

Pan European Property Equities Fund

Commentary

Q1 2013

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Overview

Equity markets globally made a strong start to the year, buoyed by an aversion of the fiscal cliff in the US and stronger-than expected economic indicators. Political change in Japan and subsequent expansionary monetary policy talk from the Bank of Japan also aided global risk appetite. European shares made gains, despite the surprise Italian election result and subsequent concerns over Cyprus. However, listed real estate stocks lagged wider markets, having outperformed significantly in 2012. Underlying property fundamentals continue to reflect polarisation between prime and secondary assets and a divide in performance between Southern and Northern Europe. However, the listed companies' focus on better quality assets led to modest earnings and asset value growth being seen in results. Listed companies also continued to demonstrate their access to debt markets at ever more attractive rates. In addition, more than €2.7bn of new equity was raised, with the initial public offering (IPO) of LEG Immobilien in the German residential space the largest, but smaller placings by a handful of UK companies, most notably British Land and Intu Properties also contributing. The new equity is generally being used to fund acquisitions, which should enhance both earnings and dividends in the future. Overall, the fund's benchmark index¹ increased by 0.1% over the quarter.

Performance and activity

The fund performed in line with its benchmark over the quarter. An overweight allocation to Sweden and underweight position in Switzerland added value. Out overweight stance in the UK was also positive at a stock level, although this was largely offset by sterling weakness. Stock selection was mixed. We saw strong performance from a handful of smaller and non-benchmark stocks, most notably Inland Homes, Capital & Regional, Grainger and St Modwen in the UK, and Nexity in France. However, performance in the Netherlands was detrimental, with our preference for Eurocommercial over Wereldhave detracting.

Over the quarter, we made adjustments to the fund at stock level, without making great changes to the country allocation. Among continental retail names we switched out of Corio, following a strong start to the year, and added Klepierre in France where we see greater potential for operational improvement. In Germany we sold TAG in the residential space, participating in the IPO of LEG, which has since disappointed. We also added to Alstria Office in a discounted placing which, we think offers significant value. Among French office names, we built on our exposure to Icade, selling Gecina. In the UK, we added to British Land, selling Segro, and also participated in the IPO of Countrywide for exposure to an improving residential market.

Outlook

In Europe, London is the only market with any real rental growth. On the continent, there are a handful of property companies whose portfolios, balance sheets and management skills should be able to maintain dividend yields of 5-6%, but with little growth. As a result, those stocks focused on London are trading at premiums to NAV, while the rest are, with a few exceptions, valued at discounts of 10% or more. Property as an asset class has the important advantage of being a real asset with an income yield much higher than cash or government bonds. It is also a reasonable inflation hedge, and we would expect, in most scenarios, average property values to recover in line with tenant demand, given the general lack of new development. However, in a weak economy there will be a big difference between the best and the rest, meaning that the larger companies with better assets will tend to outperform.

¹ FTSE EPRA/NAREIT Developed Europe Capped Net Total Return Index (in euro).

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