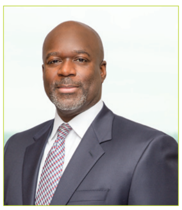
STARLIGHT GLOBAL REAL ESTATE FUND

Real estate outperforms again



Dennis Mitchell, MBA, CFA, CBV
CEO & CIO, Starlight Capital

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

Key takeaways

- In January, global real estate generated a 7.0%[1] total return, outperforming global equities and U.S. equities
- 2019 will see elevated volatility as positive economic fundamentals contrast with deteriorating economic output trends
- The top contributor to fund performance since inception is American Tower Corp., with a total return of 23.5%.

Macroeconomic Update

Heading into 2019, global risks are elevated but telegraphed. Policy risks remain the primary source of market risk as French protests, Brexit, U.S./China trade, German political succession, the Italian budget and China all pose challenges to global growth. Of these issues, U.S./China trade relations are by far the most important, given the size of the two economies and their contribution to global GDP growth. China has responded to domestic slowing by enacting over 50 unique stimulus measures (i.e. tax cuts, rate cuts, government spending, etc.), since June 2018. The U.S. has shifted from monetary stimulus to fiscal stimulus and the results have been positive to this point.

Rising global Purchasing Managers' Index (PMIs) on the back of global monetary stimulus and U.S. fiscal stimulus fueled global equity markets in 2017, as they gained 23.1%[2]. However, 2017 also featured 100bps of rate hikes by the Federal Reserve Bank, which took their toll on global PMIs in 2018. Global PMIs fell for all or most of 2018[3] and global equity markets fell 8.8%[4] (both returns in USD) in sympathy. Heading into 2019, a further 100bps of rate hikes in 2018 could weigh on global PMIs in 2019[5] and induce further equity market volatility. Equity market weakness hit a cyclical climax in December of 2018 and the strong start to 2019 is part reflexive rebound from an oversold position and positive sentiment around the change in stance communicated by the Federal Reserve Bank.

[1] Jan 31, 2019. Source: Bloomberg LP. Global real estate represented by FTSE EPRA NARIET Developed Total Return Index (CAD) [2] As at December 31, 2017. Source: Bloomberg LP. Global equity represented by MSCI World Index. [3] Source: IHS Markit [4] As at December 31, 2018. Source: Bloomberg LP. Global equity represented by MSCI World Index. [5] Source: IHS Markit

Our belief is that 2019 will see elevated volatility as positive economic fundamentals (low unemployment, wage growth) contrast with deteriorating economic output trends (GDP growth, earnings growth). We think it unlikely that the U.S. tips into recession in 2019 or 2020 and note that most recession indicators are not signaling recession. Rising high yield credit spreads are normal near the end of central bank tightening cycles as capital flows towards better credits. Similarly, yield curves tend to flatten as decreased inflation expectations reduce the long end of the curve. Chairman Powell's recent comments on patience and flexibility make it unlikely the Federal Reserve Bank will move to end the current expansion prematurely.

In the near term, the outcome of U.S./China trade negotiations will impact market performance. An extension that delays implementing new tariffs will be welcomed by the markets, however, a deal with the elimination of existing tariffs would boost global growth expectations and equity markets. We believe strong employment levels and rising wages will support continued consumption in the U.S. while Chinese stimulus measures will stabilize growth in China. Equity markets, while volatile, should deliver solid returns given normalized market multiples, attractive dividend yields and positive earnings growth.

In January, global real estate outperformed global equities and U.S. equities (7.0%, 4.0% and 4.2% total returns[6], respectively). This extends the long-term trend of global real estate equities outperforming global equities and underscores the need for advisors to add a strategic allocation to their client's portfolios.

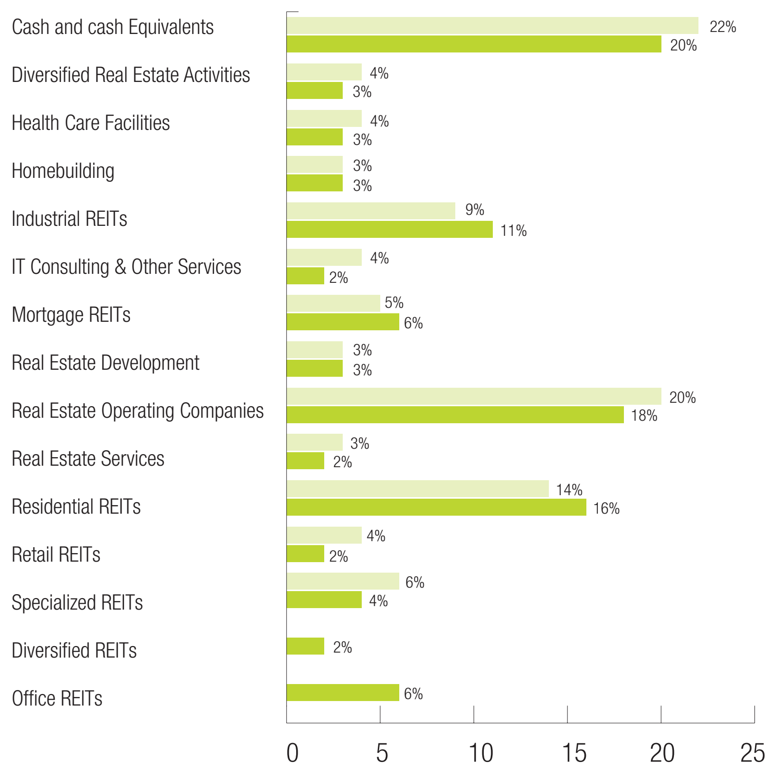
Starlight Global Real Estate Fund

Overview

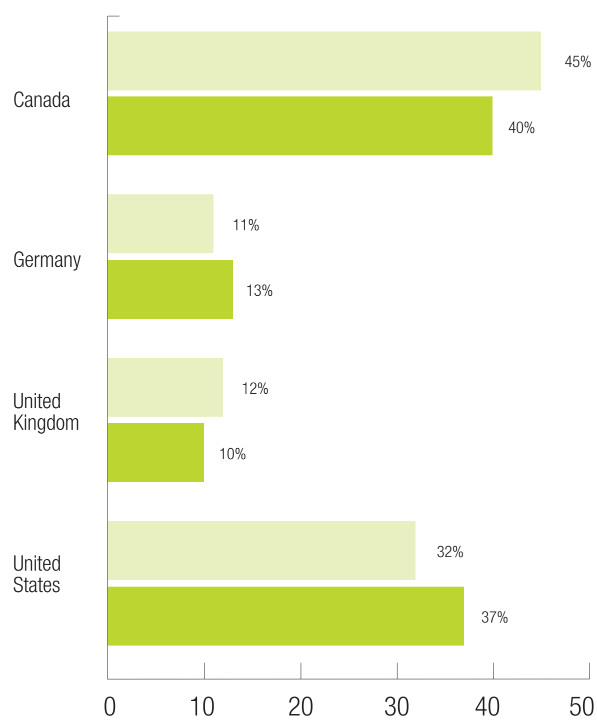
The geographic and sector allocations of the Fund are shown (adjacent) here. The AUM of the Fund grew 55.4% in January and this accounts for much of the decline in the GBP and CDN holdings. Incremental new capital was largely allocated to new U.S. and European positions. Major changes in sector allocation were driven by capital inflows as 10 new positions were established in January. No positions were exited in January and the cash weighting reflects our lag in deploying lumpy capital inflows as the market rose.

[6] As of January 31, 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 and S&P 500 Index, respectively.

Starlight Global Real Estate Fund – Sector Allocation



Starlight Global Real Estate Fund – Geographic Allocation



31/Dec/18 31/Jan/19

Portfolio Review

The top two contributors to fund performance since inception are American Tower Corp., with a total return of 23.5% and Vonovia SE, with a total return of 11.0%. American Tower operates the largest portfolio of telecommunications towers globally, with a significant presence in the U.S. and a growing footprint in India, Latin America and Europe. American Tower's primary business is leasing antenna space on multi-tenant towers to wireless service providers and radio and television broadcast companies. American Tower reported a strong Q3, with outperformance on both U.S. and International tower leasing. The company also raised its 2019 guidance on the back of strong organic tenant billings growth. American Tower is a direct beneficiary to the explosive growth of data consumption as well as the wireless network upgrade cycle (i.e. 4G to 5G). We still see upside to American Tower shares, though we have trimmed our exposure as a result of the strong outperformance.

Vonovia SE is Europe's leading residential landlord. Vonovia owns approximately 400,000 residential units in attractive cities in Germany, Austria, and Sweden, worth approximately EUR 41.8 billion. Vonovia reported strong Q3 results in December, with like-for-like rental growth of 4.1%. Vonovia reports full year 2018 results on March 7 and has guided to full year 2018 NAV growth of +13% y/y, implying a NAV of approximately EUR 45/share. From 2014 through 2017, Vonovia reported an average 22% annual total return (dividend + NAV growth) vs 12% for the pan-European real estate sector. We believe German residential offers an attractive risk/return profile. We expect German residential rents and asset value growth to exceed inflation, driven by a very favourable supply-demand imbalance and a positive macro backdrop (10-year German bond yields sub 0.2%).

Since October of 2018, four companies in the **Starlight Global Real Estate Fund** have increased their dividends/distributions by an average 5.3%.

The top detractor from fund performance since inception is Colliers International Group Inc. Colliers is a global real estate services and investment management company operating in 69 countries with a workforce of more than 13,000 professionals. In addition, Colliers' leadership team has significant equity ownership and a proven record of delivering more than 20% annualized returns for shareholders, over more than 20 years. Colliers reported strong Q3 results in October, ahead of expectations. Revenue grew 16% y/y (6% organic growth), and adjusted EPS rose 39% y/y. Colliers raised its FY2018 guidance, which calls for 25%-30% full year 2018 EPS growth. Colliers is well on its way to achieving its Enterprise 2020 plan to double the size of the company by 2020 (from 2015), without issuing equity. Despite strong results, Colliers saw its multiple contract in late 2018. Colliers has rebounded in 2019, up over 11% as of January 31, 2019, and we expect this trend to continue following its' Q4 results on February 13, 2019.

Since October of 2018, four companies in the Starlight Global Real Estate Fund have increased their dividends/distributions by an average 5.3%.

Portfolio Outlook

The Starlight Global Real Estate Fund has grown to 32 positions and we expect to continue deploying capital into these names on an opportunistic basis. Longer-term the portfolio should hold approximately 30 names with a current 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 will drive allocations to European real estate firms higher.

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 names 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 the 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. Overall, we believe there continues to be too much supply, and the risk remains to the downside.

Overall, we believe the Fund is well positioned to participate in continued up-markets while providing protection on the downside. We will closely monitor the investment environment and will 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

Starlight™ Capital