Quay Global Real Estate Fund

Monthly performance update

As at 31 December 2018

At a Glance

Feature	Fund facts
APIR Code	BFL0020AU
Investment objective	To generate a real total return of at least 5% above CPI per annum over a 5+ year investment horizon
Portfolio managers	Chris Bedingfield/Justin Blaess
Stock number	26
Inception date	30 July 2014[1]
Recommended investment period	Long term (5+ years)
Minimum investment	A$20,000
Additional investment	A$5,000
NAV[2]	1.1138
Buy/sell (%)	0.30/0.25
Entry/exit fees	Nil
Distributions	Bi-annual
Management fee[3]	0.82%

Market Commentary

Equity market declines continued in December following meaningful falls in October and November. For global equities, December recorded a further -4.2% return to take the quarter return to -11.0%, as investors continued to rotate away from risk assets. Reasons behind the sell-off were many but include fears of additional interest rate rises in the US, slowing global growth, falling oil prices and an escalation of the trade war between the USA and China. Adding to market fears was speculation the US President was considering replacing the chairman of the Federal Reserve, and the risk of a 'hard' or no-deal Brexit outcome continues to become more likely.

For Australian investors, a weaker Australian dollar acted as a buffer for locally reported returns, with a +3.8% contribution from currency movements.

As we reported last month, it has been a long cycle and investors appear to be reacting to any news that may indicate a downturn.

The Australian equities market was surprisingly resilient, recording a return of -0.1% for the month. Despite this, returns for the quarter weren't so great at -8.2%.

Fund Performance

Global Real Estate wasn't immune from the sell-off in December as the panic in equity markets became much more widespread. The Quay Global Real Estate Fund posted a return of -2.3%, after a +3.2% gain from currency movements.

The best geographies this month were Hong Kong and the United Kingdom. The US and Canada were the worst performers.

The best stocks based on contribution to returns were Hysan and Wharf REIC (both HK, Diversified), while Chartwell (Canada, Healthcare) and RLJ (US, Hotels/Lodging) detracted the most.

Late in the month we deployed some of our cash holdings to take advantage of the general price weakness and added Shurgard Self-Storage (Belgium, Storage) to the portfolio. Shurgard is the largest owner of storage assets across Europe. We like storage because of the defensive nature of the cashflows and the low levels of stay in business capex. Over the long term we believe SHUR will benefit from increased levels of product awareness across its European platform and very low levels of supply where the provision of storage space per capita across Europe is a fraction of the levels in the US and Australia.

The Year in Review

It's been a challenging year for equity investors. This time last year there was much commentary about synchronised global growth and the term "melt-up" (in reference to global equities) was being used by commentators in the press. Global equities delivered a +5.7% return in January, driven largely by the tech sector. Global Real Estate was unpopular because of the enthusiasm by the market for growth and risk. We wrote back then that caution was warranted, and made a comparison to 1999 and how Global Real Estate was a strong outperformer over the subsequent year. To date, that view appears somewhat vindicated.

While the Fund's total return of +7.6% for the year exceeded our investment objective of CPI +5% p.a. and also exceeded Global equities (+1.6%), Australian equities (-3.1%) and Global listed real estate (+4.8%), the returns could have been better (more on that below).

It is worth noting that being unhedged protected the Fund's returns in what was a challenging year. The attribution between local and currency returns for 2018 were -0.7% and +8.3% respectively as the AUD weakened during periods of 'risk-off'. As long-term followers of our Fund will know, this outcome is very much by design and the reason for launching an unhedged strategy in 2014. For more on this topic and our philosophy toward currency risk please refer to an early publication of Investment Perspectives: Foreign exchange - hedged or unhedged?

The following chart highlights the best and worst three contributors to returns. While it is always easy to discuss and celebrate the 'winners', we find it more productive and informative to focus on the 'losers'. Therefore, this commentary will only focus on the detractors.

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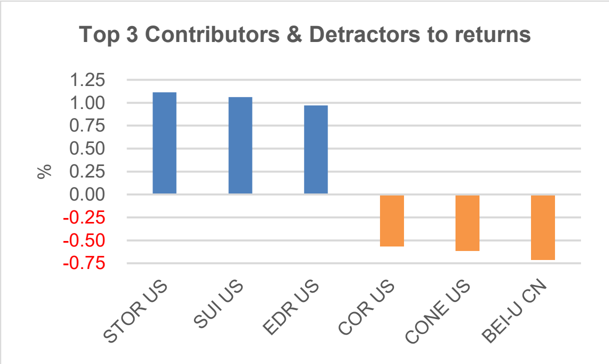

BEI-U (Boardwalk REIT, Apartments, Canada) is a relatively recent addition to the Fund, being acquired in October. However, with a significant percentage of its portfolio located in Alberta (60%), which has a reliance on the energy industry, the subsequent steep fall in the oil price also translated into a 21% fall in BEI's share price despite no news from the company.

While the fears about a slow-down in the Alberta economy are warranted we are not panicked by the outlook for BEI. As a provider of affordable housing, its product appeals to a wider demographic, and it has good governance and high levels of management alignment. While its gearing is at the higher level for our investees, its debt is effectively insured by the Canadian Government under the National Housing Act that increases overall credit quality and enables access to preferential interest rates as well as facilitating easier renewals. What's more, interest cover is still at an acceptable 2.4x and the board also recently adopted a pay-out ratio of 50% of AFFO (a measure of free cashflow after capital expenditure) that is the lowest of our investees. This is credit friendly and will eventually provide a source of cheap capital for funding future external growth. The current share price implies a steep discount to both market value (27%) and replacement cost (46%).

Both CONE (Cyrus One, US) and COR (Coresite, US) are US-based data centre REITs. The data centre sector has had a tough six months. Comments about over supply in the hyperscale segment of the sector during the 3Q18 reporting season was the start of a rut in their share prices that has continued as the market has become more risk adverse.

We sold CONE early in the year owing to balance sheet concerns as well as ongoing poor disclosure. However, we like the long term thematic supporting the data centre sector and COR was subsequently bought, unfortunately before 3Q18. Over the long term, we believe COR will turn out to be an outstanding investment. As well as offering value at current prices and being supported by a strong thematic, it has a strong balance sheet with debt/EBITDA of 3.6x or interest cover of 9.3x that can be used to fund its pipeline of external growth at 12% cash yields. Additionally, disclosure is good, and the management team is conservative and has a clear long-term strategy and a philosophy for creating value that is aligned with our thinking.

Outlook

It is always difficult to predict returns on a monthly or even yearly basis. Such forecasts may provide short term comfort for investors but can lead to long term disappointment. We prefer to focus on the longer term.

While there is currently much fear in the market and identifiable near-term risk events, such as Brexit and global trade, it is also worth pointing out that the economies of the US, Canada are Europe are generally doing well. In our travels we meet with management teams around the world, and as recently as December they still gave us confidence about the earnings outlook with no identifiable red flags. What's more, supply is generally in check in sectors where we have exposure, and there hasn't been an industry wide increase in leverage, unlike in the period before the GFC. This is confirmed by an active direct market where capital is still plentiful and transactions are generally very supportive of REIT prices. Consequently, if current REIT pricing persists it is hard not to expect increasing M&A in select sub-sectors.

Last year one of the big push backs to Global Real Estate was rising interest rates. At the time, US 10-year treasury yields were 2.4% and ultimately reached 3.2% in November. Today they are back to 2.6% and the yield curve is flat and teetering on inverting. We have always argued that historically, this type of interest rate environment is supportive to REITs relative to equities. We feel the performance last year continues to support this assertion.

While we don't know what the short term will bring, we feel comfortable about the long-term outlook for our investees backed by solid long-term secular themes, run by competent management teams with moderate financial leverage and attractive valuations. We remain committed to identifying the best global real estate investment opportunities that meet our long-term return objective of CPI + 5% p.a.

Performance

Timeframe	Fund return (net)[1]	Index**	Value add
1 month	-2.3%	-2.0%	-0.2%
3 months	-2.9%	-3.1%	+0.2%
6 months	-1.1%	-1.3%	+0.2%
1 year	+7.6%	+4.8%	+2.8%
2 years (p.a.)	+8.1%	+3.5%	+4.6%
3 years (p.a.)	+6.5%	+3.9%	+2.6%
Since inception (p.a.)*	+13.2%	+8.8%	+4.4%

Performance figures include dividends and are after all fees and costs and gross of any earnings tax, but after withholding tax
* Inception date is 30 July 2014[1]
** FTSE/ EPRA NAREIT Developed Index Net TR AUD[4].

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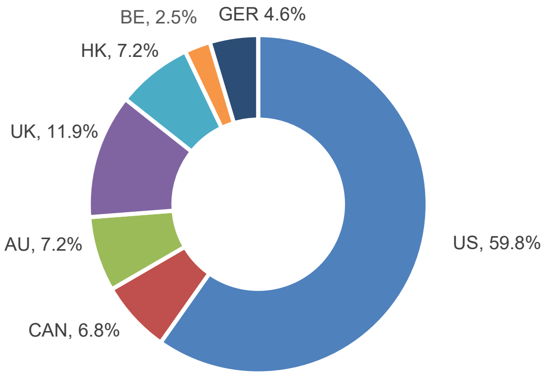
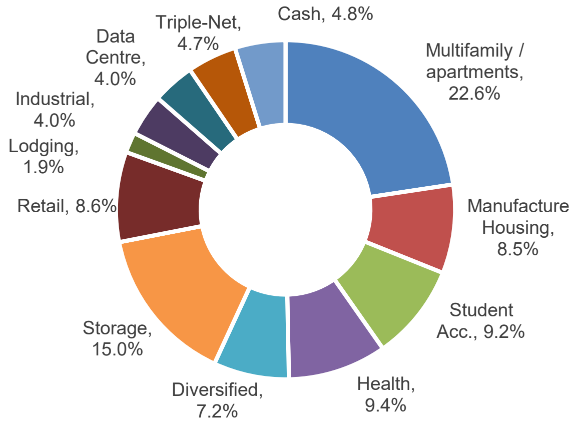
Geographic Weightings



Sector Weightings



How to invest

The Fund is open to investors directly via the PDS (available at quaygi.com), or the following platforms.

Platforms
AON
BT (Wrap, Panorama)
Hub24 (Super, IDPS)
Macquarie Wrap (IDPS, Super)
Netwealth (Super Service, Wrap Service, IDPS)
Powerwrap (IDPS)

Contact details

For more information, please call 1800 895 388 (AU) or 0800 442 304 (NZ) or visit quaygi.com

[1] The Quay Global Real Estate Fund was launched 31/1/2016 (The Daily Series). Performance information before this date relates to the strategy (Series 1), which was launched 30/7/2014. For those who are invested in the Daily Series, please contact Client Services (1800 895 388 (AU) or 0800 442 304 (NZ) or client.services@bennelongfunds.com) to request your performance history.

[2] Adjusted for expected withholding taxes.

[3] The management fee does not include fund expenses, which are capped at 0.10% per annum on net asset value, or the performance fee. Any performance fee payable is 15.375% of the excess return over the greater of CPI and the FTSE/EPRA NAREIT Developed Index (net) Total Return (AUD). All fees quoted include GST net of reduced input tax credits. For more information, refer to the Product Disclosure Statement (PDS) dated 1 February 2017 (ARSN 610 224 381).

[4] Source: FTSE International Limited (“FTSE”) © FTSE 2017. “FTSE®” is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under licence. "NAREIT®" is a trade mark of the National Association of Real Estate Investment Trusts and "EPRA®" is a trade mark of European Public Real Estate Association and all are used by FTSE under licence. All rights in the FTSE indices and / or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and / or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE’s express written consent.

The Fund is managed by Quay Global Investors, a Bennelong Funds Management boutique.