

Global Matters Weekly

23 March 2020

(ii) Liquidity of Property

– Jackson Franks

As we temporarily enter a new way of living, I spent Wednesday night giving my grandparents a step by step guide on creating a Skype account. After a good 45 minutes (which felt like weeks) and a lot of patience we managed to complete the process. They couldn't quite believe that they could see me and me them as we sat down to eat dinner together via Skype. With my Grandpa's interest in the financial markets, especially the real estate sector, we had a lot to talk about considering six UK open-ended property funds were suspended last week with the expectation that others will follow this week.

At Momentum we do not invest in open-ended real estate funds because of the clear liquidity mismatch of offering daily dealing on an illiquid asset such as a property. Due to the length of time it takes to sell a property, a minimum of 3 months but in time of market stress often longer, when the sector sees an increased level of redemptions the open-ended property strategies are unable to cope with the cash demand and therefore suspend dealing. Gating the fund enables the manager to postpone redemptions over a period of time so they can raise the cash needed to pay out to investors by selling an asset or raising further capital. This could be an uneasy time for retail investors who are wanting to reduce their exposure to the sector but are unable to do so.

Open-ended property funds are not the only way to gain direct exposure to the property market. At Momentum we gain exposure to the sector for our clients through Real Estate Investment Trusts ("REITs") and a private equity vehicle known as the Momentum Africa Real Estate Fund ("MAREF") which are suitable for retail and qualified institutional investors respectively. A private equity style vehicle, such as MAREF, has its advantages and disadvantages for investors. Investors would be locked into the strategy for the duration of the

fund's life. This gives the manager time to generate returns undistracted by the impulses of investor flows. Having said that, this style is illiquid and if the investor requires liquidity during the life of the fund (the majority are 8+ years), they cannot redeem.

REITs, similar to private equity vehicles, have a fixed pool of capital for the investment manager to invest across the sector whilst offering a similar liquidity experience to investing in publicly traded stocks. REITs are easy to understand from an investor's perspective: by leasing space and collecting rent on its acquired real estate, the company generates income which is then paid out to shareholders in the form of dividends. REITs are required to distribute 90% of their taxable income to shareholders which is significantly higher, on average, than other equities. However, because REITs are listed, their share price is driven by two factors: (1) the valuation of their underlying assets and (2) the relative number of buyers and sellers of their shares in the stock market. The manager never has to face redemptions, as investors simply sell their shares in the market if they so wish.

It is critical that any investor in the real estate sector understands and appreciates the illiquid nature of the underlying asset class. At Momentum, we manage this illiquidity risk by sizing our real estate exposure appropriately and investing in liquid REITs instead of open-ended daily investment vehicles, thus avoiding the risks arising from an asset liability mismatch. Although the listed status of a REIT introduces an element of equity market risk and pricing volatility which is evident in these uncertain times, investors can still liquidate their holdings if so required, or indeed add to their holdings at what might prove to be heavily discounted valuations. Neither of those options are available to holders of most UK open-ended property funds at this point.

The Marketplace

- The rapid spread of COVID-19 has led to the continued lockdown of parts of Europe and the US, although a steady slowdown in cases is being seen in Italy
- Global equity markets declined 12.2% over the past week
- Brent crude fell 20.3% ending the week at \$27.0 a barrel
- Gold fell 2.0% ending the week at \$1498.7 an ounce

Market Focus

US

- Nearly one in three Americans are ordered to stay at home as multiple states, including New York and California, enter lockdown.
- The number of Americans applying for first-time unemployment benefits jumped last week, increasing by 70,000 to 281,000, the fourth-biggest weekly increase on record.
- Where some lost jobs others gained, with the likes of Walmart and Amazon showing significant demand for workers.
- The main US equities index declined 15.0% over the week. Corporate fixed income markets also experienced a heavy selloff with investment grade bonds falling 8.9% and high yield bonds declining 10.2%.
- US Treasuries returned 30 basis points over the week, bringing their year to date return to 7.0%.

Europe

- The European Central Bank announced a €750bn Pandemic Emergency Purchase Programme in order to assist the Eurozone economy.
- European equities fell by 0.7% over the past week, with emerging European equities falling 7.4%.
- Many EU countries are now implementing fiscal stimulus to aid the economies through the lockdown, such as Spain's €200bn package.
- Euro government bonds fell 70 basis points. Investment grade and high yield indices fared worse, returning -4.4% and -9.5%, respectively.

UK

- The Bank of England made an additional 15 basis points cut to its base rate, bringing it to 0.1%, and announced a corporate funding facility for firms.
- The Bank of England also announced a £200bn increase in asset purchases, whilst the UK chancellor announced a £350bn fiscal stimulus package.
- UK equity markets declined 2.8% over the week.
- UK gilts fell 30 basis points over the past week, whilst their investment grade counterparts declined 5.4%.

Asia/Rest of The World

- Emerging Latin America suffered a strong decline over the past week, falling 20.8%.
- The People's Bank of China kept rates unchanged, even after the Federal Reserve and 17 other central banks had decided to cut rates.

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Asset Class/Region	Currency	Currency returns			
		Week ending 20 Mar. 2020	Month to date	YTD 2020	12 months
Developed Market Equities					
United States	USD	-15.0%	-21.9%	-28.4%	-17.2%
United Kingdom	GBP	-2.8%	-20.8%	-30.4%	-26.0%
Continental Europe	EUR	-0.7%	-20.6%	-27.2%	-18.0%
Japan	JPY	1.7%	-15.0%	-25.4%	-18.5%
Asia Pacific (ex Japan)	USD	-10.0%	-19.1%	-25.4%	-20.2%
Australia	AUD	-13.0%	-24.7%	-27.1%	-18.6%
Global	USD	-12.2%	-22.8%	-29.7%	-20.3%
Emerging markets equities					
Emerging Europe	USD	-7.4%	-28.1%	-40.8%	-29.7%
Emerging Asia	USD	-8.7%	-16.6%	-22.6%	-17.1%
Emerging Latin America	USD	-20.8%	-38.0%	-48.5%	-46.3%
BRICs	USD	-8.9%	-18.4%	-24.6%	-19.8%
MENA countries	USD	-3.0%	-19.7%	-25.9%	-24.8%
South Africa	USD	-18.3%	-30.7%	-45.0%	-41.6%
India	USD	-13.8%	-25.0%	-32.1%	-30.0%
Global emerging markets	USD	-9.8%	-20.0%	-27.8%	-22.9%
Bonds					
US Treasuries	USD	0.3%	1.4%	7.0%	13.3%
US Treasuries (inflation protected)	USD	-0.8%	-4.9%	-1.3%	4.2%
US Corporate (investment grade)	USD	-8.9%	-13.8%	-10.6%	-1.4%
US High Yield	USD	-10.2%	-17.0%	-18.1%	-12.4%
UK Gilts	GBP	-0.3%	0.6%	6.0%	11.0%
UK Corporate (investment grade)	GBP	-5.4%	-9.4%	-7.3%	-1.0%
Euro Government Bonds	EUR	-0.7%	-2.8%	0.1%	5.1%
Euro Corporate (investment grade)	EUR	-4.4%	-7.3%	-6.6%	-3.3%
Euro High Yield	EUR	-9.5%	-17.2%	-18.6%	-13.8%
Japanese Government	JPY	-0.9%	-2.2%	-0.8%	0.2%
Australian Government	AUD	-0.4%	-2.1%	2.2%	7.4%
Global Government Bonds	USD	-2.4%	-2.6%	0.3%	5.0%
Global Bonds	USD	-3.5%	-4.9%	-2.9%	2.1%
Global Convertible Bonds	USD	-6.2%	-12.2%	-12.4%	-8.0%
Emerging Market Bonds	USD	-8.8%	-15.3%	-14.1%	-8.6%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-25.5%	-33.2%	-37.9%	-31.7%
Australian Property Securities	AUD	-27.5%	-37.4%	-37.0%	-36.4%
Asia Property Securities	USD	-13.6%	-23.7%	-30.6%	-30.1%
Global Property Securities	USD	-21.0%	-31.4%	-36.7%	-30.8%
Currencies					
Euro	USD	-3.7%	-3.0%	-5.0%	-6.1%
UK Pound Sterling	USD	-5.8%	-8.9%	-12.3%	-11.8%
Japanese Yen	USD	-3.0%	-2.5%	-2.1%	0.5%
Australian Dollar	USD	-5.4%	-10.1%	-16.9%	-17.8%
South African Rand	USD	-6.9%	-10.0%	-20.1%	-18.0%
Swiss Franc	USD	-3.5%	-1.9%	-2.1%	1.0%
Chinese Yuan	USD	-1.2%	-1.5%	-1.9%	-5.7%
Commodities & Alternatives					
Commodities	USD	-10.1%	-21.0%	-32.0%	-31.5%
Agricultural Commodities	USD	-1.9%	-6.6%	-13.5%	-13.5%
Oil	USD	-20.3%	-46.6%	-59.1%	-60.6%
Gold	USD	-2.0%	-5.5%	-1.6%	15.1%
Hedge funds	USD	-3.8%	-8.1%	-9.1%	-4.0%

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