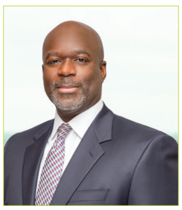
STARLIGHT GLOBAL REAL ESTATE FUND

"Beds and sheds" strategy continues to produce strong total returns



Dennis Mitchell, MBA, CFA, CBV
CEO & CIO

Michelle Wearing, CA, CPA, CBV
Associate Portfolio Manager,
Real Estate

Key takeaways

- Year-to-date global real estate equities have generated a 10.6%[1] total return
- One of the top contributors to Fund performance in June was Pure Multi Family REIT ("Pure")., with a total return of 6.8%[2]
- Blackstone stated "logistics is our highest conviction global investment theme today"

Macroeconomic update

Central bank intentions and actions have once again emerged as the dominant driver of market sentiment. Federal Reserve expectations have moved from four rate hikes in 2019 to two rate cuts. The European Central Bank has reintroduced targeted longer-term refinancing operations (TLTROs) and Mario Draghi's language today mirrors his "…whatever it takes…" comments in 2012. China has introduced well over 60 stimulus measures in the last year. All this dovish activity has resulted in a collapse in developed market long bond yields over the course of Q2 and into Q3. While we can understand the move in yields, we do not believe any of the major developed economies are headed towards a sustained and meaningful recession. Therefore, the move in yields, while understandable, is not sustainable and should reverse during Q3 and into Q4. This anticipated reversal in yields is as positive as we expect it to be driven by rising Purchasing Managers Indices (PMIs) and inflation as global stimulus from central banks finally begins to impact economic output.

The S&P 500 generated total returns of 3.6%[3] during the month of June but only 2.2%[4] for all of Q2. Global equities similarly generated total returns of 3.2%[5] in June but only 2%[6] for all of Q2. These datapoints correlate strongly with the path of long bond yields and highlight the market's sensitivity to near term rate cut expectations. So, while economic datapoints should trough in Q3 and rise into Q4, equity markets are likely to consolidate during that time period as leadership shifts from growth stocks to value stocks, developed markets to emerging markets and from large cap stocks to small cap stocks.

[1] As of June 28, 2019. Source: Bloomberg LP. Global real estate represented by the FTSE EPRA/NAREIT Developed Total Return Index (CAD). [2] Source: Bloomberg LP. [3] As of June 28, 2019. Source: Bloomberg LP. S&P 500 Total Return Index (CAD). [4] From March 29, 2019 to June 28, 2019. Source: Bloomberg LP. S&P 500 Total Return Index (CAD). [5] As of June 28, 2019. Source: Bloomberg LP. Global equities represented MSCI World Index (CAD). [6] From March 29, 2019 to June 28, 2019. Source: Bloomberg LP. Global equities represented MSCI World Index (CAD).

In June, the global PMIs was flat at 52.1. The small dip in Manufacturing to 49.4 was exactly offset by the small uptick in Services to 51.9. Neither number is very robust, but the global economy remains under pressure from tariffs and Brexit. U.S. PMIs were down slightly but the weakness was concentrated in Orders, with some additional weakness in Manufacturing Prices Paid and Services Employment. Eurozone PMIs were up slightly with Manufacturing at 47.6 and Services at 53.6. Eurozone Manufacturing PMIs remain depressed with France showing some signs of life. Eurozone Services PMIs traction was again driven by France with Spain showing some gains as well. Chinese PMIs were flat at 49.4 for Manufacturing and 54.2 for Services. We would expect the resolution of the trade war with the U.S. to be the final stimulus to drive Chinese PMIs, and subsequently global growth, higher.

Consensus estimates for 2019 S&P 500 EPS growth are now 2.6%. Q2 is anticipated to be the trough quarter at -0.2% but if the current trend of beats continues then Q2 could be as high as 3.1%, factoring in share buybacks. However, Q3 is unlikely to see meaningful EPS growth as consensus estimates are now 0.8%. Building off the poor finish to last year, Q4 EPS growth should rebound to 7.0% bringing 2019 to the estimated 2.6% EPS growth for the year.

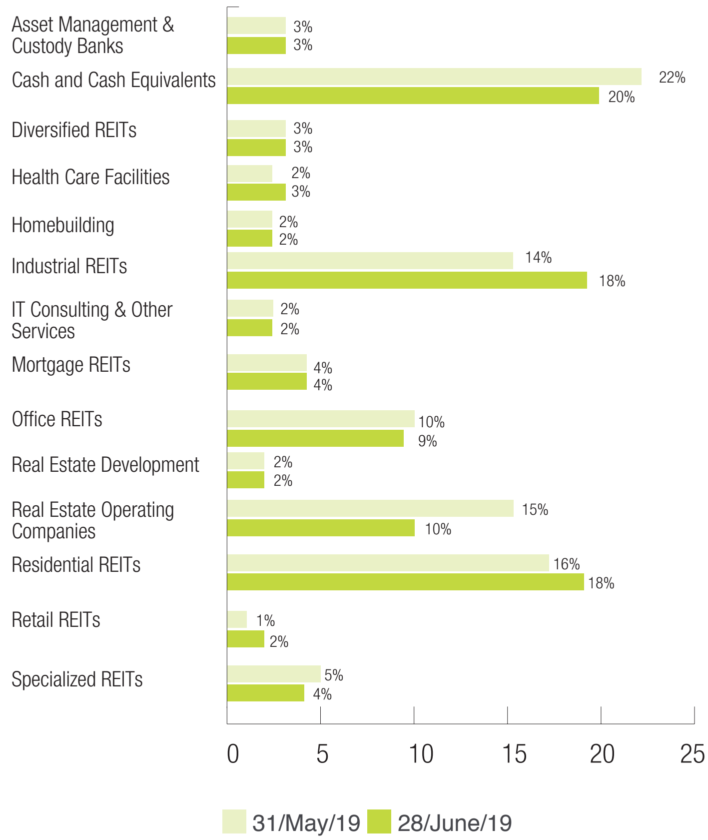
The FAANG stocks continue to weigh on the S&P 500 as do Energy and Materials stocks. Absent these three sectors, EPS growth is much more robust. More domestically focused U.S. companies continue to outperform their globally focused peers, demonstrating the continued strength of the U.S. economy. The 2020E P/E multiple for the S&P 500 has recovered to 16.2x and the current dividend yield is 1.9%. Mid to high single digit total returns from this point would seem to be in order, but with a continued uptick in market volatility.

In June, global real estate trailed global equities and U.S. equities (-1.5%, 3.2% and 3.6% total returns[7], respectively). However, year-to-date global real estate equities have generated a 10.6%[8] total return and this performance underscores the need for advisors to have a strategic allocation to real estate in their clients' portfolios.

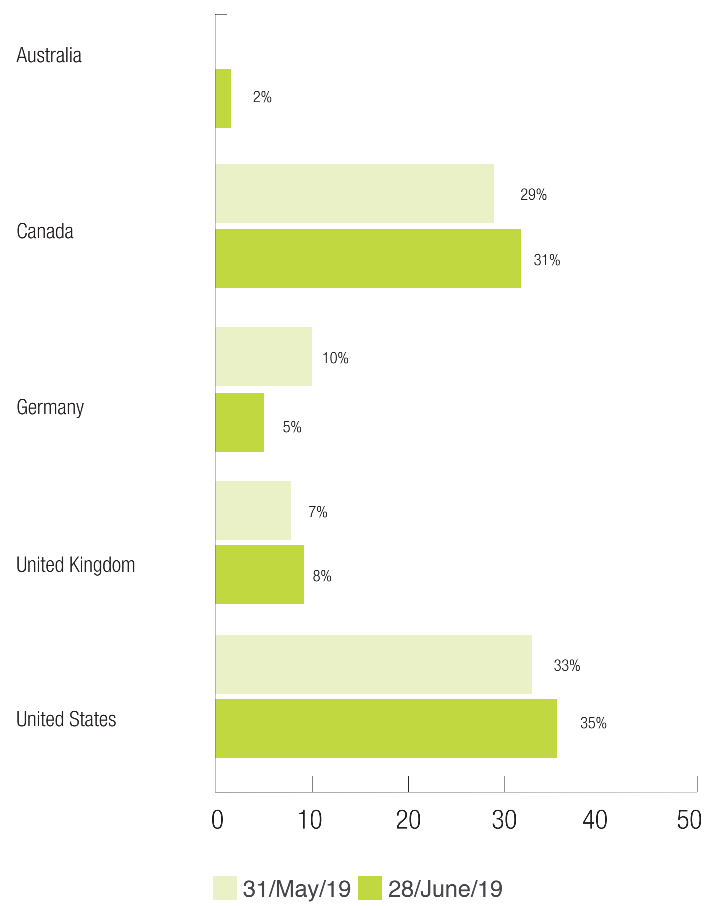
[7] As of June 28, 2019. Source: Bloomberg LP. Global real estate, global equities, and U.S. equities represented by the FTSE EPRA/NAREIT Developed Total Return Index (CAD), MSCI World Index (CAD) and S&P 500 Total Return Index (CAD), respectively.

[8] From December 31, 2018 to June 28, 2019. Source: Bloomberg LP. Global real estate represented by the FTSE EPRA/NAREIT Developed Total Return Index (CAD).

Starlight Global Real Estate Fund – Sector Allocation (%)



Starlight Global Real Estate Fund – Geographic Allocation (%)*



*excludes cash & cash equivalents

Starlight Global Real Estate Fund Overview

The Fund's geographic and sector allocations are shown on the previous page. Assets Under Management (AUM) rose 9.4% in June. Incremental new capital was largely allocated to new positions in Australia and the U.K., and our existing U.S. and Canadian positions. In June, we added two new position and two positions were eliminated. The Fund's cash weighting reflects our lag in deploying lumpy capital inflows as the market continued to rise.

Portfolio Review

Two of the top contributors to Fund performance in June were Pure Multi Family REIT ("Pure")., with a total return of 6.8%[9] and, Prologis Inc. ("Prologis"), with a total return of 5.8%[10].

Pure is a Canadian REIT which owns 22 institutional quality residential apartments totaling over 7,000 units in the U.S. sunbelt (Dallas, San Antonio, Houston, Austin, and Phoenix). On June 26, 2019, Pure announced that it had received an unsolicited conditional proposal from American Landmark/Electra America for the acquisition of all of the outstanding Class A Units of Pure, for a total price of US$7.61. The offer price represents a 15% premium to the closing price on June 25, 2019, 6% premium to consensus NAV, and implies a 5.2% cap rate. Prior to receiving the unsolicited conditional proposal, Pure entered into a letter of intent with an arm's length third party, pursuant to which Pure, agreed to engage in exclusive negotiations for a period of time with respect to a potential transaction. Electra America first approached Pure on December 12, 2017 with a conditional proposal to acquire all of the outstanding Class A Units of Pure, which led to Pure undertaking a strategic review process. The formal sales process concluded without a transaction, as disclosed by Pure on August 24, 2018. We were not surprised to see another offer for Pure, given the high-quality portfolio (average age is 12 years) and the fact that Pure was trading at an almost 10% discount to consensus NAV.

Prologis Inc. is the global leader in logistics real estate, with a focus on high-barrier to entry, high-growth markets. As of March 31, 2019, Prologis owned or has investments in, properties and development projects expected to total 772 million square feet in 19 countries. Prologis leases modern distribution facilities to a diverse base of approximately 5,100 customers across two major categories: business-to-business and retail/online fulfillment. On June 2, 2019 Blackstone announced the acquisition of U.S. logistics assets from GLP for US$18.7 billion, implying a 4.75% cap rate and US$105/ square foot. In its press release, Blackstone stated "logistics is our highest conviction global investment theme today", providing further tailwinds to the industrial REIT sector. The U.S. availability rate for Industrial has been declining for 35 quarters and ended Q1/19 at 7.0%, while net absorption (33 million square feet) continued to outpace completions (32 million square feet). We continue to see upside to Prologis' share price, despite the strong performance in June, driven by a very favourable supply-demand imbalance for logistics space and a positive macro backdrop.

Year-to-date, 20 companies in the **Starlight Global Real Estate Fund** increased their dividends or distributions by an average 6.4%, and one company initiated a dividend.

One of the top detractors from Fund performance in June was ADO Properties S.A. ("ADO"). ADO is a residential landlord with a portfolio of approximately 24,000 apartment units in Berlin, Germany. On June 6, 2019 it was announced that a member of the Berlin Senate would propose a five-year rent freeze commencing 2020. On June 18, 2019, the Berlin Senate passed the proposed rent law, which is now being drafted and handed over to the Berlin Chamber of Deputies for further deliberation and adoption after the Senate resolution of October 2019. The new law, which is scheduled to commence in 2020, applies retroactively to June 18, 2019. Many experts have argued that the Berlin rent law violates the German Constitution and the law is expected to be challenged at the federal level. During the month, we exited our position in ADO. Although we believe the Berlin residential stocks are attractively valued post the June selloff, we believe they will continue to be impacted by the negative headlines and any legal challenge to the rent law could take years.

Year-to-date, 20 companies in the Starlight Global Real Estate Fund increased their dividends or distributions by an average 6.4%, and one company initiated a dividend.

[9, 10] Source: Bloomberg LP.

Portfolio Outlook

The Starlight Global Real Estate Fund continues to holds 31 positions. Longer-term the portfolio should reach a targeted strategic allocation of 30% each to Europe, the U.S. and Canada supplemented by opportunistic investments in Asia and Australia. As Europe works through its legislative calendar, we expect to increase allocations to European real estate firms.

The industrial sector has generated double-digit returns driven by the rise of e-commerce and the need for fulfillment centres, last-mile delivery and logistics facilities. We believe industrial businesses are still compelling on valuation while providing strong dividend growth.

We remain optimistic with respect to the multi-family sector and believe stock selection will be key to generating strong returns. We believe multi-family REITs offer an attractive risk/return profile driven by favourable supply-demand imbalances in many urban cities globally. We look for companies that generate strong cash flow, have a defensive balance sheet and provide exposure to markets with high barriers to entry.

Conversely, we remain cautious on the retail sector as we expect the negative sentiment from e-commerce to continue. Globally, we continue to see retailers reducing their square footage and retail rents declining. Appraisers are reducing retail valuations as the asset class remains out of favour with investors. We believe there continues to be too much supply, and the investment risk remains to the downside.

Overall, we believe the Fund is well positioned to participate in continued up-markets while providing downside protection. We will closely monitor the investment environment and actively manage the Fund's positioning by carefully selecting individual businesses in-line with Starlight Capital's proven investment philosophy.

Starlight Capital
1400–3280 Bloor Street West,
Toronto, Ontario, Canada M8X 2X3
info@starlightcapital.com
1-833-752-4683
starlightcapital.com