Jonathan Litt
Founder & CIO

REITs Do Well During the Fed Tightening Cycle

- REITs sold off about 7% from their peak in early September initially on the back up in 10 year US Treasury yields. The current knee-jerk sell-off is light in terms of decline and duration relative to prior sell-offs, but will likely subside and create an attractive entry point into real estate stocks.
- Historically, the forward returns following these acute periods when REIT shares sell-off are quite attractive, typically exceeding the returns of the broad market both in the short term and over the course of the following year.
- Over longer time periods of both 10 year yields rising and Fed tightening cycles, REITs have on average generated attractive total returns up until the later stages of Fed tightening.
- After the end of Fed tightening is typically the time to be cautious as both the capital markets are tightening, and the economy is slowing.

REIT Pullback Creating Buying Opportunity

REITs declined by ~7% since their September 5th peak, which was precipitated by a rise in 10 year US Treasury yields as well as increase in equity offerings within the sector during September. Sharp declines in REIT share prices due to fears of quickly rising interest rates have occurred regularly in the past and have acted as attractive entry points for the group. The current decline is shorter than the average decline and duration of the seven other occasions shown in Figure 1, hence more near-term downside could occur, but this decline too will likely prove to be an attractive entry point. Total returns subsequent to such declines over the next 30 days and 1 year were 7.1% and 25.3% respectively, nearly doubling the S&P 500 returns of 3.5% and 16.8%, respectively.

Figure 1. REITs Rebound Strongly Following Interest Rate Fear Periods

	Acute Period of Interest Rate Fears						Subsequent REIT Returns		Subsequent S&P Returns	
Period	Days	Rate Rise in Fear Period (bp)	Total Rise (bps)	REITs	S&P	REITs vs. S&P	30 Days	1 Year	30 Days	1 Year
6/16/94 - 11/22/94	159	93	247	-11.1%	-1.4%	-9.8%	7.3%	24.1%	2.4%	36.5%
5/12/99 - 12/15/99	217	68	263	-21.0%	4.4%	-25.4%	12.1%	38.0%	3.8%	-4.0%
4/1/04 - 5/10/04	39	88	119	-17.7%	-3.8%	-13.9%	11.0%	42.4%	4.3%	9.2%
3/17/06 - 5/23/06	67	39	91	-9.3%	-3.6%	-5.7%	3.5%	28.0%	-0.7%	23.4%
11/5/10 - 11/16/10	11	31	134	-9.2%	-3.8%	-5.4%	2.3%	11.1%	5.7%	7.2%
7/17/12 - 8/14/12	28	23	47	-3.0%	3.2%	-6.1%	4.5%	6.8%	4.2%	22.8%
5/21/13 - 8/19/13	90	94	135	-18.0%	-0.9%	-17.2%	9.3%	26.6%	5.0%	22.9%
9/5/14 - 9/25/14	20	5	27	-7.6%	-2.0%	-5.6%	n/a	n/a	n/a	n/a
Interest Rate Fears	**79**	**55**	**133**	**-12.1%**	**-1.0%**	**-11.1%**	**7.1%**	**25.3%**	**3.5%**	**16.8%**

Note: Returns reflect closing prices
Source: Land and Buildings, Bloomberg, and NAREIT

REITs Perform Well in Periods of Rising Treasury Yields

Historically, rising interest rates have created a favorable backdrop for property stocks to post attractive returns (Figure 2). Specifically, REITs have risen 11.9% on average since 1994 during 12 periods when the 10-year treasury yield rose 60 basis points or more for a sustained period.

Breaking the 12 periods of rising interest rates into early and late periods of economic expansion, the strongest periods of performance were during early economic expansions when REITs rose 17.4% on average (Figure 3). The current economic expansion is likely to last longer than normal given the modest recovery thus far and the favorable monetary policies currently being employed by many central banks around the globe, making the most comparable periods to history the early economic recovery periods.

Figure 2: REITs Have Generated Strong Returns as 10-Year Rates Rise During Early Economic Expansions

Note: Returns are REIT returns during the specified rate rising period
Source: Land and Buildings, Bloomberg, NAREIT

During periods of late economic expansions, property shares delivered poor performance as the end of the tightening cycle choking off demand and capital.

Figure 3. REITs Have Historically Generated Strong Returns in Periods of Rising US Treasury Yields

	Period of Rising Interest Rates					Subsequent REIT Returns		Subsequent S&P Returns	
Period	**Days**	**Rate Rise (bp)**	**REITs**	**S&P**	**REITs vs. S&P**	**30 Days**	**1 Year**	**30 Days**	**1 Year**
1/12/94 - 11/7/94	299	247	0.8%	0.0%	0.8%	-1.6%	20.5%	-2.3%	30.0%
1/19/96 - 4/14/97	451	145	40.5%	24.8%	15.7%	2.0%	24.1%	12.6%	52.6%
11/7/01 - 4/1/02	145	123	17.8%	3.3%	14.5%	1.1%	-4.1%	-5.2%	-23.8%
6/13/03 - 6/14/04	367	177	23.0%	15.8%	7.2%	6.9%	39.0%	-1.1%	8.9%
6/2/05 - 6/28/06	391	136	21.4%	5.5%	15.8%	7.4%	17.3%	2.7%	23.1%
11/30/09 - 4/5/10	126	79	20.7%	9.1%	11.7%	3.3%	20.6%	-1.7%	14.5%
10/8/10 - 2/8/11	123	134	9.1%	14.4%	-5.2%	-1.1%	12.4%	-2.0%	4.1%
7/24/12 - 12/31/13	525	162	5.5%	42.6%	-37.1%	3.5%	n/a	-2.8%	n/a
Early Recovery	**303**	**150**	**17.4%**	**14.4%**	**2.9%**	**2.7%**	**18.5%**	**0.0%**	**15.6%**
10/5/98 - 1/21/00	473	263	0.8%	48.2%	-47.4%	-5.7%	27.2%	-6.5%	-5.8%
12/1/06 - 6/12/07	193	82	-4.7%	7.9%	-12.6%	-0.6%	-12.6%	3.8%	-8.7%
Late Stage Expansion	**333**	**173**	**-1.9%**	**28.1%**	**-30.0%**	**-3.2%**	**7.3%**	**-1.3%**	**-7.2%**
3/17/08 - 6/13/08	88	95	9.1%	7.1%	2.0%	-11.0%	-46.2%	-8.7%	-28.5%
12/18/08 - 6/10/09	174	186	-1.0%	7.6%	-8.5%	-12.5%	55.9%	-6.2%	18.1%
Recession	**131**	**140**	**4.1%**	**7.3%**	**-3.3%**	**-11.7%**	**4.8%**	**-7.5%**	**-5.2%**
Total	**280**	**152**	**11.9%**	**15.5%**	**-3.6%**	**-0.7%**	**14.0%**	**-1.5%**	**7.7%**

Source: Land and Buildings, Bloomberg, and NAREIT

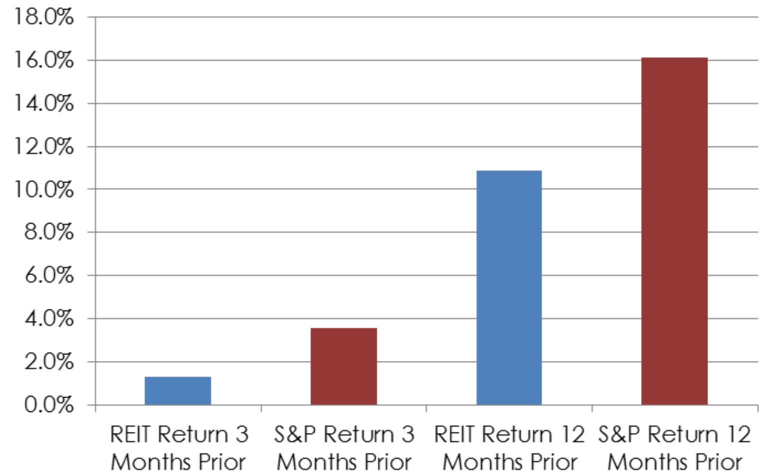
REITs Have Generated Positive Returns Before and After Fed Rate Hikes

REITs have outperformed the S&P on average in the 3 and 12 months following the first rate hikes in the last 3 interest rate tightening cycles. REITs have underperformed the S&P 500 on average in the 3 and 12 months leading into the last 3 interest rate tightening cycles (1994, 1999 and 2004). However, the REITs have already underperformed the S&P by approximately 5% since September 5th, reflecting a similar magnitude to the typical underperformance REITs experience leading into Fed tightening.

With traditional property REITs now trading at about 10% discounts to net asset value on average, the recent underperformance of REITs is creating a set up for a similar trend this time as well.

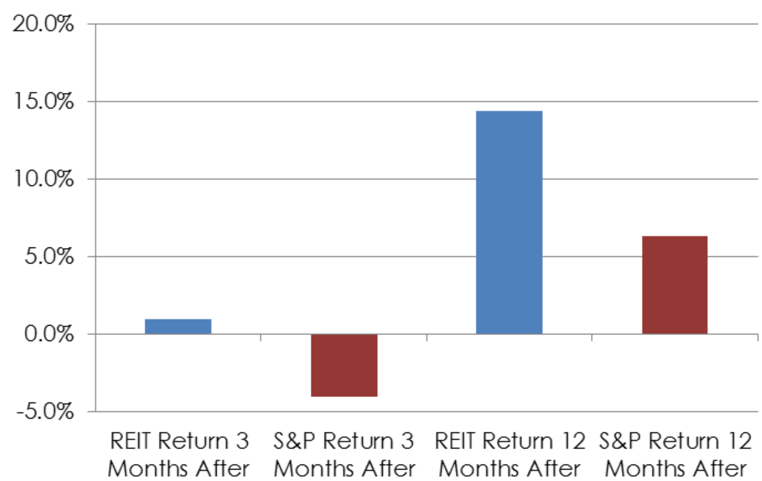
It has long been our view that real estate stocks will generate attractive total returns even in the face of modestly rising interest rates and the performance of REITs after the first Fed Funds rate increase supports this view. It is typically after the end of the tightening cycle when real estate capital markets tighten and real estate fundamentals weaken causing real estate stocks to generate negative returns.

Figure 4: REITs Have Historically Underperformed the S&P Leading Into Initial Fed Rate Increases



Note: Based on 1994, 1999 and 2004 initial Fed Funds rate increases
Source: Land and Buildings, Bloomberg

Figure 5: REITs Have Historically Outperformed the S&P After Fed Rate Increases



Note: Based on 1994, 1999 and 2004 initial Fed Funds rate increases
Source: Land and Buildings, Bloomberg

1 Landmark Square | 7th Floor | Stamford CT 06901 | 203.987.5827 | eb@lnbcg.com

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1 Landmark Square | 7th Floor | Stamford CT 06901 | 203.987.5827 | eb@lnbcg.com