First State Investments

Monthly update

Global Properties

First State Global Property Securities Fund

April 2017

Market review

The FTSE EPRA/NAREIT Global Developed Index (GBP) declined by -2.2% in April.

UK REITs outperformed as financial markets greeted the prospect of an early British general election. The decision to go to the country was made by Prime Minister, Theresa May, in a bold attempt to increase the Conservative Party's majority going into Brexit negotiations. The UK economy continues to benefit from a devalued sterling and low unemployment rate.

US property securities fell in GBP terms, despite the US 10 year Treasury yield finishing the month 11 basis points lower at 2.28%. We attribute gently declining rates to a less hawkish Federal Open Market Committee, soft US GDP growth in the first quarter of 2017, and growing scepticism that the Trump administration will successfully pass their proposed stimulus and tax cut plans, following Republicans' failure (to date) to pass Affordable Care Act repeal legislation in the US House of Representatives.

Fund performance and activity

The Fund dipped -1.9% in April, 38 basis points better than its benchmark index. Overweight exposure to US data centre stocks CyrusOne and Interxion was a positive driver of relative performance for a second consecutive month. Growing demand for data centre services, underpinned by the increasing popularity of cloud computing, continues to support this specialist sub-sector.

An overweight holding in UK student accommodation REIT, Unite Group, also helped relative performance. The stock was buoyed by a higher valuation for its property portfolio driven by healthy occupancy rates and rental growth, and by positive sentiment towards UK REITs.

Holdings in US retail REITs including Simon Property Group and Regency Centers Corp detracted from relative performance, as concerns about the financial health of US retailers (i.e. retail tenants) and competition from rapidly growing e-commerce sales, weighed heavily on investor sentiment towards US retail REITs.

During the month, the Fund trimmed its position in Apartment Investment & Management Company, a geographically diversified US apartment REIT; and increased its exposure to UDR Inc, a leading coastal and Sunbelt focused US apartment REIT.

In general, US apartment REITs' first quarter results were well received. Rental growth, occupancy and leasing fundamentals generally met or modestly exceeded expectations. Coastal focused apartment REITs, such as UDR, had the most encouraging results as gateway markets performed surprisingly well despite new supply headwinds. Results commentary suggests this momentum has continued into the second quarter of 2017, implying that positive trends are likely to persist.

At current levels we believe UDR Inc is attractively valued and well positioned to benefit from improving fundamentals in gateway coastal markets, where ~80% of its portfolio is located. In contrast, Apartment Investment & Management Company has a far more geographically diversified portfolio and a less appealing valuation. For this reason, we adjusted our funds' US apartment exposures accordingly.

The Fund sold its holding in diversified Hong Kong-listed Cheung Kong Property Holdings following recent share price strength and increased its position in peer Henderson Land, which is forecast to deliver stable earnings through its high quality Hong Kong rental property portfolio.

The portfolio's holding in Land Securities was divested following recent share price gains. The UK economy and property markets have weathered Brexit-related uncertainty well so far. However, evidence that corporate accommodation decisions are being delayed, resulting in market vacancy rates ticking up and increasing tenant lease incentive levels, has led us to take a cautious approach to diversified REITs, including Land Securities, which have exposure to the London office markets.

Market outlook and Fund positioning

While property securities tend to underperform general equity markets in rising rate environments, they could still generate positive returns for investors. Higher interest rates are typically due to better GDP growth and/or increased inflation expectations. Many property sectors are positively leveraged to higher GDP growth, while future rents often include an element of inflation protection (albeit as an indirect, partial offset).

The Fund's US holdings are focussed on higher quality REITs with healthy, if gently moderating fundamentals, well-regarded management teams, investment grade credit ratings and, for a majority of our holdings, attractive discounts to Net Asset Value (NAV). Major current sector exposures include high quality data centres, CBD office REITs, apartments, Class A regional malls and shopping centres. While we view the hotel and industrial sectors as well placed to benefit from higher GDP growth, we remain cautious on these sectors mostly given the excessive new hotel supply and current US industrial REIT valuations.

The portfolio's UK exposure remains focused on high quality retail malls and student accommodation. Exposure to the UK office sector has been reduced to zero. We expect some London office rental rates to reduce as a result of ongoing market uncertainty, but believe the fundamentals of other UK sectors such as regional retail assets are less likely to be impacted.

As a result of ongoing ECB stimulus measures, Continental European REIT valuations remain at elevated levels; even allowing for recent improvements in economic fundamentals. Our positions in this region are focused on high quality shopping centres and diversified REITs.

In the Asia-Pacific region, the Fund has maintained its exposure to Singapore, whose economy continues to improve. S-REITs are trading at relatively attractive valuations and generating defensive, recurring cash flows. We have maintained holdings in selected Hong Kong property companies which are trading at attractive valuations, with healthy balance sheets, investment grade property portfolios and stable medium term earnings growth outlooks.

The Fund's Japanese holdings consist of large property companies that are set to benefit from continued rental growth and the opening of new office and retail properties; and smaller J-REITs with appealing investment cases.

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