CenterSquare
INVESTMENT MANAGEMENT

Entrepreneurial Culture, Institutional Strength.

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WHAT YIELD CAPITULATION MEANS FOR REAL ASSETS

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The second quarter of 2016 saw a continuation of the low yield, low growth investment environment that has come to be accepted as the new normal. Estimates of China's gross domestic product (GDP) growth, although still of concern, were overshadowed by the United Kingdom's approval to leave the European Union (EU). Recurrent terrorist attacks, the growing refugee crisis in Europe, and an unprecedented U.S. election climate further complicated an already labored path to global economic stability and growth. However, the Federal Reserve's retreat from its hawkish stance and capitulation to the global low yield interest rate environment boosted real asset markets in the U.S. and abroad.

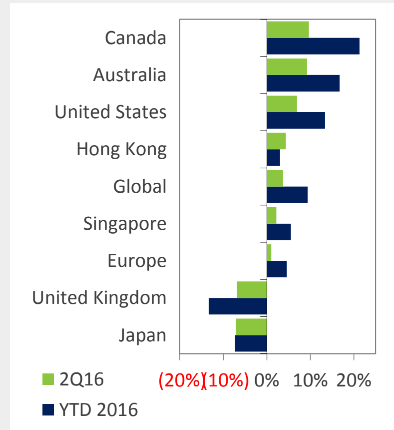
The years since the Global Financial Crisis (GFC) have been marked by a broad and seemingly undiscriminating recovery; however, the tide that lifted all boats has passed. Going forward we see returns in this "new, new normal" driven by two factors - diverging fundamentals, and yield capitulation.

DIVERGING FUNDAMENTALS

In defining diverging fundamentals, we must first recognize that the post-GFC tide that lifted all markets has now subsided. In the earlier stage of the business cycle, real estate markets worldwide, and particularly in the United States, benefitted from accommodative monetary policy, falling yields, relatively steady demand, and tepid supply leading to broadly strong returns of 100%+. In our view, the cycle has now matured and global economic concerns, demand deceleration, and pockets of supply are forcing fundamental-driven pricing. And, for the first time in years, we are witnessing diverging fundamentals and the beginning of imbalances in select markets between supply and demand. This will have an impact on our investment

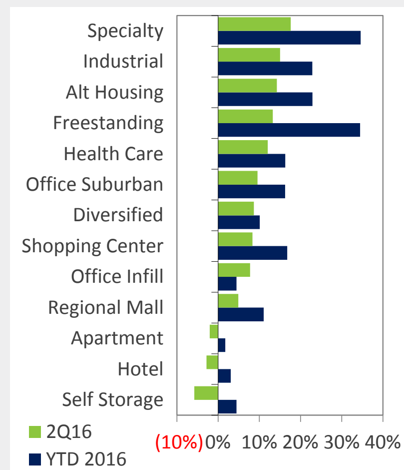
2Q16 PERFORMANCE REVIEW

FTSE EPRA/NAREIT DEVELOPED INDEX



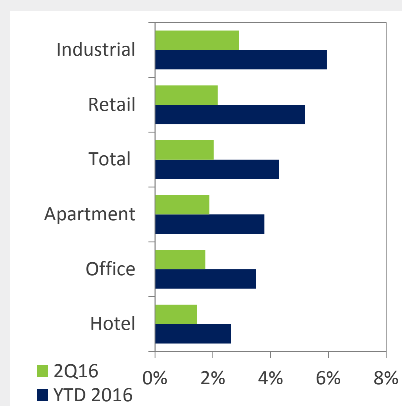
All returns in local currency.
Source: Bloomberg, FTSE, July 2016

FTSE NAREIT EQUITY REITS INDEX



Source: Bloomberg, FTSE July 2016

NCREIF PROPERTY INDEX



Source: NCREIF, July 2016

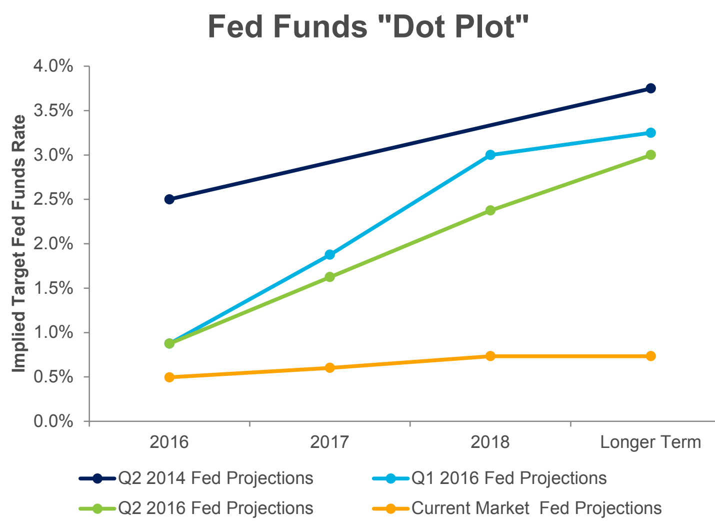
strategies and capital allocation, as we do not view this shift as a short-term blip. We will be closely monitoring individual markets with heavy emphasis on data-driven models.

YIELD CAPITULATION

The second important feature of the new, new normal is yield capitulation. The current low interest-rate environment has persisted for an extended period of time, ever-sensitive of and responsive to any intention by the Federal Reserve to raise interest rates. Over the past few quarters, planned or enacted rate increases, set against a backdrop of lowering or negative global interest rates, exposed a dramatic gap between the market's economic viewpoint and the Federal Reserve's. However, that gap has now narrowed as the Fed has revised its stance over the past few months. Interest rates that were "lower for longer" will now be "lower for a lot longer." In fact, following Britain's support of the Brexit referendum, a drop in the U.S. 10-year Treasury rate from its historic low of 1.70% to 1.35%[1] solidified the U.S.'s capitulation to European and Japanese policy and interest rate conditions.

Because of the Fed's capitulation—which indicates that although growth remains in positive territory, it is not enough to drive inflation or provoke an additional rate hike—we do not expect a Federal Funds rate increase until 2017. This is a historic low for long-term interest rates in the United States, a fact that has given investors pause as to how much longer this trough will persist. From our vantage point, we are reminded that the trillions of dollars invested in the government bond market confirm that today's appropriate interest rate for the next 10 years is approximately 150 basis points. Therefore, we have no reason to believe there will be a snapback in the near-term.

Yield Capitulation by the Federal Reserve

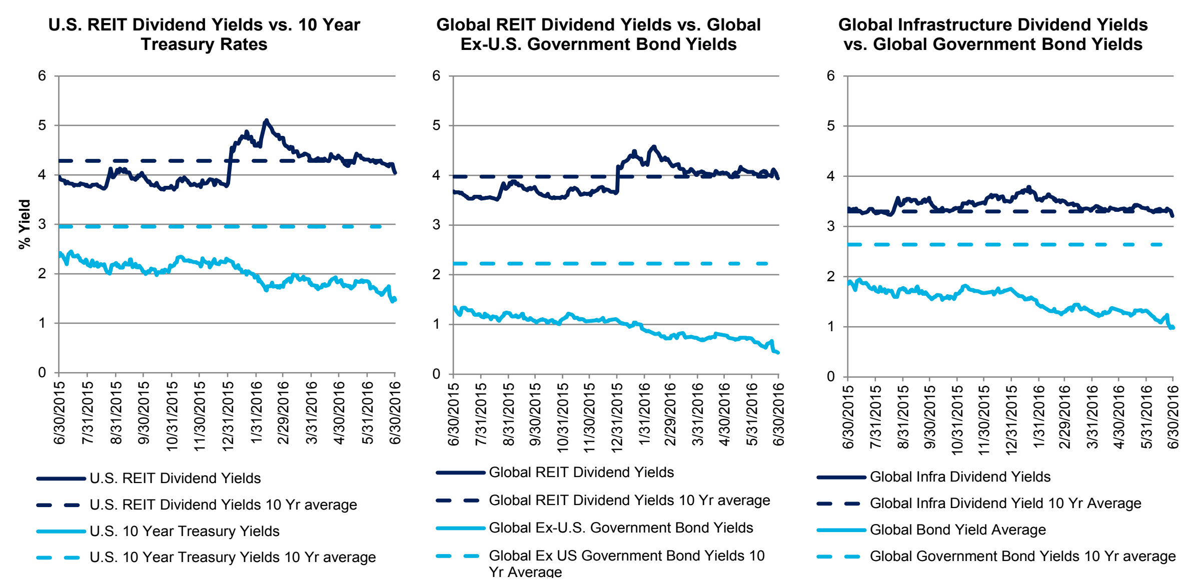


Source: Federal Reserve, as of July 2016

The Federal Reserve's retreat from its aggressive rate hike plan not only created a drop in interest rate projections but also a boost for real asset markets. REITs, utilities, equities, and other assets posted impressive returns during the second quarter. The market appears to be lining up capital; large amounts of cash are sitting on the sideline waiting for rates to rise. Examining the spread between U.S. REIT dividend yields over the last year versus 10-year Treasury rates, global REIT dividend yields versus global Ex-U.S. government bonds, and global infrastructure dividend yields versus global government bond yields, we see a consistent and widening spread between listed real asset dividend yield and corresponding government bond yields. This is, in our view, is evidence that we may soon see ripe conditions for significantly higher prices in both real estate and infrastructure securities.

This optimism, however, is tempered by caution

Interest Rates and Real Assets

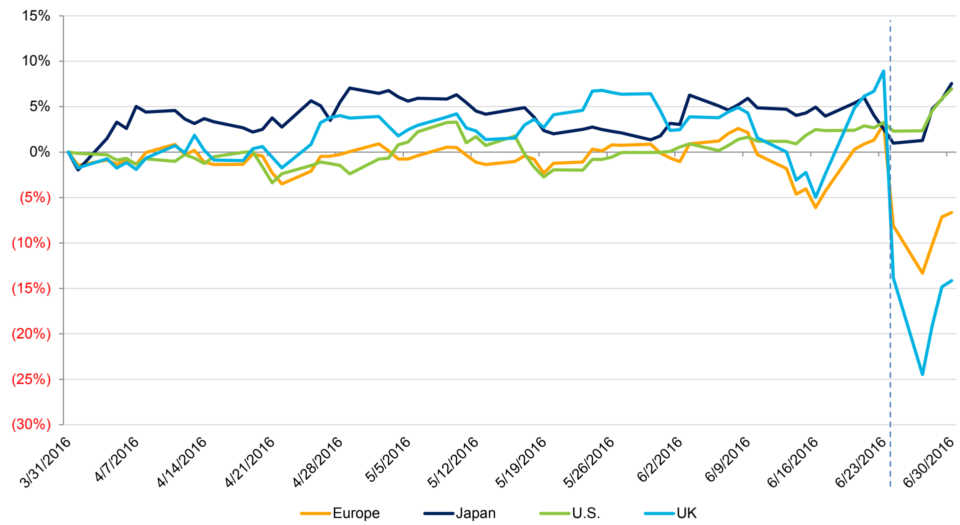


Source: FTSE NAREIT Equity REITs Index, FTSE EPRA/NAREIT Developed Index, FTSE Global Core Infrastructure Index. Global Ex-U.S. Government Bond Yields and Global Government Bond Yields were determined using a weighted average of major local government bond yields weighted using the MSCI World Equity Index regional weights. All data is as of 6/30/2016.

[1] *Source: Bloomberg, July 2016.*

regarding fundamentals in certain markets. From our perspective, there is no doubt that the commercial real estate market will be more challenged over the next seven years compared to the prior seven. There are pockets, such as Houston, that are experiencing oversupply and weaker demand. New York City and San Francisco have an excess of high-end apartment complexes, with more supply coming online. However, we view this variability in fundamentals as an advantage, aiding in more quickly and decisively uncovering attractive investments, allowing them to be evident against their weaker counterparts.

Global REIT Market Performance Pre- and Post-Brexit



Source: Bloomberg, FTSE, July 2016. Total returns of local market real estate indices in USD, i.e. the FTSE EPRA/NAREIT Japan Index for Japan, FTSE EPRA/NAREIT Europe Ex-UK for Europe, etc.

THE VALUE OF BREXIT

Markets worldwide began a steep decline the day after the United Kingdom voted to exit the EU. British real estate, specifically concentrated in London, suffered a significant hit from the June 23rd referendum. One day post-Brexit U.K. REIT declines implied that commercial property values would fall 30%[2]; however, the precipitous fall began to correct by quarter's end. We expect that actual property values may fall only by 10%.We believe additional meaningful value declines are unlikely, given that the sterling will likely bear the brunt of the increased U.K. risk premia, and lower interest rates, in addition to a flight to safety, will allow real estate to be more attractive and support cap rates.

It must be noted that the news of U.K. currency and property value declines is not dire in our eyes. Britain has, nearly overnight, reduced the value of their currency—something Japan has been trying to achieve for 20 years—which will ultimately be positive for manufacturers and exporters, and may actually result in the importation of inflation as a weaker currency purchases assets in other markets. This likelihood causes us to be sanguine on U.K. property prices in the near- and medium-term, as markets begin to erase post-Brexit losses.

REIT PERFORMANCE

British and European REITs fell precipitously immediately following Brexit. Including currencies, U.K. REITs sold off close to 30% in the first two days, with Europe losing about 15% value. While U.K. stocks remained down over the period, European real estate assets regained their losses, and most other markets including the United States and Japan rose, buoying global REITs. In fact, the 3.7% slide experienced by global real estate stocks in the two days following Brexit was erased, and over all the market ended the quarter in positive territory.

From a valuation perspective, Japanese and Australian REITs were the priciest at the end of the quarter, while Hong Kong and China were least expensive relative to NAV. The United Kingdom understandably had the biggest shift, as the market wrote down property values ahead of the auditors. Overall, global REITs continue to look surprisingly cheap, given the yield-starved environment that exists globally.

NORTH AMERICA

United States

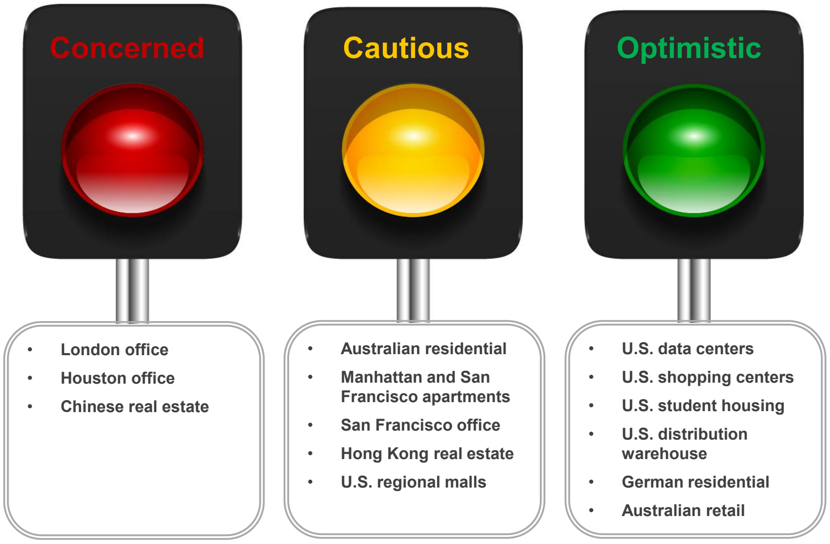
North American REITs experienced a strong rally during the quarter as U.S. real estate fundamentals remained stable and healthy expectations of growth normalization persisted. As of June 30, U.S. REITs were trading in-line with net asset value (NAV), had a notable spread to the 10-year Treasury yield relative to history, and a slightly discounted multiple relative to the S&P 500 Index. Given the low U.S. interest rate environment and persistently low yields globally, we are surprised that U.S. REITs do not appear more expensive.

As we move into the third quarter of 2016, we believe that U.S. shopping centers offer the most attractive risk-versus-reward profile, as demand remains strong yet supply approaches all-time lows. Data centers will likely continue to benefit from exploding demand regardless of the economy. We are less bullish on specialty companies such as those that own

[2] FTSE EPRA/NAREIT Developed Index, UK IPD Capital Growth All Property Index, June 2016.

prisons, storage facilities, and lease casinos. Regional malls as well as diversified REITs—or non-specialists in any sector—remain unattractive as well.

REIT Market Risk Check



Source: CenterSquare, July 2016

Canada

Although growth remains anemic and economic uncertainty persists, the low interest-rate environment lifted Canadian real estate stocks for the period. However, valuations appeared to be stretched after this outperformance, as the Canadian economy rebuilds on a porous oil-price-dependent economy.

EUROPE

The United Kingdom

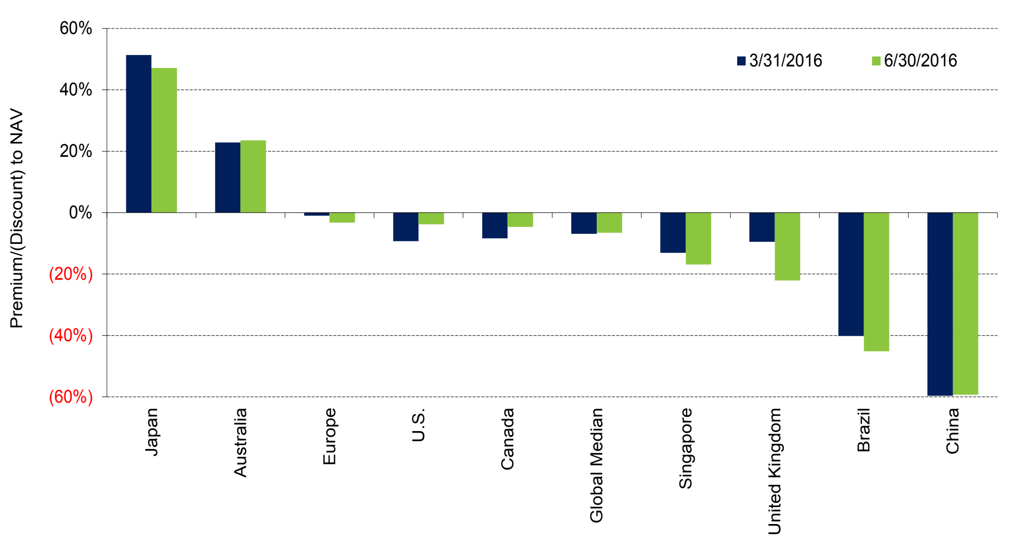
Brexit ushered in immediate economic and political upheaval, with global stocks dropping and the sterling losing value precipitously, trading under its 31-year low the day after the referendum was approved.[2] A recession is now a strong possibility as high volatility in financial markets and heightened geopolitical uncertainties amplify while Britain navigates the next two years of emancipation from the EU.

As aforementioned, REIT declines after the referendum passed implied that commercial real estate values in the United Kingdom would fall 30%. Although regaining some losses by quarter's end, the U.K. office sector continues to be a risk not worth taking disproportionately at this time. We believe, though, that at some point, office exposure as a value proposition will become attractive again. Central London retail and niche sectors such as healthcare, storage, and logistics appear to be solid despite the overall U.K. economic volatility.

European Union

We believe there are a number of post-Brexit risks not currently priced in, and we remain concerned that European real estate prices relative to the United Kingdom are now the most expensive in over a decade. The potential risk of additional EU referendums on the heels of the U.K. vote—particularly in France and Italy—will contribute to further market uncertainty. However, longer-term opportunities in Continental European office may arise, as financial market activity moves away from the United Kingdom, benefitting Dublin, Frankfurt, and, to a lesser extent, Paris. Additionally, German residential, which offers the most defensive rental growth in Europe, and Nordic central business district (CBD) office and retail, appear to be bright spots in the Eurozone.

Premiums / Discounts to NAV - 2Q16 vs. 1Q16 by Region*



Source: CenterSquare, SNL FInancial, July 2016. The companies comprising each country shown are based on SNL Financial's universe of real estate securities domiciled in each country.
** Calculated using company-reported NAV with the exception of the U.S. and Canada, which are calculated using an average of consensus NAV estimates.*

ASIA-PACIFIC

Hong Kong

A market heavily influenced by the outlook and level of U.S. interest rates, Hong Kong underperformed

[2] *"Pound slumps to 31-year low following Brexit vote," Katie Allen, theguardian.com, June 24, 2016.*

during the quarter. A tepid residential market, weak retail sales, and risks to global growth weighed on Hong Kong developers. Year-over-year sales growth in discretionary spending rose only in the supermarket and food and drink sectors, while nearly every other retail sales category posted double-digit declines for the same time period. However, the primary market competition in this region should intensify as more units come online and developers compete on value rather than price.

Singapore

Concerns over China's growth weighed on Singaporean stocks with Chinese exposure as consensus forecasts for China's GDP hovers at 6.5% for 2016 and 6.3% for 2017. Singapore continued to be affected by low local growth and oversupply in most property sectors, and uncertainty linked to Brexit slowed some major developers.

Japan

Japan's GDP growth for 2016 is expected to lag its official target—1.4% vs. 2.0%—which caused weak consumer confidence and low capital expenditures, as corporates safeguard via significant cash balances. Japanese developers also suffered from the global growth overhang during the period. The Japanese property market, however, was aided by the Bank of Japan's continued purchase of JREITs as well as the introduction of its negative interest rate policy (NIRP) in the first quarter of the year, a measure meant to encourage corporate activity. The hospitality sector also benefitted from an increase in tourist arrivals despite a strengthening yen, a trend that appears likely to persist.

Australia

Australia's recent election resulted in the conservative government's incumbency, but did not bring to pass the economic reform mandate proffered. Despite this, economic growth remained positive; and this trend is expected to extend through the remainder of 2016, as the Royal Bank of Australia signaled it will enact quantitative easing measures if necessary. Sidney office rents were up as vacancy tightened due to assets coming offline for infrastructure redevelopment. However, the mining capital Perth experienced the opposite, with rental growth declining 20%. We expect high quality retail to remain resilient in Australia with discretionary spending outperforming non-discretionary.

CONCLUSION

As the year progresses, we are aware of the likelihood of a growth recession, but we remain optimistic about the investment environment for real assets. Low inflation and subdued growth forced the Federal Reserve to capitulate in regards to near-term interest rate bumps, reducing the risk for policy mistakes. China's economic woes are finally being met by policy makers, and the United Kingdom appears to be reversing its post-Brexit freefall. Diverging fundamentals may uncover more risk, but potentially higher capital flows into income-producing real assets is likely as a result of the lower interest rates for longer.

We remain positive on quality companies, and currently have established a portfolio with less leverage than the benchmark. Although these tilts proved positive during the first six months of 2016, uplift in lower quality names is becoming noticeable Conservative exposure to lower quality, high yielding stocks throughout Asia-Pacific, Europe, and North America may capture some of the positive performance that we anticipate over the next several months. We still expect companies with superior organic growth and/or leverage to secular demand trends to outperform those that rely heavily on acquisition for growth. Our focus remains on the search for yield against a global economic backdrop that continues to support lower rates for longer.

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DEFINITION OF INDICES

The following indices were included in the commentary for illustrative purposes only and have been selected as they are well known and are easily recognizable by investors. The indices have volatility and other material characteristics that may differ from actual investments, are unmanaged, are not available for direct investment, and are not subject to management fees. Because of these differences, benchmarks should not be relied upon as an accurate measure of comparison.

FTSE NAREIT Equity REITs Index
The FTSE NAREIT Equity REITs Index is a free float market capitalization-weighted index measuring equity tax-qualified real estate investments trusts 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. The performance presented is based on total return calculations which add the income a stock's dividend provides to the performance of the index and is gross of investment management fees. The FTSE NAREIT Equity REITs Index is part of the FTSE NAREIT U.S. Real Estate Index Series.

FTSE EPRA/NAREIT Developed Index and Developed ex-U.S. Index
The FTSE EPRA/NAREIT Developed Real Estate Index Series covers both the FTSE EPRA/NAREIT Equity Index and the FTSE EPRA/NAREIT Developed ex-U.S. Index. Designed to track the performance of listed real estate companies and REITs worldwide, the series acts as a performance measure of the overall market. The performance presented is based on total return calculations which add the income a stock's dividend provides to the performance of the index, and is gross of withholding taxes and investment management fees. The index changed names on March 23, 2009, and was formerly known as the FTSE EPRA/NAREIT Global Real Estate Index.

NCREIF Property Index
The National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index is a quarterly time series composite total return measure of investment performance of a very large pool of individual commercial real estate properties (apartments, hotels, industrial properties, office buildings and retail only) acquired in the private market for investment purposes.

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