Reitway Global | Monthly Commentary | February 2023

March 8 2023

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- The GPR 250 REIT World Index (USD) produced a net total return of -4.2%
- We reiterate our preference for hybrid companies that possess both offensive and defensive characteristics

The month of February turned out to be a bear clamp on the market's ankle, putting a drag on January's momentum. The GPR 250 REIT World Index (USD) produced a net total return of -4.2%, pulling back from its six-month peak of ~1 415 to flirt with key resistance level at 1 300. Whether the market will respect this resistance remains to be seen. The hotel/resort sector performed the worst among REIT peers—producing a return of -6.6%, while diversified was the best performing sector, delivering -1.1%.

US economic data for the month is what snapped the back of the bull starting with a humdinger beat by non-farm payrolls of 517k versus the 193k that was expected. The reading was followed by a slew of upsetting core inflation data triangulating between core CPI, core PPI, and core PCE—two of which beat expectations by a significant margin: core PCE m/m 0.6% vs 0.4%; core PPI m/m 0.5% vs 0.3%; core CPI m/m 0.4% vs 0.4%, stoking further rate hike fears and pushing the market's expectations for the terminal rate out to 5.4% from the 4.9% where it started the month. Some committee members admitted that if the mentioned data had been released before the rate hike on February 1st they would likely have voted for another 0.5% hike instead of the 0.25% the committee had ultimately voted on. The 0.25% hike put the fed funds rate at 4.75%.

In other central bank news both the BOE and ECB hiked by another 0.5% to reach policy rates of 4% and 3% respectively with the most hawkish rhetoric of the big three (ECB, BOE, and the Fed) continuing to come from the ECB while the BOE hinted at tilting dovish based on wording changes to their statement, the minutes, and comments on mispriced longer-term rate expectations in the market.

In earnings season, US single-family REIT expenses took a bit of a bite in Q4; management expects expense pressures to continue into 2023. We are acutely aware of this force and believe single-family to be a robust space for an economic slowdown with conservative guidance from management leaving room for beats on both the revenue and expense side. On the US Multifamily side, expense growth is guided at a lower range than single-family. Top line growth, however, is expected to be lower as well. North of the US border, one of our largest active weights, Boardwalk REIT, posted strong results for Q4 and reported accelerating growth in 2023 of 10.5% same store NOI growth, well above its US peers. Public Storage, one of our benchmark's largest holdings, beat Q4 earnings expectations by 5.2% and fell slightly short (1.6%) of market expectations for '23.

In Europe, February was rather slow on news other than the traditional full year earnings reports, as transaction market volume is still close to non-existent. The most important event was Castellum that announced an emergency rights issue (~21% of market cap) to shore up their balance sheet. The issue will lower their loan to value (LTV) to 50% which means they need significant disposals to reduce leverage. The fund does not hold shares in Castellum.

The retail (+3.6%) and self-storage (+2.3%) sector continued their momentum while the residential (-4.6%) sector struggled. In terms of regions, London Specialists (+3.3%) and Spain (+2.4%) did best, while Sweden (-5.5%) and Germany (-4.3%) was less robust.

In mid-February, Kazuo Ueda was elected successor to Haruhiko Kuroda as governor of the BOJ. Ueda, a known dove, had served on the bank's policy board from 1998 to 2005 where he pushed for the unorthodox monetary policy, we are seeing in Japan today. On the 27th of February he communicated that Japan's inflation must increase significantly for the BOJ to consider tightening policy. In the month of February, the Yen weakened considerably against the dollar from 128.64 to 136.35.

Rishi Sunak made good headway in his active quest for a Brexit deal when he received confirmation from the leader of the Labour Party that they would vote in favour of the deal that was signed by both the EU and the UK on the 27th of February. The big hurdle for the deal is to pass Belfast in Northern Ireland that has been at the core of the UK's disorderly exit from the EU. The new deal would safeguard trade flows within the UK while protecting Northern Ireland's place in the island nation.

The US economy has stayed resilient for longer than we expected it would, with inflation persisting and the consumer remaining strong. Alas, given the current economic backdrop, recession indicators, and past reactions of economies to tightening cycles, our mild recession base case remains intact. We reiterate our preference for hybrid companies that possess both offensive and defensive characteristics.

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+27 21 551 3688

info@reitwayglobal.com

1st Floor, Crystal Towers, Cnr of Century Boulevard and Rialto Rd, Century City, Cape Town, 7441

www.reitwayglobal.com