APN Global REIT Income Fund - The year ahead and the one just finished

Last year began less than 12 months into a global pandemic and without any vaccines in sight. Severe restrictions had been imposed, then lifted and reimposed in the name of public health. And monetary and fiscal stimulus was being deployed at wartime levels in the hope of building a bridge to the post-pandemic future.

As vaccines became imminent, the focus shifted to reopening, inoculation and dealing with the effects of the stimulus. Many of these issues remain, but with the added threat of inflation (see below).

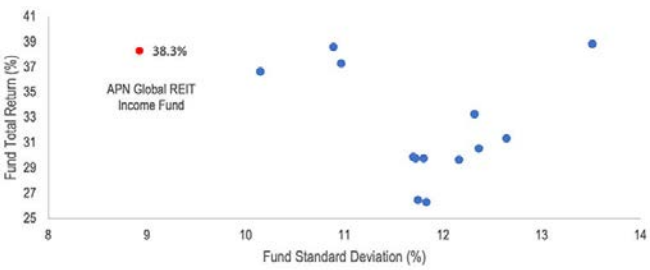
At APN, we entered 2021 battle-hardened and confident. Our investment process had proved its mettle in previous crises. We believed it would help us continue to deliver attractive returns to investors in the APN Global REIT Income Fund, especially when also considering risk measured by the standard deviation of return.

So, what did we learn?

Well, the belief we held at the beginning of last year appears justified. The APN Global REIT Income Fund's selective approach to global REIT investing delivered stand out performance, on an absolute and risk-adjusted basis.

The Fund's total return of 38.3% in 2021 placed it in the top quartile of other global REIT funds[1].

APN Global REIT Income Fund was the top performer on a risk-adjusted basis in 2021



Source: Morningstar data extracted on 27 January 2022, analysis compiled DXAM/APN RES

While achieving such a relatively high total return is satisfying, the Fund is also focused on minimising volatility. Risk-adjusted returns is the measure used to assess performance. As a testament to our investment process, on this measure, we performed even more strongly compared to other global REIT funds.

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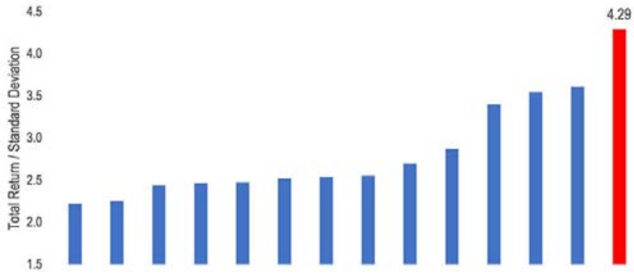

Source: Morningstar data extracted on 27 January 2022, analysis compiled DXAM/APN RES

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For investors prepared to look through the shorter-term volatility and appreciate the attractive pricing, opportunities were plentiful. In absolute terms, real estate sub-sector performance was positive across the board. The challenge was in understanding how each sub-sector was being affected by the pandemic and its ability to recover from those impacts.

The greatest contributor to the sector's total return was the industrial REITs. All benefitted from a continuation of pandemic-assisted structural trends where government assistance to households combined with a boom in online retail. Not only did this bring forward future online spending, but many consumers also began shopping online for the first time. The sector prospered as a result.

Residential REITs, particularly in North America, also benefitted from a confluence of supply and demand factors that pushed up market rents, boosting bottom-line REIT earnings. After a difficult 2020, retail and specialised REITs returns also contributed, albeit to a lesser extent as did office, healthcare and hospitality and leisure-oriented REITs.

Asset valuations generally held up, supported by a significant number of direct real estate transactions. This demonstrated the depth of capital markets and the sustained demand for real estate globally. In 2020, there were fears that the office and retail REIT sectors may not have a strong future. 2021 conclusively dispelled that myth.

Regional performance in absolute terms was also positive but much less dispersed. The US REITs performed the strongest, contributing around 85% of the total return achieved by the sector globally. This is best explained by better performing industrial, residential and specialised REITs at a sector level and a less restrictive handling of the pandemic.

Compared to other developed markets, the US had a stronger rebound in economic growth and consumption. By way of comparison, Singapore REITs, despite the country's high vaccination rates, were relatively weak due to a persistently oppressive approach to managing the pandemic through lockdown restrictions.

The complexity of investing in a global REIT market enduring a pandemic wasn't easy but our process served us well. Having worked to understand the forces at play in each sub-sector and assess value with an informed lens allowed us to capitalise on the many available opportunities.

APN Real Estate Securities was founded in 1998. Having lived and prospered through the dotcom crash and financial crisis of 2008, we have experience with crises. The returns we achieved in 2021 speak to this fact.

That, though, is behind us. What of the future?

Markets are still grappling with increasing bond rates, inflationary pressure, and high virus case numbers. That said, while new variants remain a risk, we are probably closer to the end of the pandemic than the beginning.

In developed countries, employment is strong and the outlook positive. The big risk is inflation and how central banks respond to it. With supply chains stretched and employment strong, there is growing pressure on prices and wages in many developed economies. Interest rates rises are on the cards, and recent share price falls indicate how markets are starting to price these in.

This invites an explanation on how the APN Global REIT Income Fund is positioned to deal with these new circumstances.

We have already outlined our thoughts on the future of the office (see parts one, two and three). As for shopping centres, see How can shopping centres be dead when I can't find a park? and What's next for retail REITS? In short, we believe these sectors will adapt, as they have done in the past, rather than disappear. Our approach to both sectors is to focus on high-quality, well-located properties with high-calibre tenants prepared to pay for premium occupancy.

The key to this is in understanding how well REITs are adapting to a changing environment. There are hesitancies, for example, about the office sector and the long-term impact of work-from-home on occupancy, how costly new fitouts may be required to repurpose existing space and meet green retrofitting costs, and if phased returns will reduce demand for space. In this scenario "quality is king" and we are seeing signs of this play out as prime office begins to outperform secondary on operational metrics.

Because of the conventional belief that interest rate rises impact REIT valuations via the capitalisation rate, interest rate pressure is another matter altogether. As I wrote in 2018, conventional wisdom is wrong. Rate rises tend to be good for property trusts.

All else being equal, the value of an asset's future income stream falls as interest rates rise. But it's not quite that simple. Rising rates are usually an indicator of buoyant economic conditions, low unemployment and rising consumer confidence. That tends to be good for REITs in general, which is to say the economic environment is more important than a singular rise in rates.

Take last year as an example where the US 10-year government bond rate increased by over 60%. And yet US REITs delivered a world-leading total return of almost 47% in local currency terms. That may not tally with conventional wisdom, but it is nevertheless a fact.

With vaccinated populations, economies are looking to reopen and most developed market employment rates are approaching or surpassing pre-pandemic levels. Thanks to our investment approach we're not overly concerned by bond rates and inflation expectations rising this year, just as we weren't too concerned by inflation expectations rising significantly last year.

The relatively strong performance of listed REITs in 2021 not only highlighted their resilience but reiterated the important structural characteristics of this liquid real asset class. REITs are attractive to investors as a potentially strong inflation hedge.

Our preference is for REITs best positioned to capture higher inflation while avoiding those most sensitive to rising interest rates and those that lack the ability to offset the impacts of higher rates with top-line growth.

But the bigger point is that REITs are more than just interest rates. Their operating fundamentals are improving and, with over 20 different property types and different leverage profiles, operating margins, management teams, valuations, markets, growth pipelines and ESG scores, there is much potential for us to outperform with our proven investment approach.

We're looking forward to the year ahead as one of continuing solid performance for global listed real estate. The deep and diverse global universe of REITs offers tremendous opportunities for compelling risk-adjusted returns from this liquid, real asset class.

The performance of the APN Global REIT Income Fund through 2021 was pleasing but more important were the risk-adjusted results achieved. This highlights our selective approach and focus on relative value as we look to deliver on the Fund's objectives, which are to provide investors with a higher income and lower risk relative to its benchmark while providing a level of capital growth that maintains real return over a 5-7 year time horizon.

In our next article, I'll dive into more detail about our investment approach, how this allowed us to capitalise on select opportunities through 2021 along with our current positioning, including some prospects we're very excited about.

1. Morningstar data extracted on 27 January 2022.

Forecasts are not guaranteed to occur. Past performance is not an indication of future performance. Returns after all fees and expenses. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Returns and values may rise and fall from one period to another. Fund's inception date 1 April 2019.

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APN Real Estate Securities

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