B&I Capital

Asian Market Outlook

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Market Outlook

Asian REITs and real estate securities have had strong back-to-back months in July and August and have risen by over 12% aided by recovering unit prices and stronger currencies. In local currency terms, the returns are less impressive but still reminiscent of the strong move in both the sector and currencies in the final two months of 2023 when expectations for rate cuts in early 2024 drove the sector off its lows only to give back some of the gains when macro data subsequently did not support an early Fed interest rate cut. September and October have been difficult months over the last few years; with the looming US election posing different potential policy outcomes that would impact Asia, we could see another bout of volatility after the recent strong run. However, unlike 2022 and 2023, it does appear likely that the Federal Reserve will embark on the start of its easing policy in September in advance of the election which could be more important than the winning candidate's potential economic policies. August's non-farm payroll report will be watched closely to gauge whether several interest cuts in 2024 are warranted or if the pace of reduction will be slow. We see a lower interest rate policy and weaker USD as a major positive for our sector as it will allow rates to fall in Singapore and Hong Kong and likely reduce interest rate upside risk in Japan and Australia. With results behind us and, in some cases, asset valuations reset to more reasonable levels, some of the major announcement risks are behind us for the next six months. 2024 is likely to be seen as trough earnings for several sectors and we believe stocks will start to anticipate better earnings and dividend growth for 2025 and onwards.

Japan

JREITs and Developers did outperform the Japanese equity market after the last BOJ hike despite the more hawkish tilt from Ueda. There is still a high probability of an October hike assuming no major panic in financial markets in advance of that meeting. We remain sceptical that consumers will become the next driver of CPI increases in Japan despite wage growth and a low unemployment rate. The recovery in the JPY will also help to ease imported inflationary pressures. In the short term, there are limited near term catalysts for JREITs or Developers. We expect continued strength in condominium sales and Tokyo office leasing which will bode well for 2nd and 3rd quarter results (depending on companies' fiscal year) to be reported October. We have noted that despite a moderate increase in mortgage rates, sales of new and secondary condominiums remain brisk with supply limited and affordability still very high. Nomura RE will be a main beneficiary of this trend yet has lagged year to date on concerns that it would be removed from the MSCI and potentially from the FTSE EPRA Nareit index due to income from sources other than RE. We have spoken to the company and they don't believe they should be disqualified, and we see the index adjustment in early September as a buying opportunity. Hotel JREITs have recently come under pressure from the rising JPY but we believe the current earnings momentum from strong REVPAR growth and recent acquisitions will help them continue to deliver stronger than average DPU growth and the units do not appear overvalued. To sum up, we cannot see a short-term driver for the sector as most of the focus remains around future BOJ policy which detracts from continued strength throughout the sector. Transactions remain active and unit prices undervalued for most of the JREIT sector. We would like to see further commitment to unit repurchases from larger JREITs that trade at significant discounts like GLP J-REIT and Japan Metropolitan Fund.

Australia

Results were in line with most expectations, but guidance was in general below as companies have been using relatively conservative BBSW rate assumptions relative to current rates. In addition, many companies have seen asset values reset to more appropriate levels relative to interest rates and many analysts now see 2024 as the trough for asset values and earnings. We continue to like the residential sector despite affordability and construction challenges. Stockland and Mirvac are our preferred proxies for this theme. Goodman Group (GMG) underperformance of late has yet to create an opportunity to increase positioning as we still find the valuation to be too optimistic as its EV/EBITDA rivals pure AI growth stocks, yet earnings growth is far more subdued. We like their DC approach which is relatively passive and takes advantage of its low-cost land bank and access to power but feel overall this has already been priced in and with a potential sale from long term holder, CIC, in the works there may be an overhang on the stock in the near term. CIC rescued GMG during the GFC and has had a tremendous return on its investment. The RBA continues to warn that inflation is still too high and that rate cuts are not imminent. Given the backdrop we could see them as an outlier among central banks (along with the BOJ) and this should help to support the AUD and that should help with some inflationary pressures. However, looking at swap rates further out there is an expectation of lower rates in the future, and we think REIT performance will be driven more by longer term rates. Recent consumer spending data suggests Australians are struggling due to higher borrowing costs with spending falling for the sixth straight quarter. Household spending fell 0.2% in the second quarter. We continue to prefer Scentre Group due to its exposure to affluent households and non-discretionary , Dexus Convenience Retail REIT.

Hong Kong

No country in Asia will benefit more directly from Fed rate cuts than HK as many of the REITs have their debt linked to HIBOR and are already starting to see the benefits of falling rates. A drop in HIBOR of 100 bps translates into significant DPU growth for Link REIT (+2%), Wharf REIC (+4%) and Fortune REIT (+6%). One-month HIBOR has already fallen from around 5.2% at the end of 2023 to around 3.9% today. Outbound leakage in spending continues but based on numbers for July appears to have peaked as departures have fallen month over month. In addition, the recovery in the JPY and weakness in HKD may also slow some outbound tourism from HK in the coming months. As we wrote in our special report on HK and Shenzhen retail, we are certain that part of the outbound spending leakage is structural but feel wet markets and daily necessities will remain solid as it is impossible to bring in meats, fruits and vegetables into HK. In addition, luxury, while still soft, could see some benefit from fewer Hong Kongers flying to Tokyo to purchase luxury items as the JPY has started to recover. New World Development announced a profit warning related to non-cash impairments and disposal losses of up to HKD20bn which is significant relative to its market cap at the time of HKD 19bn. It will be challenging for the group to deleverage in the current environment. The announcement had a negative impact on the sector, but most investors are aware of NWD's challenges.

Singapore

We continue to remain constructive on the SREIT sector due to a gradual reduction in Singapore lending rates and potential rotational buying into the large caps by generalist investors as they take profits from the bank stocks which have largely benefitted from the high-rate environment. We see little near-term challenges to the office sector as supply is limited and while demand has softened, we believe rents will remain at today's levels. There is some discussion regarding potential leakage of retail sales to neighbouring Johor Bahru but given the current transportation challenges we don't see any near-term impact on Fraser Centrepoint or Capitaland Integrated Commercial Trust's assets and think over time the more important factor will be strong demographics (e.g., rising population, increasing wealth) in their catchments. While some trades (nail salons, massage studios, hair salons, etc.) may need to be reduced in numbers in their shopping centers due to competition across the causeway, managements will find a way to replace with other tenants given that vacancy in most dominant suburban centers is almost zero.

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