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REAL ESTATE AS AN ASSET CLASS

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September Effect Hits Equities – North American equities were mixed for the third quarter, giving back most of their gains in September. The S&P 500 was the leader for the quarter with emerging markets struggling mightily as China slowed and global COVID case counts increased. The often-discussed September Effect caught up with equities. Since 1929 the S&P 500 has lost 1.0% on average during September versus a +0.8% for all the other months.

Bonds also gave investors something to worry about as equity market weakness coincided with bond price declines. After falling to a closing low of 1.17% in August, the US 10-year Treasury yield finished the quarter at 1.49%. Despite a rising US dollar, crude prices made their way back to cycle highs also by quarter end. Rising yields and commodity prices are following inflation numbers higher which is happening across the globe.

INDEX TOTAL RETURN	3Q21	1-YEAR
MSCI All Country World Index (USD)	(1.05%)	27.44%
S&P 500 Index (USD)	0.58%	30.01%
S&P/TSX Composite Index (CAD)	0.17%	28.02%
MSCI Emerging Markets (USD)	(8.09%)	18.20%
MSCI EAFE Index (USD)	(0.45%)	25.73%
Barclays Global Agg Bond Index (USD)	(0.88%)	(0.91%)
Barclays US Agg Bond Index (USD)	0.05%	(0.90%)

Source: Bloomberg

Investment Opportunities Within Real Estate – The global real estate market can be classified into two broad categories: residential, where lots or dwelling units are owned, and commercial, which are income generating assets. Commercial real estate includes offices, industrial, healthcare, retail centers, hotels and multifamily rental apartment properties. Other forms of real estate-related investments are real estate-intensive operating companies, real estate investment trusts, loan pools and real estate debt. Investors exploring opportunities in the asset class have many options that offer a range of benefits, risk and return profiles.

Some of the benefits of investing in real estate include attractive total returns, portfolio diversification, inflation hedges and downside protection. The necessity function of real estate creates consistent cash flows that often lead to strong returns. According to the NCREIF Property Index, returns for real estate over the last 15 years were 6.85% annually versus 10.5% for the S&P 500. While these figures may surprise investors, the diversification and inflation benefit of real estate investing make it an attractive asset class for all types of investors.

Real estate, specifically private real estate, has historically displayed low correlation relative to stocks and bonds. Furthermore, as a real asset, property markets typically rise in inflationary periods. This is particularly true for short-term lease contracts as rent resets can be negotiated more often. Public storage is an example of a short-duration lease because rental contracts are monthly.

While fiduciaries and institutional investors are aware of the diversification and inflation protection benefits of real estate, most investors are attracted to the return potential. As previously illustrated, the returns are misleading, which is due to the use of leverage. As a large, mostly stable asset, lending is required and accepted widely. Therefore, when appreciation occurs, the benefits to equity can be significant. For example, if a $1,000,000 home appreciates at the average NCREIF Property Index rate of 6.85%, it's leveraged return jumps to 11.42% if it carries a reasonable 40% mortgage.

Avenues to invest in real estate include both debt and equity (ownership) opportunities across private and public markets. The most common equity investment option, also the most liquid, is the real estate investment trusts (REITS). These are often diversified, well capitalized properties that generate cash flow that is passed on to investors. The downside of this option is the high correlation to traditional equities. On the other side of the liquidity and correlation spectrum is direct investments. The challenge with this strategy is that it requires on-the-ground personnel in target markets and in-depth knowledge of regulations, deal flow and access to capital. A good middle ground that investors are often unaware of is through private real estate investment funds. This strategy can provide slightly more liquidity than direct holdings and it requires far less expertise of the asset. To ensure professional assessments and/or opportunities are maintained a portion of the return is foregone as a service.

Real estate investing has produced solid returns for investors as interest rates have fallen for nearly 30 years. This remains the number one driver for the asset class as a whole. Returns however should be viewed through an unlevered lens (take away leverage) and for most investors, retaining experts to assess the merits of local markets is a good risk mitigation strategy to protect capital. Our partners remain steadfast and operate in growing, diverse economies for our commercial investments while diversification is enhanced through our farmland allocation.