NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS GLOBAL PROPERTY FUND

Quarter Three, 2019

For the period ended 30 September 2019

NEDGROUP INVESTMENTS GLOBAL PROPERTY FUND

Commentary produced in conjunction with sub-investment manager, Resolution Capital

PERFORMANCE

The Nedgroup Investments Global Property Fund underperformed the FTSE EPRA/NAREIT Developed Index by 0.2% for the quarter ending 30 September 2019, as the index produced a total return of 4.6% in US dollar terms. The longer term performance remains strong, ahead of the index by 1.2% annualised since inception.

Indicator	3 months	1 year	3 years p.a.	Since Inception# p.a.
Portfolio*	4.46%	12.95%	7.00%	6.10%
Benchmark+	4.63%	13.00%	5.61%	4.89%
Difference	-0.17%	-0.05%	1.39%	1.21%
Fund Size	US$175.4m			

* Net USD return for the Nedgroup Investments Global Property Fund, A class. Source: Morningstar
\# 13 July 2016.
\+ FTSE EPRA/NAREIT Developed Index (in USD Net Ret)

MARKET AND PORTFOLIO COMMENTARY

The FTSE EPRA NAREIT Developed Index produced a total return of 4.6% for the quarter ending 30 September 2019 in US$ Unhedged terms, outperforming global equities (+0.5%)[1]. REITs, equities and asset prices more generally garnered support in the quarter as interest rates declined globally following broad-based monetary policy easing to arrest flagging economic growth.

Geopolitical uncertainty remains a cloud hanging over markets given little obvious progress on the current global issues, U.S./China trade and Brexit among them. During the quarter, additional regional tensions added to the list of investor concerns, an attack on key oil infrastructure in Saudi Arabia raised tensions in the Middle East, whilst sustained social unrest in Hong Kong provided challenges for local landlords and real estate investors more broadly. Defensive equity sectors performed well including Utilities, REITs and Consumer Staples.

Our strategy outperformed the benchmark (before management fees) led by sector overweights and stock selection in the residential, industrial and healthcare segments. Notable contributors included HCP Inc (HCP), a U.S. healthcare REIT, and Equity Residential (EQR), a U.S. apartment landlord. The prompt reduction of our exposure to Hong Kong over the last two quarters also supported relative returns as the stocks continued to underperform due to the ongoing disruption and economic impact. Stock selection in logistics was also a key contributor, including an over benchmark position in Prologis (PLD).

Having no exposure to ASX-listed Goodman Group (GMG), which underperformed prior to its removal from the FTSE EPRA NAREIT indices, also supported relative returns. GMG's removal resulted from the proportion of real estate funds management revenues, including performance fees, now exceeding the acceptable level for Index inclusion. We have mixed feelings about the removal.

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[1] MSCI World Developed Index Local Currency Net TR

We acknowledge the concerns of those who argue its risk profile is not that of a traditional real estate rental model. However, its revenue is ultimately dependent upon the underlying real estate on which GMG is absolutely focused. Furthermore, it removes an outstanding logistics real estate platform with relatively low levels of debt. To us the greatest risk was not the substance of its platform or earnings mix, but the market's lofty valuation, which is the key reason we do not own the stock.

Our office exposure was the largest detractor from relative performance. As the quarter ended, office markets began to digest news that co-working operator WeWork, one of the key drivers of office space absorption globally, had experienced an abrupt reality check in its efforts to launch an IPO. Our positioning in the self-storage sector also weighed on returns.

Regionally, Japan was the strongest performing country. Our significant and long-standing underweight to this market, particularly to the better performing J-REITs, was the largest source of regional underperformance.

GROWTH VERSUS VALUE, OR JUST PLAIN VALUE?

During the quarter, equity markets whipsawed with a sharp, but seemingly short-lived, rotation into 'value' stocks evident across many developed equity markets. This reversal was a mere blip in the many years of relative outperformance of 'growth' stocks (stocks generating above average earnings growth accompanied by higher valuation multiples) vs. 'value' stocks (stocks trading at a discount to assessed value but often with less certain earnings prospects) since the Global Financial Crisis ("GFC") a decade ago.

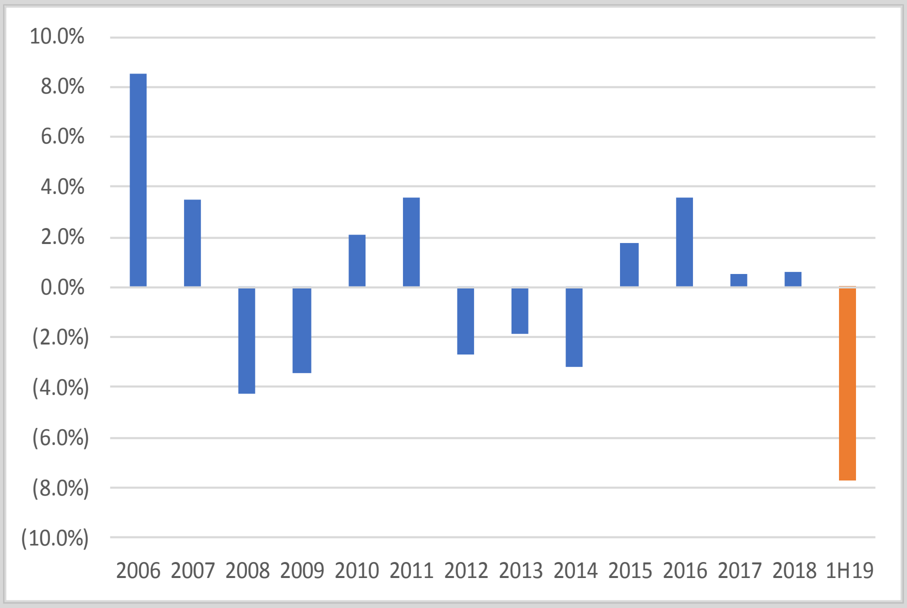
GROWTH VS. VALUE

Source: Bloomberg, RCL

REITs were not immune as the value rotation manifested in outperformance of the discounted retail and hotel REITs at the expense of 'growth' sectors with higher, albeit more fully valued earnings growth profiles (e.g., logistics, manufactured housing and U.S. multifamily). Our portfolio was not immune, and our sizeable underweights to retail and hotel property were sources of underperformance during this period. We are indifferent whether stocks are labelled 'growth' or 'value', rather we seek to allocate capital to those real estate portfolios where landlords have pricing power, capital structures are appropriate, and valuations offer potential for appreciation. Most retail and hotel REITs don't meet these criteria, hence, our relatively limited exposure.

As a timely reminder of the challenges facing retail landlords, UK-listed REITs Intu (INTU) and Hammerson (HMSO) reported interim results in July. Intu's rental income declined by 8% over the first half of the year, while Hammerson's was down 4% (excl. outlets). This quantum of decline in rental income is unprecedented even during the GFC (chart below). That it is occurring while the UK economy is growing, albeit sluggishly with material event risk, is testament to the structural pressures facing retail landlords. Post earnings results, both stocks experienced significant selling pressure with Intu down 37% and Hammerson down 23% (both in local currency terms) in July. While this degree of underperformance may seem extreme given already depressed valuation multiples, it reflects the toxic mix of too much debt and declining cash flows.

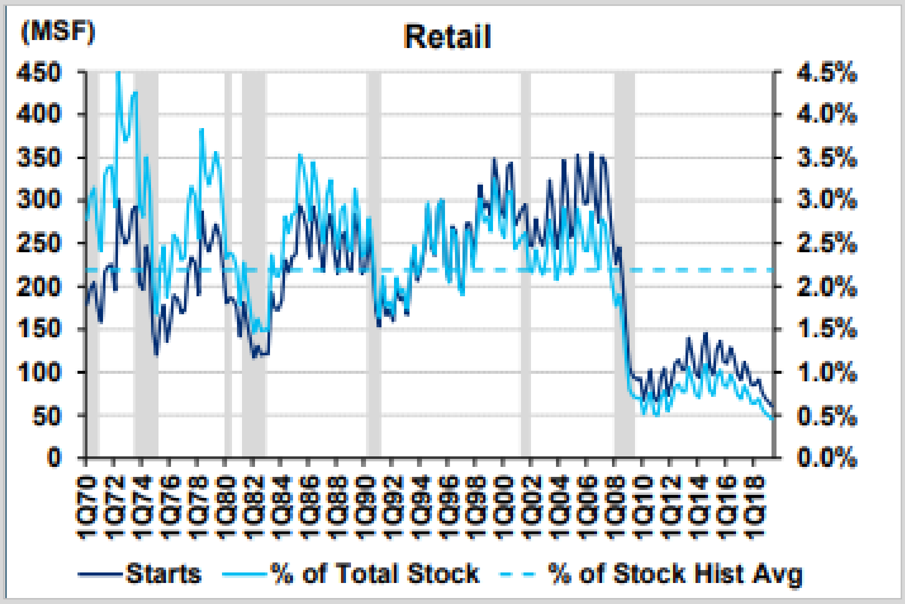
INTU LIKE-FOR-LIKE NET RENTAL INCOME GROWTH %



Source: Company data, RCL

Whilst the issues facing the leading UK retail platforms are extreme, they are emblematic of the widely known challenges facing retail property investors globally, namely physical store tenant demand seems to be in retreat and landlords have swiftly lost rental pricing power. Consequently, there is limited capital available for this industry segment, either for existing properties or additional newly developed space. As the following chart highlights, construction of new retail space has all but ceased in the U.S.

U.S. RETAIL PROPERTY CONSTRUCTION



Source: Citi Research

Furthermore, aside from small idiosyncratic transactions, since Brookfield's privatisation of U.S. mall REIT GGP in early 2018, there has been scant evidence of large-scale capital formation in the mall sector globally. For many investors in private vehicles, it is more a case of trying to exit troubled retail or dilute it by investing in other property sectors.

REIT EARNINGS – EDGING IN FRONT

U.S. reporting season in the quarter provided an update on key trends and earnings prospects across the sector. REIT earnings results were modestly ahead of expectations. In aggregate, new building supply is being met with sufficient demand to enable rents and earnings per share (FFO) to continue to grow. Comparable Net Operating Income (NOI) of 3.4% and occupancy of 94.8% both remain above the long-term average. U.S. REITs should deliver FFO growth of approximately 3.7% for the year. While more modest than recent years, it has now edged ahead of U.S. equities as macro headwinds dim the outlook for the broader economy.

At the sector level, the tailwinds continue for logistics and residential REITs where strong tenant demand continues to absorb above average levels of new building supply. Continuing recent trends, manufactured housing delivered the highest NOI growth, driven by close to record occupancy and healthy rent increases.

Performance in the retail sector was more nuanced. Mall REITs are battling elevated store closures this year which is impacting FFO growth. Through the quarter additional bankruptcies were announced, including teen fashion retailer Forever 21, which points to further rental cash flow disruption. This weighed on the sector total returns which ended the quarter down 1% (local currency terms). We remain cautious on the near-term outlook for malls, although we hold Simon Property Group (SPG) which generated total returns of 1.2%, in local currency terms, underperforming the benchmark.

Conversely, many of the strip shopping centre REITs, which have less exposure to apparel retail, have enjoyed somewhat of a reprieve from store closures. This may prove temporary but solid leasing volumes point to a pick-up in NOI and FFO growth next year should these trends persist.

In aggregate the office sector posted approximately 5% comparable NOI growth, however the range of outcomes was enormous at -9% to +14%. The tech markets on the West Coast enjoy the most favourable demand and supply imbalance. Conversely, New York and Washington D.C. continue to sag. While New York is experiencing an increase in large tech leases signed in recent months, it does not appear to be positively impacting landlord pricing power in the core midtown and downtown locations. The added uncertainty of WeWork's failed IPO and the impact on leasing demand (discussed in 'Talking REITs Q3 2019), also clouds the picture.

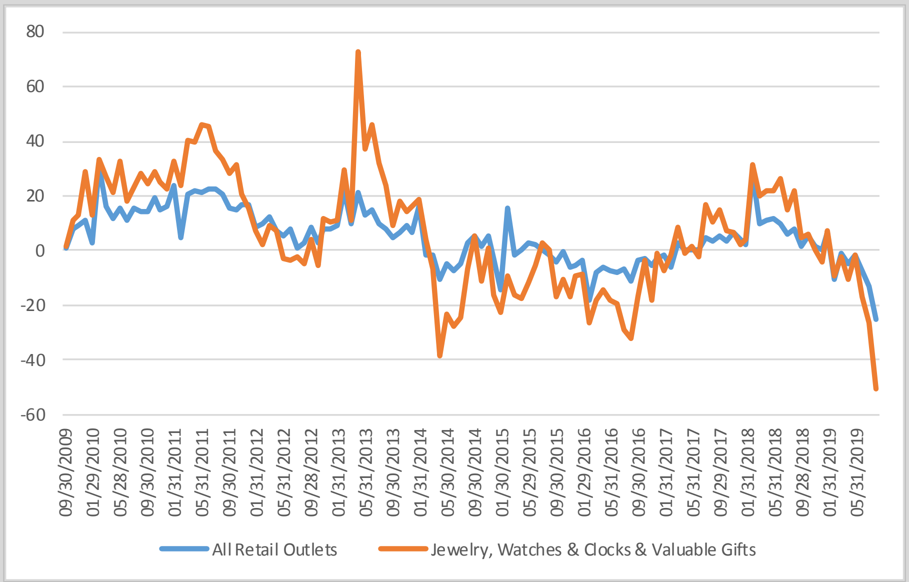
HK PROTESTS RUMBLE ON

Hong Kong continues to be disrupted by protests as locals seek to preserve Hong Kong's unique status and resist the ongoing subtle integration with Mainland China.

It's clear the disruption is adversely impacting the economy, with the sectors most exposed to tourism, hotels and retail, contracting significantly in recent months. Visitors to Hong Kong were down 5% y/y in July and 39% y/y in August. Hotel staff are taking some of the pain with hotel operators minimising cost by cutting casual labour and sending permanent staff on allocated holidays. Retail sales were down 25% y/y in August with certain luxury categories, such as jewellery and watches more severely impacted, down 51% y/y.

Press reports indicate that some retail landlords are providing rent concessions to tenants including Swire Properties (1972) at its high-end mall, Pacific Place and Hysan (14) at Times Square in Causeway Bay. For tourism-oriented properties such as Wharf REIC's (1997) Harbour City, the impact could be significant. Over half of Harbour City's sales are from Mainland tourists and 14% of rent is from tenant turnover.

HK RETAIL SALES REAL YEAR ON YEAR (Y/Y) % CHANGE



Source: Factset, Hong Kong Census & Statistics Dept.

Compounding the issue, there appears renewed efforts in recent months by several of the larger luxury brands (e.g. LVMH, Kering) to harmonise prices between Mainland China and Hong Kong. Historically one of the attractions of Hong Kong shopping was lower pricing on luxury items. With more comparable pricing in China, and recent CNY depreciation, this equation is less compelling.

Add the current negative tone in Hong Kong toward the Mainland and it looks a challenging picture for discretionary retail in the near term. While the short-term impacts are clearly negative, the critical question is: does greater Mainland Chinese influence change the long-term attractiveness of Hong Kong as a business, investment and tourism destination?

Hong Kong has a track record of bouncing back from disruptive events, for example, the Asian Financial Crisis in 1997, SARS in 2003 and the occupy Hong Kong movement in 2014. The current flare-up does seem to represent more of an existential crisis as the handover to China in 2047 creeps ever closer. Until a path to resolution becomes more apparent, we retain a measured exposure which is principally via Link REIT (823), a conservatively financed, non-discretionary retail portfolio with over 65% of revenue from food related retailers. Link generated a total return of -10% over the quarter in local currency terms, underperforming the benchmark but outperforming its Hong Kong rivals.

OUTLOOK

REITs delivered healthy returns for the quarter, taking calendar year-to-date total returns to 20%, in sharp contrast to our view of moderating returns. As we have noted previously, we do not hold a negative view, rather we are cognisant of elevated asset prices compared to most historical benchmarks and the length of the current economic expansion. While expansions don't die of old age, their progression tends to see imbalance and excess build up as investors extrapolate recent history and risk tolerance declines.

We have paid the price for our caution, our higher than average cash balances proving a drag on portfolio returns. However, we continue to see this as prudent in light of the various macroeconomic risks which could result in adverse outcomes and impact real estate operating conditions.

In a similar vein we continue to incrementally reduce risk in the portfolio, increasing exposure to less economically sensitive cash flows such as triple net REITs, healthcare and regulated residential markets, while reducing positions in office and diversified REITs. Our operational retail exposure continues to be selective given the sector's many challenges.

Performance through the year attests to the value of holding REITs in a diversified portfolio. While REIT multiples are elevated, as is the case for many asset classes, with improved portfolios, lower leverage and reduced development pipelines, REITs continue to be well placed to offer diversification in a broader portfolio context.

ESG: GRETA AND GRESB

Climate change was front and centre this quarter as global world leaders gathered at the UN Climate Action Summit 2019. Perhaps no one caught the world's attention more than Swedish teen and climate activist Greta Thunberg, as she gave an impassioned plea at the UN for world leaders to more aggressively tackle the issue of climate change.

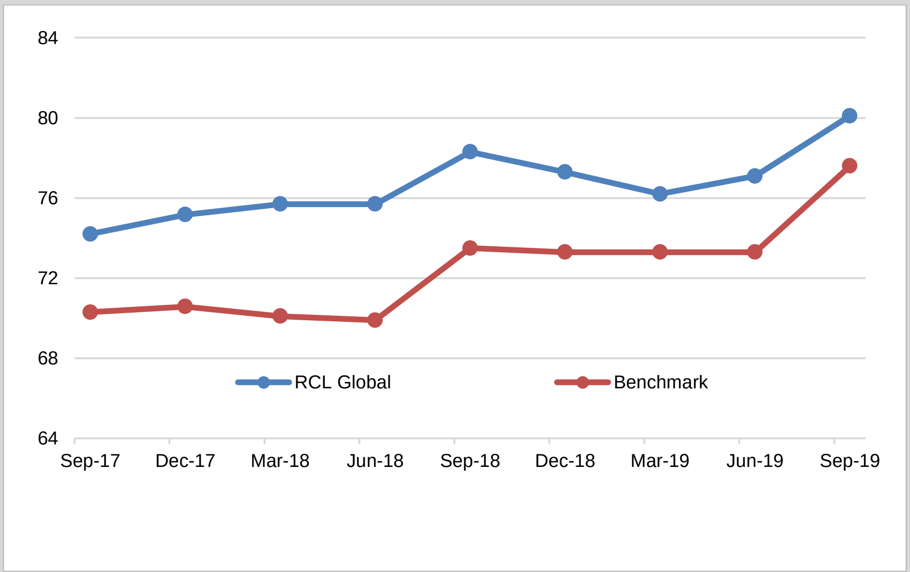
We believe the overwhelming scientific data suggests a strong link between greenhouse gas (GHG) emissions and climate change. We appreciate that weaning mankind off fossil fuels must be done in a responsible and orderly fashion, else it might create a shock to the global economy resulting in massive disruption and social unrest. Perhaps that is why some politicians seem to be downplaying the challenge. Regrettably some are merely protecting national short-term self-interest whereas for others it seems a case of none so blind as those who shall not see.

Whilst our views may matter little, our investment response is dispassionate: it is financially responsible for management to pursue property investments and property management initiatives which are environmentally sustainable. Put simply, pursuing more efficient, lower cost sources of energy, waste disposal and water consumption seems a sensible way to improve investment returns. This seems all the more compelling in light of the current low economic growth environment. As diversified A-REIT Mirvac (MGR) recently reported: "Of all our strategies, driving energy efficiency represents the best value for money."

However, to placate Greta more needs to be done. Ultimately, buying renewable energy will be by far the biggest driver of significantly (or completely) reducing GHG emissions in the property industry. Last quarter we wrote about Washington DC and New York City's new legislation which is designed to reduce GHG emissions by half in a little more than a decade and by up to 80% by 2050. We expect more of this type of legislation will be enacted in other cities and countries, though with much tighter deadlines as urgency increases in years to come. Property companies and investors should be on the front foot to future proof their portfolio, because it would be financially irresponsible to do otherwise.

One of the ways we track the 'environmental credentials' of our portfolio is to compare our portfolio GRESB score with the index. GRESB stands for the Global Real Estate Sustainability Benchmark and seems to be the benchmark for the property industry. This is a voluntary survey in which property companies need to submit an enormous amount of data to GRESB, which subsequently rates the property company.

WEIGHTED AVERAGE GRESB SCORE



Source: GRESB, ResCap

Pleasingly, more of our portfolio holdings participate in the GRESB survey than the overall index (both weighted). Furthermore, the portfolio GRESB score is better than the index (80 vs 78). However, we should and will do more do more in years to come, as this is a multi-year journey.

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UK investors should read the Appendix for UK Investors in conjunction with the Fund's Prospectus which are available from the Investment Manager. www.nedgroupinvestments.com

The Fund has been recognised under paragraph 1 of schedule 4 of the Collective Investment Schemes Act 2008 of the Isle of Man

Isle of Man investors are not protected by statutory compensation arrangements in respect of the Fund.

The Prospectus of the Fund, the Supplement of its Sub-Funds and the KIIDS are available from the Investment Manager and the Distributor or from its website www.nedgroupinvestments.com

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