

# U.S. REIT Fact Sheet & Commentary

Quarter Ending March 31, 2019



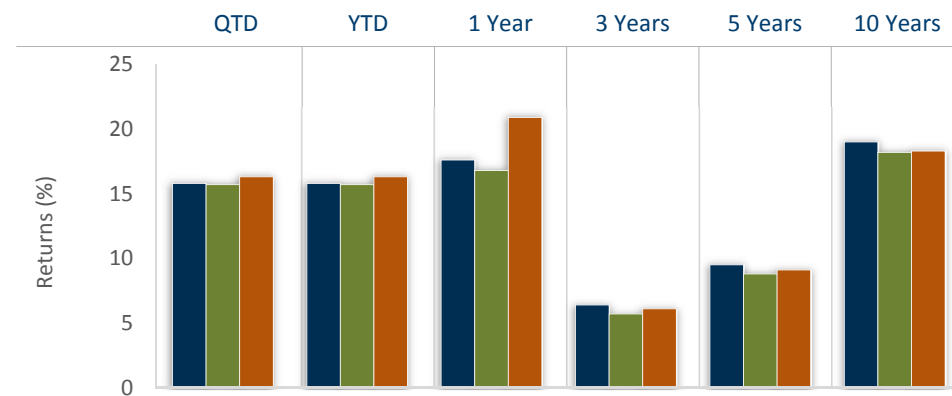
**DUFF & PHELPS**  
INVESTMENT MANAGEMENT CO.

A VIRTUS INVESTMENT PARTNER

## PORTFOLIO STRATEGY

- Holdings: 25-45 securities
- Sector Exposure: Greater of 2x benchmark holdings or 5% of total portfolio
- Single Security Limit: Greater of 10% of portfolio or 2% over benchmark
- Expected Turnover: < 50%
- Cash: Typically fully invested
- Benchmark: FTSE Nareit Equity REITs Index

## PERFORMANCE (%)<sup>1</sup>



	QTD	YTD	1 Year	3 Years	5 Years	10 Years
Composite Gross Return	15.8%	15.8%	17.6%	6.4%	9.5%	19.0%
Composite Net Return	15.7%	15.7%	16.8%	5.7%	8.8%	18.2%
FTSE Nareit Equity REITs Index	16.3%	16.3%	20.9%	6.1%	9.1%	18.3%

## INVESTMENT PHILOSOPHY

- We believe our rigorous fundamentally driven investment process will produce superior performance over time.
- We focus on high quality owner/operators of real estate because our research shows they have offered durable cash flows and attractive risk-adjusted returns.
- The value of listed real estate securities is a compilation of not only the underlying asset values but also the value of management's ability to capitalize on opportunities.
- We believe successful real estate investing requires active management and patience to take advantage of multi-year value creation opportunities.
- Capping AUM at 1% of the investment universe preserves our trading flexibility, liquidity, and potential for repeatable results.

## PORTFOLIO CHARACTERISTICS

	Portfolio <sup>2</sup>	Benchmark
FFO Multiple (P/E), 2019 est.	18.2x	18.3x
Earnings Growth Rate, 5-year est.	5.1%	4.6%
Dividend Yield	3.7%	4.1%
Dividend Growth, 5-year est.	5.2%	4.3%
Weighted Avg. Market Cap (bn)	\$17.0	\$18.5

Sources: FTSE, Bloomberg Finance LP, Duff & Phelps.

## TOP TEN HOLDINGS<sup>3</sup>

	Portfolio( %) <sup>2</sup>
Prologis Inc.	6.4
Digital Realty Trust Inc.	5.7
Avalonbay Communities Inc.	5.1
Alexandria Real Estate Equities	4.8
Simon Property Group Inc.	4.7
HCP Inc.	4.6
Regency Centers Corp.	3.9
Sun Communities Inc.	3.8
Cousins Properties Inc.	3.7
Equity Residential	3.3

## RISK/RETURN (10 YEARS)

	Composite	Benchmark
Alpha	0.9%	-
Total Return Beta	1.0	1.0
Sharpe Ratio	1.0	1.0
Standard Deviation	18.6%	18.9%
Information Ratio	0.4	-
Tracking Error	1.8	-

Source: eVestment

## CONTACT INFORMATION

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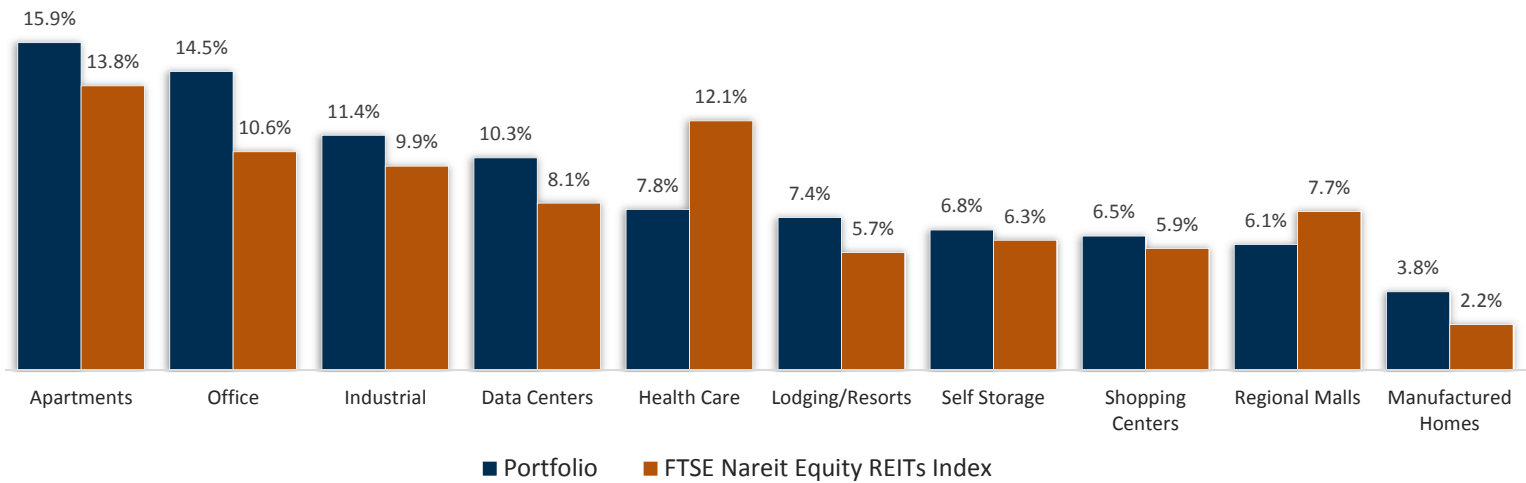
<sup>1</sup>Inception date is January 1, 1995. Periods over one year are annualized. Please see the GIPS Compliant Presentation for more information.

<sup>2</sup>Portfolio information is based on a representative institutional account excluding cash. Holdings are subject to change.

<sup>3</sup>It should not be assumed that securities identified were or will be profitable. The top ten holdings list represents the largest percentage holdings at quarter end of a representative institutional account excluding cash and does not represent all of the securities held in client portfolios. The securities identified may no longer be held in client portfolios and the holdings of any particular client portfolio may vary. The list is provided for illustrative purposes and should not be considered a recommendation to purchase or sell a particular security. A complete list of holdings and transactions for the previous twelve months is available upon request.



## Top 10 Portfolio Sector Weights vs. Benchmark(%)<sup>2</sup>



Source: Bloomberg Finance LP

## Market Review

REITs and equity markets staged a strong rally in the quarter, with REITs more than making up for the fourth quarter 2018 decline. The allocation benefit of REITs was visible again, as REITs outperformed the broader market. The FTSE NAREIT Equity REITs Index delivered a 16.3% return in quarter, versus a 13.6% return by the S&P 500, 270 bps of outperformance by REITs. By comparison, last quarter REITs outperformed in the challenging environment then as well, -6.7% vs -13.5%, for 680 bps of outperformance, demonstrating the benefit of REITs in both recent up and down environments. The allocation benefit of REITs may be even more telling further into an economic cycle.

As the quarter commenced, Fed Chair Powell articulated a better message on January 4, 2019, noting how the Fed would be receptive to using all of its tools, including a change in previously planned balance sheet unwinding and rate increases, depending on the economic data and market environment. The Fed further helped the markets at the March meeting and subsequent press conference, when the Fed pulled its previous expectation of raising rates in 2019 and diminished concerns of further tapering, noting it was much closer to a steady state balance sheet. Clearly the Fed was listening more attentively to the numerous economic and geo-political factors which had contributed to the tough finish to 2018 and continued growth concerns as 2019 began. After nine rate increases this cycle, including its first in December 2015, the Fed appears to have wrapped up its relative solo act versus other global central banks.

The fourth quarter equity market selloff left REITs at significant discounts to private market valuations. Both the attractive valuations and durable nature of their contractually based cash flows received market recognition in the quarter. At the same time, capital continued to be raised for private real estate funds, boosting the potential of M&A.

While growth rates in earnings for the broader market were called into question, REITs had a solid fourth quarter earnings season and are demonstrating more consistent earnings drivers as we begin 2019. REITs, as measured by Evercore ISI, posted 2.7% same store net operating income growth last quarter, a level of organic growth which compares to the long run average of 3.1%. The visible organic growth supports our point of the durable cash flow and earnings drivers for REITs. We would also note REITs continued to prune their portfolios of high quality real estate into the robust private bid, strengthening their balance sheets further, while demonstrating patience for redeployment opportunities whether in redevelopment, development, acquisitions or share buybacks.

Taking a closer look at the performance of the individual property sectors that are represented within the FTSE NAREIT Equity REITs Index ("the Benchmark") the top performing property sectors during the quarter on a total return basis were Industrial, Office and Data Centers, all of which lagged last quarter.

The bottom performing property sectors in the quarter included two of the fourth quarter and 2018 outperformers, Self Storage and Health Care, as well as Regional Malls, which continued to lag.



## Portfolio Overview

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Property sector allocation was a positive contributor, but was offset by security selection, largely from data centers, causing the portfolio to lag slightly.

The strongest relative contributors to performance in the quarter were Office, Industrial and Regional Malls, all benefiting from security selection and property sector allocation, overweight allocations in the case of Office and Industrial, and an underweight allocation in Regional Malls.

Office benefitted from our overweight position, in particular to outperforming Alexandria Real Estate, the preeminent owner/operator of lab space, as well as overweight positions in Cousins and Kilroy Realty, high-quality sharp shooters in the South and West Coast, respectively. Cousins took advantage of its improved currency by announcing a 100% stock deal for peer Tier REIT in the last week of the quarter, further strengthening its positions in key markets in the South, such as Austin. The lack of exposure to lagging NY based SL Green was also a notable contributor within Office.

Industrial benefited from our overweight position in ProLogis, which had a notable recovery after being unduly impacted last quarter, our position in Americold Realty, and lack of exposure to Liberty Property Trust, which had lagged its peers after outperforming last quarter.

Regional Malls benefited from a more recent position in Taubman Centers, as well as an underweight to Simon Property Group and overall underweight exposure.

The largest relative detractors were modest in number as only one property sector, Data Centers, had an adverse impact of more than 10 basis points, due to an overweight allocation as it lagged and security selection from overweight positions in laggards Cyrus One and Digital Realty Trust, and an underweight position in Equinix, which outperformed after lagging last quarter. Diversified was next among detractors due to security selection as our sole holding Vornado Realty Trust, lagged its sector and the benchmark. Single Family Homes also detracted due to stock selection.

Recapping security selection, the largest three contributors overall were Brixmor in Shopping Centers, Alexandria in Office, and CubeSmart in Self Storage. The largest three detractors were Cyrus One, Equinix and Digital Realty Trust in Data Centers.

## Investment Outlook

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Looking ahead, we expect continued variance in the global economic growth picture and regional real estate fundamentals. Regionally, we are looking to the U.S. for economic growth leadership. We expect the variance in global growth trajectories to create opportunities for active managers such as ourselves, who are focused on owner-operators of high quality real estate, with solid balance sheets and proven management teams, to deliver outperformance versus the broader REIT market. Overall, we expect cash flow and dividend growth for global real estate securities to be solid once again in 2019. Key themes we are focusing on include:

- *Rents, not rates:* While there is likely to be upward pressure on interest rates in many markets, rental rate growth – particularly for high quality real estate, will continue to support further cash flow and dividend growth.
- *New supply:* While new supply levels are generally catching up to years of undersupply, selective geographic markets and property sectors will remain impacted by new development.
- *Balance sheet health:* Cash flow and dividend growth rates are converging across many global markets, but U.S. balance sheets are benefiting from more active pruning and remain better positioned with less leverage than most international markets.
- *M&A tailwind:* M&A activity picked up in 2018, driven by healthy discounts-to-NAV in public real estate security markets, as well as large pools of private equity real estate capital looking to be put to work. We expect this to continue in the year ahead.



## Investment Outlook cont.

Our base case total return drivers for global real estate in 2019 include:

- An attractive estimated cash flow growth of 4-6%.
- Dividend yield of approximately 4%, with above average growth expected in the U.S. given lower payout ratios.
- Healthy demand, increasing rents and manageable new supply driving cash flow and dividend growth.
- From a global perspective, real estate fundamentals remain more attractive for the industrial/logistics and data center property sectors with secular tailwinds from ecommerce and the cloud.

There are several potential upside catalysts to our base case. A key macro consideration would be greater than expected global economic growth, which would drive higher real estate occupancies and rents. Another upside factor would be rotation into real estate securities from bonds and broader equities, as investors embrace asset classes which provide diversification benefits alongside traditional allocations. And an increased potential for M&A and privatizations continues to exist, given the listed discounts to private real estate market prices, robust bids, and the ongoing appetite for high quality, core real estate among institutional investors.

From a balanced perspective, we also note certain downside risks to our base case assumptions. A key risk would be ongoing waves of macro-political shocks, which could lead to broad based economic deceleration or a dislocation in global debt markets. Also, interest rates could increase at a faster pace and magnitude than a lift in net operating income growth and replacement costs could absorb. And an acceleration in the pace of new commercial real estate supply would also be a concern.

Overall, we believe the global real estate market cycle still has room for further growth against a backdrop of solid catalysts which underpin our base case.

As always, thank you for your continued support of our team and investment strategy.



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Portfolio Manager

**Past performance is not indicative of future results.** Returns are expressed in U.S. dollars and include the reinvestment of dividends and other earnings. Composite returns are net of trading costs but do not reflect the deduction of investment advisory fees, custodial charges or other expenses. Indices are not available for direct investment and index returns do not reflect the deduction of any fees. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities. Forward-looking statements are necessarily speculative in nature. It can be expected that some or all of the assumptions or beliefs underlying the forward-looking statements will not materialize or will vary significantly from actual results or outcomes.

The Benchmark is the FTSE Nareit Equity REITs Index, a free-float market capitalization-weighted index measuring equity tax-qualified real estate investment trusts (REITs) not designated as timber or infrastructure REITs, which meet minimum size and liquidity criteria that are listed on the New York Stock Exchange, the American Stock Exchange or NASDAQ.

The S&P 500 Index is a free-float market capitalization-weighted index of 500 of the largest U.S. stocks and is generally representative of the performance of larger companies in the U.S.

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GIPS Compliant Presentation

Year-end (12/31)	Annual Composite Return (%)		Annual Benchmark Return (%)	3-Year Annualized Standard Deviation (%)		Number of Accounts	Asset-weighted Dispersion (%)	Composite Assets (US \$M)	Firm Total Assets (US \$B)
	Gross	Net		Composite	Benchmark				
2018	-5.32	-5.94	-4.62	13.35	13.38	10	0.1	1,274	9.0
2017	7.28	6.63	5.23	13.03	13.11	11	0.1	1,679	10.2
2016	8.00	7.22	8.52	14.92	14.80	10	0.2	1,814	10.3
2015	3.63	2.86	3.20	14.30	14.37	10	0.1	1,757	9.2
2014	33.08	32.11	30.14	13.27	13.08	10	0.0	2,088	10.8
2013	1.76	1.00	2.47	16.92	16.51	8	0.1	1,648	9.2
2012	18.12	17.25	18.06	18.37	18.00	11	0.1	1,716	8.9
2011	11.13	10.30	8.29	30.34	31.28	11	0.1	1,457	8.6
2010	29.37	28.43	27.96	37.65	39.20	13	0.1	1,427	7.2
2009	30.30	29.34	27.99	37.82	39.14	13	0.2	1,275	6.5

Duff & Phelps Investment Management Co. claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Duff & Phelps Investment Management Co. has been independently verified for the periods January 1, 1993 through December 31, 2017. The verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

**1. Organization** – Duff & Phelps Investment Management Co. (“Duff & Phelps” or the “firm”) is a registered investment adviser and a wholly owned subsidiary of Virtus Investment Partners. Duff & Phelps manages assets on behalf of institutional and retail separate accounts and open-end and closed-end funds. Registration of an investment adviser does not imply any level of skill or training.

**2. Composite Description** – The U.S. REIT Composite includes all fully discretionary accounts, excluding wrap/SMA accounts, managed by the firm with account market values greater than \$1 million at the time of initial investment that focus their investments in U.S. real estate investment trust securities with the objective of producing excess returns above the FTSE Nareit Equity REITs Index over a full market cycle (i.e., three to seven year horizon). The inception date of the U.S. REIT Composite (formerly the Real Estate Investment Trust (REIT) Composite) was January 1, 1995 and the Composite was created on January 1, 2001. The Composite was redefined November 30, 2018 to exclude wrap/SMA accounts in order to distinguish it from other products. Prior to October 2013, the Composite did not reference its objective relative to the Benchmark. This reference was added to distinguish the Composite from other products; there was no change in the benchmark or the strategy.

Composite policy requires the temporary removal of any account incurring a significant cash flow. Effective July 1, 2016, a significant cash flow is defined as a client initiated inflow or outflow of cash or securities of 25% or more of beginning period assets. From April 1, 2014 through June 30, 2016, temporary accounts were utilized to remove the impact of significant cash flows of 10% or more. From August 1, 2009 through March 31, 2014, Composite policy required the temporary removal of any account incurring a significant cash flow of 10% or more. Prior to August 2009, accounts incurring significant cash flows of 10% or more were reviewed for discretion.

**3. Benchmark** – The Composite Benchmark is the FTSE Nareit Equity REITs Index, a free-float market capitalization-weighted index measuring equity tax-qualified real estate investment trusts (REITs) not designated as timber or infrastructure REITs, which meet minimum size and liquidity criteria and are traded on the New York Stock Exchange, the American Stock Exchange, and the NASDAQ National Market System.

**4. Calculations** - Returns are total, time-weighted rates of return expressed in U.S. dollars and include accrued income. The Composite and Benchmark results reflect the reinvestment of dividends and other earnings. Portfolios are valued on a trade date basis. Monthly performance is calculated by linking daily returns. The Composite return is an asset weighted average of the performance results of all the portfolios in the Composite based on beginning of month values. The annual dispersion is asset-weighted and measures the deviation of individual portfolio returns around the Composite returns for portfolios in the Composite for the entire year. The 3-year annualized ex-post standard deviation measures the variability of the Composite and the Benchmark returns over the preceding 36-month time period. The number of accounts as of December 31, 2016 was previously misstated as 7 and is now correctly shown as 10.

**5. Performance and Fee Information** – Investment performance returns are presented on both a gross of fee and net of fee basis. Gross composite returns are calculated net of trading costs, but do not reflect any deduction for investment advisory fees, custodial charges or other costs that a client might incur in connection with the management of an account. The firm's fee schedule for management of separate institutional REIT accounts is: .75% on assets up to \$10 million, .65% on the next \$15 million, .60 on the next \$25 million, and .50% on amounts in excess of \$50 million. Returns realized by clients will be reduced by these costs. Actual investment advisory fees incurred by clients may vary. Initial minimum account size for institutional accounts is \$5 million. Effective October 1, 2016, net composite returns are calculated by subtracting actual separate account investment management fee rates from gross account returns based on month-end assets. Net account returns are reduced by performance fees when applicable and deducted from composite results on a cash basis. Previously, net composite returns were calculated by subtracting the highest separate account investment management fee in effect for the period. Index returns do not reflect the deduction of any fees.

**6. Additional Information** – Duff & Phelps's policies for valuing portfolios, calculating performance and preparing compliant presentations, as well as a complete list of composite descriptions, are available upon request.

**Past performance is not indicative of future results.**

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