Investment Note

13 Nov 2017

Asia-Pacific (AP) REITs: Solid regional fundamentals drive outlook

Real Estate Investment Trusts (REITs) are an increasingly popular investment due to their income generation and portfolio diversification properties. In this note, the Singapore equities team shares why this is particularly true in Asia: Strong economic growth, coupled with corporate plans to build logistical hubs and data centers, have bolstered Asia-Pacific (AP) REITs prospects, offering investors an attractive long-term opportunity.

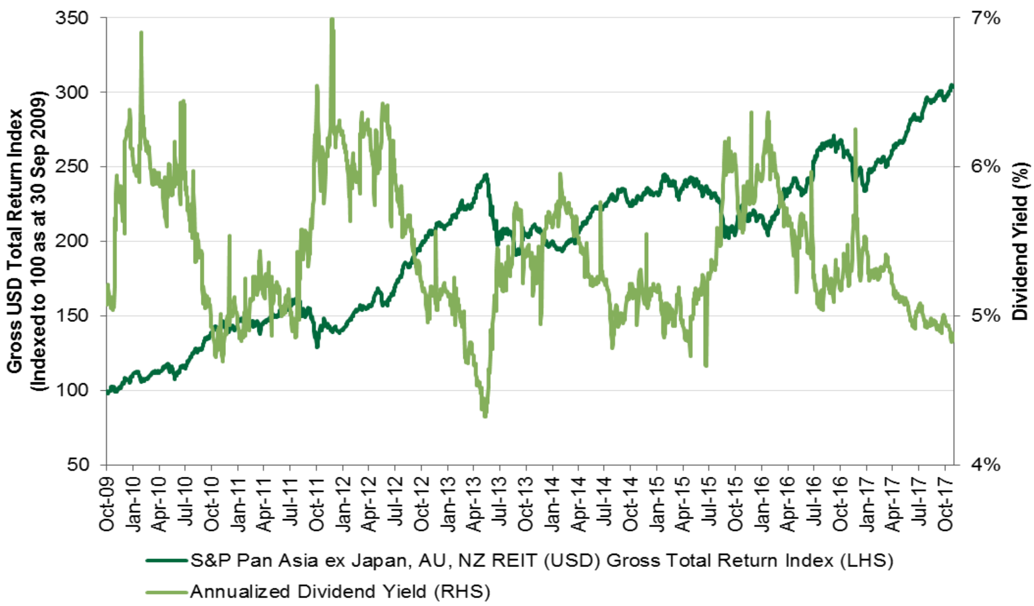
I. REITs: Performance and return characteristics

REITs traditionally are an attractive investment as they generate steady income streams and offer capital appreciation potential.

Through October 31 2017, Asia-Pacific REITs[1] have posted a 14.9% annualized return (Figure 1). Price return accounted for 8.6% of the return, while dividend income accounted for 6.3%- an attractive yield in today's low interest rate environment. Lower interest rates largely drove performance over the past eight years: increased investor demand for REITs due to the potential of dividend income and capital appreciation, was met with increasing supply among REIT providers on the back of lower financing costs and rising asset prices.

AP-REITs' returns are also due to several unique properties of the investment.

Figure 1: Pan Asia REITs performance, October 2009- October 2017[2]



[1] AP REITs refers to returns of S&P Pan Asia ex-Japan AU, NZ, (USD) Gross Return Index.
[2] Bloomberg, Manulife Asset Management,

First, REITs as an ‘alternative investment’ provide diversification benefits for investors. For investors with a portfolio, AP REITs have relatively weak (historical) correlation with other popular investments such as US bonds (0.29), commodities (0.41), and US equities (0.57) over roughly the past decade (Figure 2)[3]. They also provide potential diversification benefits for investors holding Asian bonds (0.71) and Asian equities (0.80)[4].

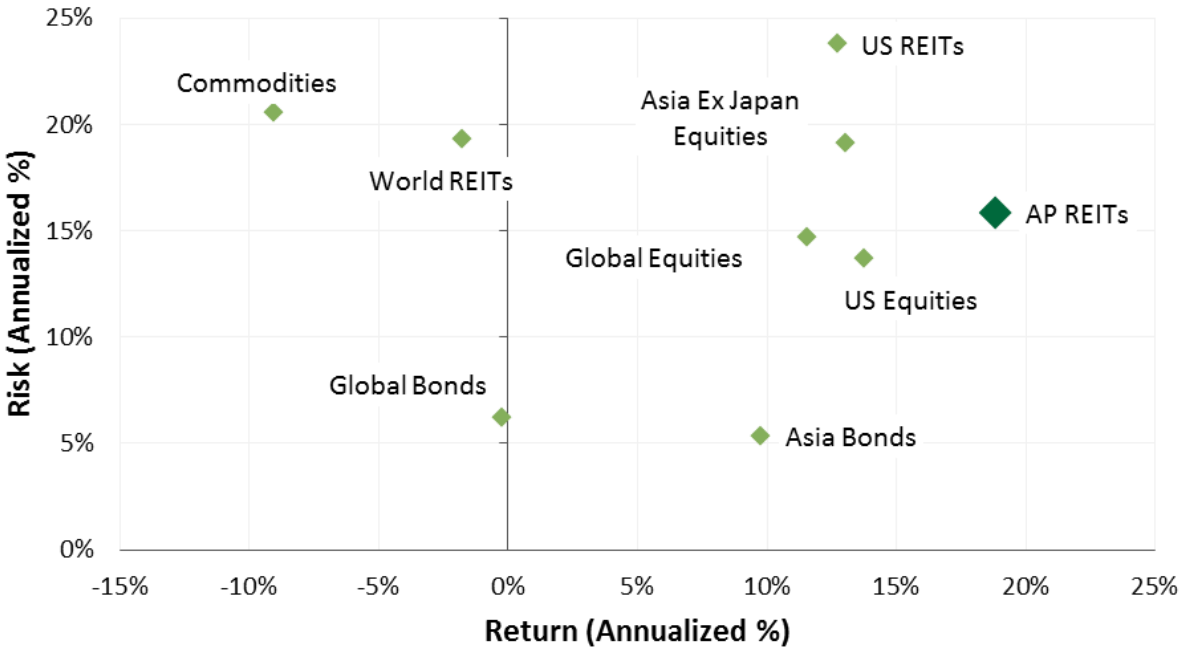
Figure 2: AP REITs correlations with major asset classes[5]

	Asia Pacific REITS	World Equities	Global Bonds	US Equities	US Bonds	Asia Equities	Asia Bond	Emerging Market Equities	Emerging Market Bonds	Commodities
Asia Pacific REITS	1.00									
World Equities	0.65	1.00								
Global Bonds	0.71	0.62	1.00							
US Equities	0.57	0.97	0.49	1.00						
US Bonds	0.29	-0.06	0.59	-0.12	1.00					
Asia Equities	0.80	0.82	0.68	0.74	0.12	1.00				
Asia Bond	0.71	0.45	0.80	0.35	0.65	0.63	1.00			
Emerging Market Equities	0.79	0.84	0.70	0.77	0.09	0.98	0.62	1.00		
Emerging Market Bonds	0.74	0.55	0.79	0.44	0.54	0.68	0.90	0.70	1.00	
Commodities	0.41	0.57	0.34	0.54	-0.27	0.48	0.09	0.55	0.25	1.00

Second, REITs provide attractive risk-adjusted returns versus other asset classes. As Figure 3 illustrates, AP REITs offer the highest annualized return among the examined asset classes over the time period, with lower annualized volatility than other REITs (World and US), commodities, and Asia-Pacific (ex-Japan) equities.

[3] Bloomberg as of September 2017. Asset classes represented by: Asia Pacific REITs = S&P Asia Pacific REIT ex Japan TR Index, World Equities = MSCI World GR USD Index, Global Bonds = BofAML Global Corporate Index, US Equities = S&P 500 TR Index, US Bonds = BofAML US Corporate and Government Index, Asia Equities = MSCI AC Asia ex Japan GR USD Index, Asia Bonds = JPMorgan Asia Credit USD Index, Emerging Market Equities = MSCI EM GR USD Index, Emerging Market Bonds = JPMorgan EMBI Global TR USD Index, Commodities = S&P GSCI TR USD Index Source: Bloomberg 31 October 2017, Monthly returns in USD.
[4] Bloomberg as of September 2017.
[5] Bloomberg, correlation table covers October 2008 to September 2017.

Figure 3: AP REITs offer attractive risk-adjusted returns[6]



II. AP REITs: Investment Outlook

The outlook for AP REITs is positive based on solid regional fundamentals, even in the face of potential interest rate increases.

Robust economic and segment growth

The recent recovery in the AP REIT market is linked to buoyant economic conditions globally and in Asia. In Singapore, a major regional real estate market, third quarter GDP growth was 4.6%, a near-term high. Hong Kong, another key real estate market, recorded the fastest growth in five years in the second quarter of 2017 on the back of continued economic stabilization in China. While this robust pace of growth may not be maintained, solid regional growth prospects will likely continue.

The growth outlook, coupled with increasingly attractive valuation prospects, explains why we are positive on the asset class. By geographical market, we currently have a small overweight in the Singaporean real estate market. In particular, we are constructive on the office and industrial segments. With valuations rising in Singapore to meet existing market demand, we are concentrating on prime office space in the Central Business District (CBD). Indeed, growth in grade A office rents in Singapore turned positive in the third quarter of 2017 for the first time in nearly two years with positive news flow and increased land bidding for new office space.

[6] Asset classes are represented by: AP REITs = S&P Asia Pacific REIT ex-Japan TR Index, World REITs = MSCI World REITs USD Index, US REITs = MSCI US REITs Gross TR Index, US Equities = S&P 500 TR Index, Asia Equities = MSCI AC Asia ex-Japan GR USD Index, Global Equities = MSCI TR Gross World USD Index Asia Bonds = JPMorgan Asia Credit USD Index, Global Bonds = BofAML Global Corporate Index, Commodities = S&P GSCI TR USD Index Monthly total returns in USD Manulife Asset Management, Bloomberg, risk-return timetable covers October 2008 to September 2017.

Singapore's unique regional position: logistical warehouses and data centres

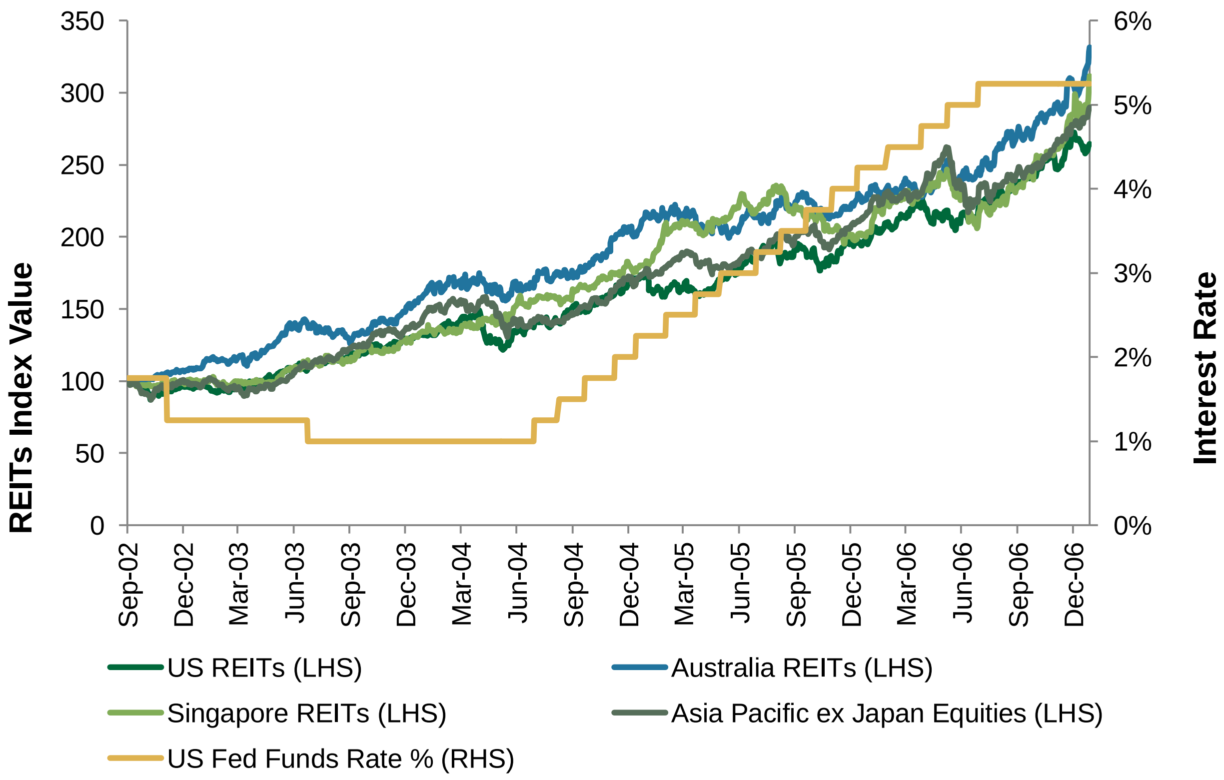
The industrial segment is also attractive due to Singapore's unique regional position as a logistical and data centre hub. As companies add to existing capacity in these growing industries, and new companies enter the region, we view Singapore's real estate market as a key beneficiary of this trend. This augurs increased demand for limited warehouse space and other development spaces in the city-state.

Finally, improved economic prospects also will likely boost the hotel and resorts segment. We have added some exposure to this segment due to the stabilizing RevPAR (Revenue Per Available Room) after 1-2 years of decline in the hospitality segment. We believe that this trend will continue to be positive into next year with a clear pipeline of supply absorption due to an increase in convention activity.

Resilient performance during interest rate increases

Even with these positive factors, investors may worry about the prospect of future interest rate increases as developed countries' central banks undertake monetary tightening. AP REITs have shown resilience in previous interest rate hiking cycles. Figure 4 shows the performance of AP REITs during the interest rate hike cycle of 2004-2006. Although there is initially volatility for REITs around the time of the interest rate hike, their performance trended higher during this period of rising interest rates.

Figure 4: AP REITS performance in a rising interest rate environment[7]

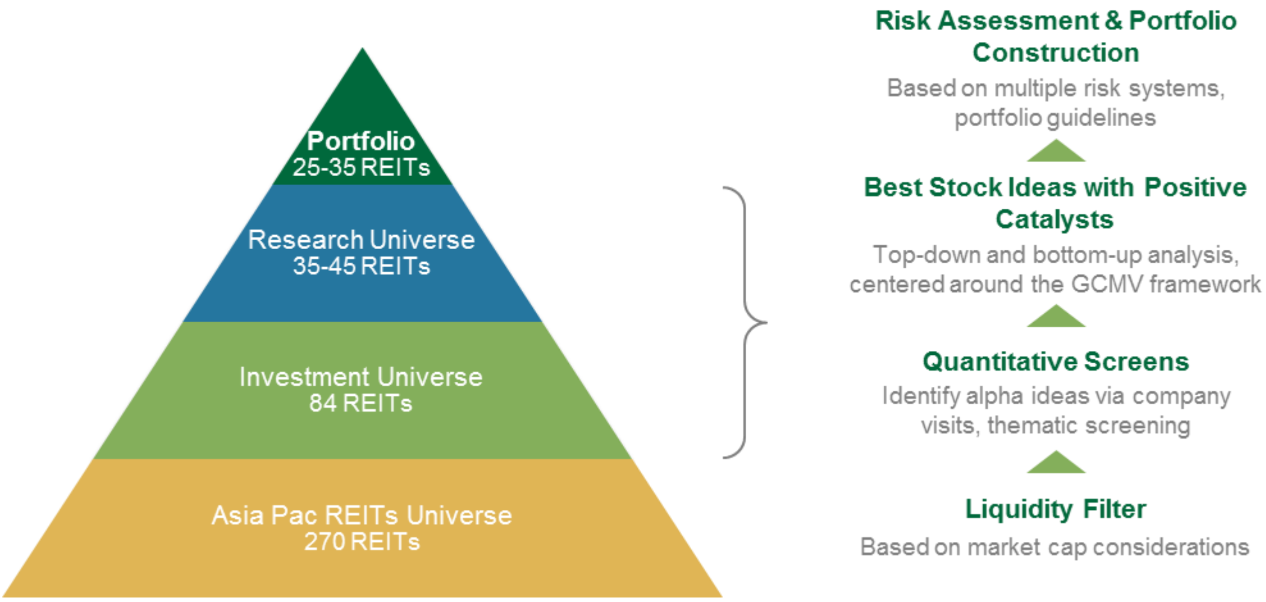


[7] US REITs = MSCI US REIT Index, Australia REITs = S&P/ASX 300 A-REIT Index, Singapore REITs = FTSE ST REIT Index, Asia Pacific ex Japan Equities = MSCI AC Asia Pacific ex Japan Index. Performance figures are in USD, and were re-based to 100 from 2 September 2002. Based on total returns. Source: Bloomberg, Manulife Asset Management, as of 31 December 2006.

III. AP REITs: Risk Management

With REITs, as with all investments, robust research capabilities are critical for success and serve as the foundation for risk management. Our team adopts a fundamental bottom-up approach when researching possible investments to include in the portfolio (Figure 5). All companies that we invest in must meet the criteria that are a part of our investment framework. Thus, our risk management framework ensures that every REIT included in the portfolio meets the strict requirements of our investment portfolio. Robust due diligence is conducted to maintain these requirements including site visits, management meetings, analyst meetings, and internal assessments on a continual basis.

Figure 5: Bottom-up REIT investment process[8]



IV. Conclusion

AP REITs offer investors an attractive mix of regular income, attractive risk-adjusted returns, and portfolio diversification properties. The outlook for the asset class is positive in Asia: strong economic fundamentals, coupled with growing demand in several key real estate segments, will serve as catalysts moving forward.

[8] Manulife Asset Management. GCMV : Growth, Cash Generation, Management, Valuation.

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