# International Real Estate Securities Fact Sheet & Commentary

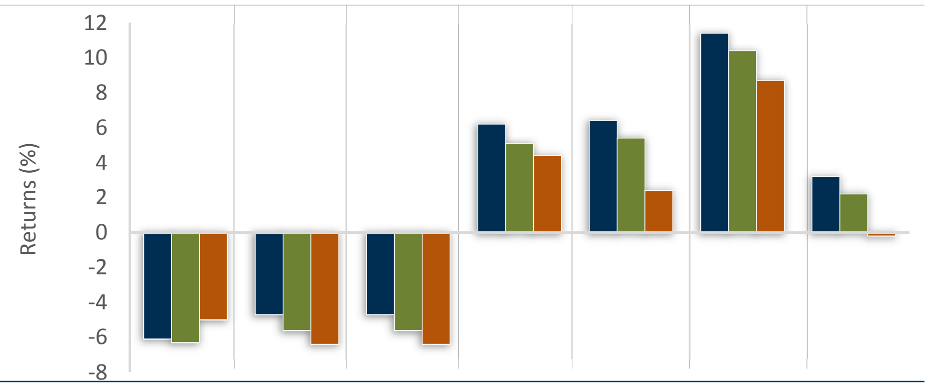
Quarter Ending December 31, 2018

DUFF & PHELPS INVESTMENT MANAGEMENT CO.
A VIRTUS INVESTMENT PARTNER

## PORTFOLIO STRATEGY

- Holdings — 30-50 securities
- Single Security Limit — < 500 bps of relative exposure
- Historical Turnover — < 50%
- Cash — Typically fully invested
- Benchmark — FTSE EPRA Nareit Developed ex U.S. Index (net)

## PERFORMANCE (%)[1]




| | QTD | YTD | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception |
|---|---|---|---|---|---|---|---|
| **Composite Gross Return** | **-6.1%** | **-4.7%** | **-4.7%** | **6.2%** | **6.4%** | **11.4%** | **3.2%** |
| Composite Net Return | -6.3% | -5.6% | -5.6% | 5.1% | 5.4% | 10.4% | 2.2% |
| FTSE EPRA Nareit Dev ex U.S. Index (net) | -5.0% | -6.4% | -6.4% | 4.4% | 2.4% | 8.7% | -0.2% |

## 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[2] | Benchmark |
|---|---|---|
| Multiple (P/E), 2019 est. | 17.0x | 16.2x |
| Earnings Growth Rate, 5-year est. | 9.1% | 4.7% |
| Dividend Yield | 4.4% | 4.3% |
| Dividend Growth, 5-year est. | 6.3% | 4.6% |
| Median Market Cap (bn) | $2.9 | $2.3 |

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

## TOP TEN HOLDINGS[3]

| | Portfolio( %)[2] |
|---|---|
| Link REIT | 5.4 |
| Vonovia SE | 5.3 |
| Mitsubishi Estate Co Ltd. | 5.3 |
| Wharf Real Estate Investment | 4.9 |
| Invincible Investment Corp. | 3.8 |
| Unibail Group Stapled | 3.5 |
| Swire Properties Ltd. | 3.5 |
| Kenedix Office Investment Co. | 3.1 |
| Unite Group Plc | 3.1 |
| Safestore Holdings Plc | 2.8 |

## RISK/RETURN (10 Year)

| | Composite | Benchmark |
|---|---|---|
| Alpha | 3.3% | - |
| Total Return Beta | 0.9 | 1.0 |
| Sharpe Ratio | 0.7 | 0.5 |
| Standard Deviation | 16.8% | 17.7% |
| Information Ratio | 0.5 | - |
| Tracking Error | 5.8 | - |

*Source: Duff & Phelps, SS&C Technologies Inc.*

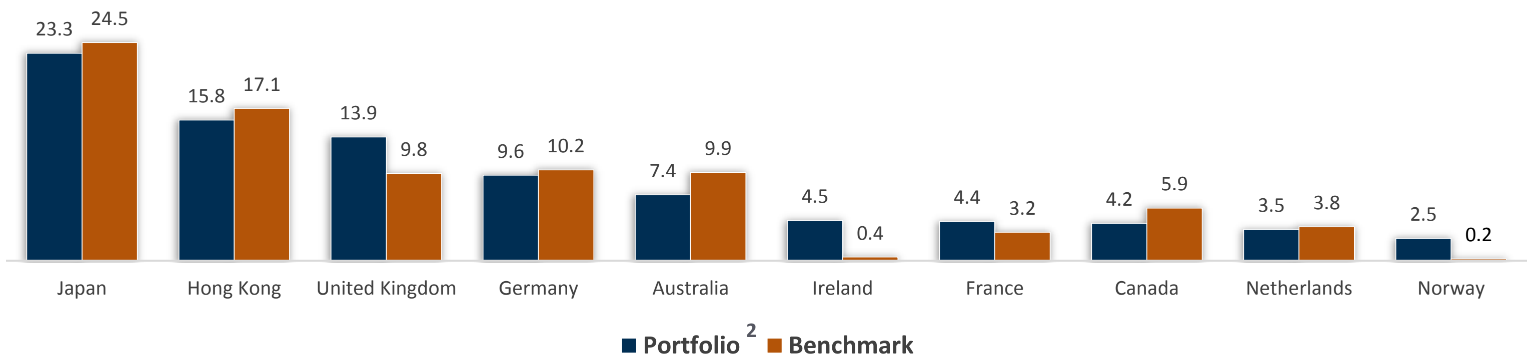
## CONTACT INFORMATION


**Sarah Honold**
Consultant Relations
312-917-6548 | sarah.honold@dpimc.com
**Robert Hiebert**
Senior Relationship Manager
312-917-6560 | robert.hiebert@dpimc.com


[1]Composite Inception Date: 10/31/2007. Time periods over one year are annualized. Please see the GIPS Compliant Presentation for more information.
[2]Portfolio information is based on a representative institutional account excluding cash. Holdings are subject to change.
[3]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.

DUFF & PHELPS INVESTMENT MANAGEMENT CO.
A VIRTUS INVESTMENT PARTNER

## Top Ten Country Weights vs. Benchmark (%)[2]




*Source: Bloomberg Finance L.P.*

## Market Review

Global financial markets came under significant pressure during the fourth quarter as a plethora of economic and political worries compounded, culminating in one of the worst December market drawdowns in decades. Amidst this heightened volatility international equities fell by 12.5% during the fourth quarter, as represented by the MSCI EAFE Index, expressed in U.S. dollars. On-the-other-hand, international real estate securities proved to be a relative port in the storm, declining only 5.0% during the quarter, as represented by the FTSE EPRA Nareit Developed ex U.S. Index ("the Benchmark"), expressed in U.S. dollars. International real estate equities outperformed international equities for the year as well, falling 6.4% versus a decline of 13.8%.

Movement in the U.S. dollar continued to be a headwind to international returns during the quarter with an increase of 1.1%, as measured by the U.S. Dollar Spot Index. The U.S. dollar hit intra-year highs during the quarter as global growth concerns, a precipitous decline in oil and increased Brexit concerns, weighed on other currencies.

There had been some expectation the Fed would appear more accommodative in its December forward commentary to global growth concerns, including the negative impact from trade tariffs with China. Instead, the Fed elected to increase rates for a fourth time of the year in December amidst the growth concerns, and articulated two probable further rate increases in 2019 and on-going balance sheet unwinding.

Fortunately, as we go to print, 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 fourth quarter equity market selloff led to significant discounts for REITs globally versus private market valuations. At the same time capital continued to be raised for private real estate funds, boosting the potential of M&A.

Taking a closer look at the performance of the individual countries that are represented within the FTSE EPRA Nareit Developed ex U.S. Index, the top-performing countries during the fourth quarter on a total return basis measured in U.S. dollars included New Zealand, Japan, Belgium, Hong Kong and Sweden. Of these countries, New Zealand and Japan managed to post positive returns for the quarter and all but Hong Kong outperformed the Index on the year. Beyond healthy underlying real estate fundamentals, New Zealand and Japan's quarterly performance was aided by positive movements in the New Zealand dollar and Japanese yen, both of which appreciated relative to the U.S. dollar.

The five bottom-performing countries during the fourth quarter were the Netherlands, France, Italy, Ireland and Finland. European focused retail real estate companies listed in the Netherlands and France continued to be under pressure again this quarter given their mixed fundamental outlook and the expected negative impact to French retail sales from the "Yellow Vest" protests that took place across France prior to Christmas. French office names also underperformed. Irish office and residential real estate shares performed poorly during the quarter as the vote on the likely doomed Brexit divorce agreement between the U.K. and Europe was delayed until January by Prime Minister May's government. The contentiousness surrounding what to do with the Irish border once the U.K. leaves the EU continues to override a healthy Irish economy and real estate market.

## Portfolio Review

Overall, our international real estate securities strategy underperformed the Benchmark in the fourth quarter. Security selection contributed positively, while country allocation detracted from our performance.

Combining country allocation and security selection, the top positive contributors to performance for the quarter were Germany, Australia and India. Security selection drove the performance of Germany and Australia and country allocation was the driver of performance in India.

From a country allocation perspective, our out of Benchmark allocation to India was the most positive driver of performance during the fourth quarter. Our exposure to India comes via our holding in Ascendas India Trust, a Singapore based India office park focused real estate firm, which posted a positive total return for the quarter. The next most positive contributor to country allocation for the quarter was our underweight exposure to Canada. While not a top underperforming country for the quarter, Canada did underperform the Benchmark, which was partially driven by the significant decline in oil.

At the security level, our overweight exposure to TLG Immobilien AG, a mid-cap German diversified real estate company, was the largest positive contributor for the quarter. Shares of the company performed strongly during the quarter as the company announced positive earnings results and previewed what is expected to be a significant increase in the underlying valuation of its properties when it reports year end results. The company's healthy exposure to the Berlin office market, one of the best in Europe, is the primary driver behind this expected valuation increase. The next largest positive contributor to security selection for the quarter was our lack of exposure to Mitsui Fudosan Co., a large-cap Japanese diversified real estate firm, which underperformed.

Combining country allocation and security selection, the top detractors were China, Hong Kong and Japan. Security selection was the primary detractor in Hong Kong and Japan, while country allocation detracted in China.

From a country allocation perspective, our out of benchmark exposure to China focused data center real estate firm GDS Holdings was the largest detractor from performance during the fourth quarter. Despite reporting very positive third quarter earnings results during the quarter, the shares fell victim to the on-going trade noise surrounding China and the significant weakness in technology shares during the quarter. The second largest country allocation detractor was our overweight exposure to Ireland. As mentioned previously, Ireland was one of the worst performing countries during the quarter as Irish listed real estate companies seem to have become a levered play on the direction of the Brexit negotiations between the U.K and Europe, which took a negative turn during the fourth quarter.

At the security level, our overweight exposure to Wharf Real Estate Investment, a large-cap Hong Kong retail real estate firm was the largest negative contributor to security selection for the quarter. Wharf shares were negatively impacted by the concern that slowing economic growth in Mainland China and the weakening Chinese yuan, would negatively impact retail sales at its primary asset Harbour City, which is based in the commercial hub of Tsim Sha Tsui. The next largest detractor to security selection was our overweight exposure to Boardwalk REIT, a mid-cap Canadian apartment REIT. Shares of Boardwalk performed particularly poorly following its third quarter earnings release on the concern that the expected rental rate recovery at its apartment units in Edmonton and Calgary would take longer than previous market expectations and may be further negatively impacted by the recent significant decline in oil prices.

## Investment Outlook

Looking ahead, we expect continued variance in the global economic growth picture and regional real estate fundamentals. Regionally, we are looking to Ireland, Australia, and 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.

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.

GEOFFREY DYBAS, CFA
Senior Portfolio Manager

FRANK HAGGERTY, CFA
Portfolio Manager

***Past performance is no guarantee of future results.*** *Returns are calculated in U.S. dollars and include the reinvestment of dividends and other earnings. 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 securities identified were selected from all of the holdings of a representative account for the period based on relative contribution to the account's return versus the Benchmark. The securities identified do not represent all of the securities purchased, sold or recommended for advisory clients and the securities identified may no longer be held in client accounts. The methodology used to calculate the contribution to return or a list showing every holding's contribution to the account's return for the period is available upon request.*

*The FTSE EPRA Nareit Developed ex U.S. Index (net) is a free-float market capitalization index measuring developed market international real estate securities engaged in the ownership, disposal and development of income-producing real estate that meet minimum size, liquidity and revenue criteria.*

*The MSCI EAFE Index (Europe, Australasia, Far East) (net) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.*

## 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 | -4.66 | -5.61 | -6.41 | 11.11 | 10.92 | <5 | n.a. | 40.2 | 9.0 |
| 2017 | 23.33 | 22.10 | 20.03 | 11.84 | 11.23 | <5 | n.a. | 26.6 | 10.2 |
| 2016 | 1.74 | 0.85 | 1.30 | 12.62 | 12.10 | <5 | n.a. | 30.1 | 10.3 |
| 2015 | 1.19 | 0.33 | -3.76 | 12.40 | 12.66 | <5 | n.a. | 40.2 | 9.2 |
| 2014 | 12.60 | 11.65 | 2.84 | 12.86 | 14.48 | <5 | n.a. | 40.2 | 10.8 |
| 2013 | 2.99 | 2.07 | 5.79 | 16.67 | 18.15 | <5 | n.a. | 41.0 | 9.2 |
| 2012 | 35.95 | 34.76 | 38.01 | 19.45 | 20.18 | <5 | n.a. | 40.6 | 8.9 |
| 2011 | -9.35 | -10.17 | -15.64 | 24.20 | 25.47 | <5 | n.a. | 20.2 | 8.6 |
| 2010 | 20.45 | 19.39 | 15.63 | 28.16 | 30.34 | <5 | n.a. | 26.4 | 7.2 |
| 2009 | 40.67 | 39.44 | 43.97 | | | <5 | n.a. | 29.9 | 6.5 |

**Partial year return. Composite inception is October 31, 2007.*

**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 International Real Estate Securities Composite includes all fully discretionary accounts that focus their investments in international real estate equity securities. The inception date of the Composite is October 31, 2007 and the Composite was created on January 1, 2008. The Composite contains less than 5 portfolios.

From September 1, 2014 to June 30, 2016, Composite policy required the creation of a temporary account for a single client initiated inflow or outflow of cash or securities expected to exceed 10% at the time of notification of beginning period assets (a "significant cash flow"). Effective July 1, 2016, Composite policy does not, and prior to September 1, 2014 did not, include the use of temporary accounts or define significant cash flows.

**3. Benchmark** –The Composite Benchmark is the FTSE EPRA Nareit Developed ex U.S. Index (net), a free-float market capitalization index measuring developed market international real estate securities engaged in the ownership, disposal and development of income-producing real estate, which meet minimum size, liquidity and revenue criteria. Prior to September 1, 2017, the Benchmark was the FTSE EPRA Nareit Developed Rental Index (net), a subset of the new Benchmark. The former Benchmark focused on companies classified as Rental and excluded companies classified as Non-Rental. The change in Benchmark was made given the widespread use of the new Benchmark in the marketplace. There has been no change in the Composite strategy, which continues to focus primarily on rental companies. Exchange rates used for the Benchmark are WM/Reuters Closing Spot Rates™ collected at 16:00 hours London time; prior to October 1, 2016, the Composite used WM/Reuters Closing Spot Rates™ collected at 16:00 hours New York time and since October 1, 2016 the Composite uses WM/Reuters Closing Spot Rates™ collected at 16:00 hours London time. Prior to 2012, the Composite utilized a systematic fair value methodology triggered by significant events (such as significant movements in U.S. markets following international markets' closings). The Benchmark does not utilize a systematic fair value methodology, and effective 2012, the Composite does not utilize such a methodology. The withholding tax rates used in the calculation of the Benchmark are those applied to dividends received by a Luxembourg based UCIT fund; the withholding tax rates used in the calculation of the Composite are those applied to dividends received by account domicile.

**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. Composite dispersion is not presented for periods with 5 or fewer portfolios. 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 and is not presented for performance periods of less than 36 months.

**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 institutional separate International Real Estate Securities accounts is: .85% on assets up to $10 million, .80% on the next $15 million, .75% on the next $25 million, and .65% 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. Previously, net composite returns were calculated by subtracting the highest separate account investment management fee (.90% through 2013 and .85% thereafter) 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.**