IMPERIUM CAPITAL

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# (IL)Liquidity of Property

Global Matters Weekly

24 October 2022

– Jackson Franks — *Analyst*

As mentioned in my previous blogs, I am an avid Watford football club supporter. Although there are some ups and (a lot more) downs, being a Watford supporter has had one positive outcome. It's enabled me to cope with the ever-changing UK political situation. Since David Cameron resigned as Prime Minister in 2016, following the UK's vote to leave the EU, there have been three UK Prime Ministers over the preceding six years, with the fourth set be announced. However, comparing this to the Watford managerial hot seat, we have seen twelve people come in as manager over the same period. Although the owners have had to absorb a lot of negativities for their cutthroat approach, their methodology has worked. Since 2016, Watford have been in the Premiere League for five out of seven seasons, the best in its history. So, although there is a limited appetite for uncertainty, I am of the firm belief that if something isn't working, then change it.

Following Liz Truss's government's mini-budget, turmoil ensued in UK financial markets. The sell-off in UK government bonds (gilts) amid concerns about monetary policy, debt, and pension funds' financial status, shook sectors including property. As with the 2016 Brexit referendum, and a period during 2019, daily dealing property funds saw high levels of redemptions. In turn, Columbia Threadneedle suspended dealing in their daily dealing property fund, bringing back the debate on whether the UK regulator should restrict retail investors from open-ended property funds.

At Momentum Global Investment Management (MGIM) 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 times 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 for 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.**

Open-ended property funds are not the only way to gain direct exposure to the property market. At MGIM we gain exposure to the sector 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 eight+ 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 easier 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 on average is significantly higher than other equities. However, because REITs are listed on the stock market, their share price is

*Sources: Unless stated all figures are from Bloomberg Finance, L.P* driven by two factors: firstly, the valuation of their underlying assets, and secondly, the broader market sentiment and buying/selling pressures. The manager never has to handle 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 MGIM, 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 particularly 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 these options are available to holders of most UK open-ended property funds at this point.

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## The Marketplace

- Global equities rose by 3.6% last week
- Xi Jinping was declared as the Chinese Communist Party Chief for a third time as he further consolidated his grip on power. His third term as General Secretary will make him the longest ruling Chinese leader since Chairman Mao
- Brent crude rose by 2.0% over the week to $93.5 a barrel
- Gold rose by 0.8% to $1657.7 per ounce

## Market Focus

### US

- US equities returned 4.7% last week as investors appeared to react to some prominent earnings reports and hints that the Federal Reserve might moderate its pace of interest rate hikes
- Rising interest rates began to show their impact on the US housing market. The US National association of Home Builders' market index fell to 38 in October (vs. 43 expected) as mortgage rates hit their highest level in over two decades
- Elsewhere in the housing market US existing home sales fell to an annualised rate of 4.71m in September (vs. 4.70m expected), which is their lowest level in a decade if you exclude the pandemic months of April and May 2020
- Hawkish Fed comments pushed the yield on the benchmark 10-year U.S. Treasury note to a 14-year high of 4.33% last Friday

### UK

- UK equities returned 1.5% last week
- Liz Truss announced her resignation as Prime Minister on Thursday after just 44 days in office. A leadership election will be held today with former Chancellor Rishi Sunak the favourite to succeed Truss after Boris Johnson pulled out of the running late last night
- The latest UK inflation data for September showed the Consumer Price Index rising to 10.1% (vs. 10.0% expected). The Bank of England announced that Quantitative Tightening/Gilt sales will commence from November 1st as it seeks to bring inflation under control

### Europe

- European equities rose by 1.6% last week
- The outlook in Europe remains bleak as the German ZEW survey's reading fell more than expected to -72.2 in October (vs. -68.5 expected)
- Also in Germany, producer price inflation remained at +45.8% year-on-year in September (vs. +45.4% expected)
- European government bond yields climbed ahead of a European Central Bank meeting that is expected to result in another 0.75-percentage-point increase in interest rates

### Asia/Rest of The World

- Global emerging market equities rose 0.2% over the week
- Japanese equities fell by 0.9% last week
- The Japanese Yen weakened through 150 per dollar for first time since 1990 but rebounded after a fresh intervention from the Japanese authorities was reported
- The release of Q3 Gross Domestic Product data and a slew of other economic data from China was delayed as the ruling Communist Party held its National Congress. Some believe that a release likely showing slowing economic growth in China would have marred the highly choreographed twice-a-decade event

| Asset Class/Region | Currency | Currency returns | | | |
|---|---|---|---|---|---|
| | | Week ending 21 Oct. 2022 | Month to date | YTD 2022 | 12 months |
| **Developed Market Equities** | | | | | |
| United States | USD | 4.7% | 4.7% | -20.6% | -16.6% |
| United Kingdom | GBP | 1.5% | 1.1% | -0.3% | 3.2% |
| Continental Europe | EUR | 1.6% | 2.6% | -18.7% | -15.2% |
| Japan | JPY | -0.9% | 2.5% | -3.2% | -3.4% |
| Asia Pacific (ex Japan) | USD | -1.2% | -2.9% | -28.5% | -31.6% |
| Australia | AUD | -1.2% | 3.1% | -6.7% | -5.9% |
| Global | USD | 3.6% | 3.6% | -22.8% | -20.6% |
| **Emerging markets equities** | | | | | |
| Emerging Europe | USD | 5.4% | 10.7% | -77.7% | -80.4% |
| Emerging Asia | USD | -1.3% | -3.5% | -31.3% | -34.3% |
| Emerging Latin America | USD | 7.6% | 11.2% | 14.6% | 14.5% |
| BRICs | USD | 0.1% | -2.7% | -29.5% | -36.2% |
| China | USD | -2.7% | -7.3% | -36.2% | -44.2% |
| MENA countries | USD | 3.4% | 3.4% | 1.0% | -1.4% |
| South Africa | USD | 2.0% | 1.4% | -17.7% | -21.6% |
| India | USD | 2.0% | 1.3% | -7.6% | -11.2% |
| Global emerging markets | USD | 0.2% | -1.2% | -28.0% | -31.2% |
| **Bonds** | | | | | |
| US Treasuries | USD | -1.1% | -2.2% | -14.6% | -13.8% |
| US Treasuries (inflation protected) | USD | -0.3% | 0.2% | -14.2% | -12.9% |
| US Corporate (investment grade) | USD | -1.2% | -2.7% | -20.9% | -20.0% |
| US High Yield | USD | 0.3% | 0.6% | -14.2% | -13.5% |
| UK Gilts | GBP | 5.0% | -1.2% | -26.7% | -24.1% |
| UK Corporate (investment grade) | GBP | 3.5% | 0.4% | -24.2% | -22.9% |
| Euro Government Bonds | EUR | -0.3% | -2.0% | -18.3% | -18.4% |
| Euro Corporate (investment grade) | EUR | -0.3% | -1.4% | -15.7% | -15.8% |
| Euro High Yield | EUR | -0.1% | -0.6% | -15.1% | -14.8% |
| Japanese Government | JPY | -0.8% | -1.1% | -4.9% | -4.8% |
| Australian Government | AUD | -1.2% | -1.5% | -12.2% | -11.8% |
| Global Government Bonds | USD | -0.7% | -2.6% | -22.3% | -22.6% |
| Global Bonds | USD | -0.7% | -2.4% | -22.4% | -22.8% |
| Global Convertible Bonds | USD | 0.9% | 0.2% | -24.0% | -27.3% |
| Emerging Market Bonds | USD | -1.1% | -3.1% | -32.8% | -32.6% |

*Source: Bloomberg. Past performance is not indicative of future returns*

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| Asset Class/Region | Currency | Currency returns | | | |
|---|---|---|---|---|---|
| | | Week ending 21 Oct. 2022 | Month to date | YTD 2022 | 12 months |
| **Property** | | | | | |
| US Property Securities | USD | 3.1% | -1.0% | -29.6% | -23.8% |
| Australian Property Securities | AUD | -0.1% | 1.2% | -29.9% | -25.4% |
| Asia Property Securities | USD | -2.7% | -4.2% | -19.9% | -24.7% |
| Global Property Securities | USD | 1.2% | -2.1% | -30.2% | -27.9% |
| **Currencies** | | | | | |
| Euro | USD | 1.2% | 0.5% | -13.6% | -15.4% |
| UK Pound Sterling | USD | 0.9% | 1.2% | -16.8% | -18.4% |
| Japanese Yen | USD | 1.1% | -1.7% | -21.9% | -22.8% |
| Australian Dollar | USD | 2.4% | -1.1% | -12.6% | -14.9% |
| South African Rand | USD | 1.0% | -0.3% | -12.1% | -19.4% |
| Swiss Franc | USD | 0.6% | -1.6% | -8.8% | -8.1% |
| Chinese Yuan | USD | -0.6% | -1.6% | -12.1% | -11.6% |
| **Commodities & Alternatives** | | | | | |
| Commodities | USD | -0.9% | 2.1% | 16.9% | 15.3% |
| Agricultural Commodities | USD | 0.1% | 0.4% | 7.2% | 14.4% |
| Oil | USD | 2.0% | 6.3% | 20.2% | 10.5% |
| Gold | USD | 0.8% | -0.2% | -9.4% | -6.9% |
| Hedge funds | USD | 0.0% | 0.0% | -4.6% | -5.2% |

*Source: Bloomberg. Past performance is not indicative of future returns*

## Important notes

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Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

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