building. With a middling economy, assume 2% growth for next year's NOI, a 3.0% 10 Year Treasury Note yield and a 5.75% cap rate on the building. Even with a 100 bps reduction in growth rates leading to only a 25 bps reduction in cap rates, the building would be worth $17.2 million in the best of times compared to $17.7 million during economic mediocrity. While REITs have had a nice rebound in First Quarter, with a number of high quality portfolios still trading at meaningful discounts to NAV, investors should maintain their focus on REITs before private equity cherry picks the lot.