Sprott Global Real Estate Fund

August 2017 Commentary

Since the start of 2017 through to the end of August, the FTSE EPRA/NAREIT Developed Index was essentially flat on a total return basis in Canadian Dollar terms. Europe was the place to be over the first eight months of the year, after underperforming in 2016, with the FTSE EPRA/NAREIT Developed Europe Index generating a total return of 10.85% in Canadian Dollar terms (see Exhibit 1).

Investment Team

Jeff Sayer, CFA
Vice President, Portfolio Manager

Exhibit 1: 2017 Total Return of the FTSE EPRA/NAREIT Developed Index and Developed Europe Index

Source: Bloomberg.

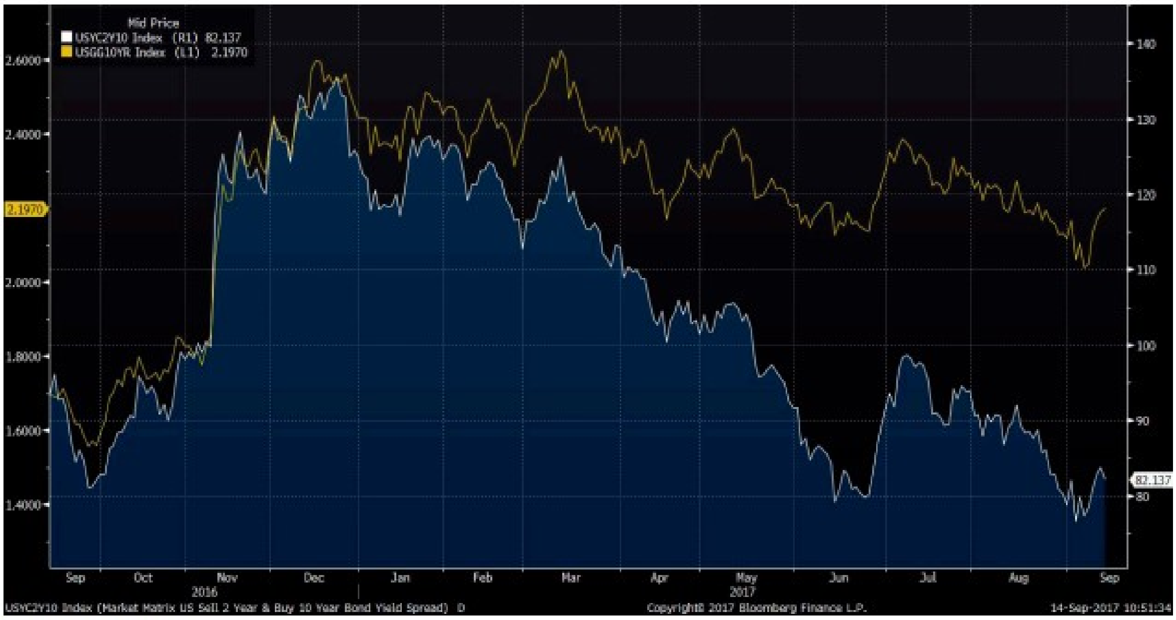
Within the broad FTSE EPRA/NAREIT Developed Index, real estate developers, operating companies and industrial REITs were the clear winners, generating solid double digit gains. Certain specialty REITs, including wireless communication towers and data centers also outperformed year to date. On the flip side, retail REITs, hotel & resort REITs and office REITs were at the bottom of the performance rankings, generating mid to high single digit losses.

One of the key themes of 2017 has been the “Amazon-effect” on the retail sector. The US Census Bureau of the Department of Commerce recently reported that ecommerce sales accounted for 8.9% of total retail sales in the second quarter of 2017 and grew at a pace of 16.2% compared to the second quarter of 2016. High profile retail bankruptcies and approximately 6,000 store closures in 2017 drove investors to seek the other side of the trade, including industrials with warehousing or logistics capabilities tied to ecommerce sales and deliveries.

The interest rate cycle also impacted the psychology of investors, particularly for those who live in hot housing markets, although we would point out that residential and commercial real estate are distinct assets classes. Without a doubt the housing market is sensitive to interest rates but the shape of the yield curve is generally a more important performance driver for the REIT sector.

Even though the US Federal Reserve appears committed to tightening monetary policy gradually over time, after hiking rates four times since December 2015, the yield curve has flattened (see Exhibit 2). History suggests that this is a positive environment for equities and income-producing securities.

Exhibit 2: US Government 2-year bond and 10-year bond yield curve and US Government 10-year bond yield



Source: Bloomberg.

PORTFOLIO UPDATE

The Sprott Global Real Estate Fund has generated a total return of 6.26% year to date. The Fund's underweight exposure to the United States, Japan and Australia and overweight exposure to Canada and Europe (relative to the benchmark) had a positive contribution to performance. The Fund's underweight exposure to the retail, residential and hotel & resort sectors and overweight exposure to real estate operating companies and the specialized REIT sector (data centers and wireless communication tower REITs) also had a positive contribution to returns.

Since our last update, new positions include Cellnex Telecom, Interxion Holding, Outfront Media, Ashtead Group and Nexus Real Estate Investment Trust. Positions which were exited include ADO Properties, American Campus Communities, CBL & Associates, Crown Castle International, Global Logistics Properties, Inovalis REIT, Morguard North American REIT and Unibail-Rodamco.

Top contributors to the Fund year-to-date include Aroundtown Property Holdings (+128 bps), American Tower Corp. (+92bps) and ADO Properties (+74 bps). Both Aroundtown Property Holdings and ADO Properties benefited from continued tightness in European commercial and residential markets. American Tower benefited from double digit growth in revenue and cash flow as consumer demand for better mobile coverage and access speeds led to organic and new site billings growth.

Top detractors year-to-date include GGP (-65 bps), SL Green Realty (-51 bps) and Gazit-Globe (-42 bps). GGP has been weak due to the retail narrative but owns some of the highest quality malls in the United States. SL Green is also out of favour, with exposure to primarily Manhattan office buildings, but trades at a significant discount to its net asset value, which should narrow as key properties are leased up. Gazit-Globe, a thinly-traded multinational supermarket-anchored shopping center play, also trades at a wide discount to its net asset value but could theoretically monetize any one of its publicly traded holdings at market and narrow some of the valuation disconnect.

PORTFOLIO OUTLOOK

The disparity of returns across the various geographic regions and sub-industries within the FTSE EPRA/NAREIT Developed Index demonstrate the importance of identifying both country and sector specific factors that will produce returns, including a supportive macroeconomic environment, outsized growth potential and attractive valuation levels. It also validates the rationale of having a global real estate fund, with the freedom to invest anywhere in the world, in both REITs and real estate-related equities.

Given the disappointing performance of certain real estate sectors in the United States but a yield curve that suggests a benign investment environment, we are looking for opportunities. At some point, retail and office weakness may become a buyable, especially for the highest quality properties and best locations given the current discount to net asset value, which on average has reached double digits. For now, the industrial and specialty REIT sectors continue to look intriguing given above average growth metrics, although valuation levels have admittedly become elevated through the year.

Fundamentals remain positive in Western Europe and the International Monetary Fund recently suggested that “the cyclical rebound could be stronger and more sustained in Europe, where political risk has diminished”. With the IMF currently calling for growth in the Eurozone to reach 1.9% in 2017 and 1.7% in 2018 and the ECB expected to remain relatively dovish, macroeconomic conditions bode well for commercial and residential real estate in the region.

Jeffrey Sayer
Portfolio Manager
Sprott Global Real Estate Fund

[1]All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at August 31, 2017; e) 2015 annual returns are from 08/04/15 to 12/31/15.

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