COMMENTARY

March 8, 2019

Dear clients and colleagues,

Yesterday, the European Central Bank (ECB) announced its would keep its benchmark refinancing rate at 0% (where it has been since March 2016) and indicated it intended to defer a rate hike until 2020 at the earliest. It also revised 2019 inflation expectations downwards to 1.2% from 1.8%, well below the target of “below, but close to, 2% over the medium term” it deemed necessary to initiate the first rate hike in almost eight years. At the same time, 2020 and 2021 inflation expectations were also revised downwards to 1.5% and 1.6% respectively.

Recent weak economic data releases indicate a slowdown in the eurozone due to a multitude of factors such as geopolitical concerns, tariffs and concerns in emerging markets. This supportive monetary policy stance will continue on the back of a new round of targeted longer-term refinancing operations (TLTROs) to be launched in the fall and the reinvestment of the proceeds of maturing bonds.

Outside the eurozone, this week one of the policymakers on the Bank of England’s (BoE) monetary policy committee commented that an interest rate cut would be more likely to occur in the event of a hard Brexit. She added that a soft Brexit does not automatically mean an interest rate hike. This follows another BoE policymaker suggesting there will be additional monetary policy easing should a hard Brexit come to pass. The Bank of Japan has stated that an exit from its monetary easing will be debated, but it does not have a specific plan due to the length of time likely needed to achieve its target inflation rate of 2%.

Closer to home, the Bank of Canada kept its interest rate unchanged citing a more pronounced global slowdown than previously anticipated. The timing of future interest rate hikes was also said to be increasingly uncertain, and some economists, admittedly the minority, believe the next move could even be a cut.

With a view that interest rates are going to be lower for longer, Global Alpha recently increased its exposure to real estate by increasing existing positions in the sector across all regions and introducing a new name, Patrizia Immobilien, to the portfolio. The expectation of rising interest rates pushing up yields, and therefore capital values down, has abated.

Patrizia Immobilien AG is a fully integrated real estate company, covering the entire value chain — acquisition, management, optimization and ultimately disposal. Patrizia has a global presence with 24 offices around the world, 19 of them in Europe. The company believes that close proximity to clients and/or assets is essential, that it is a big advantage to be seen as a local asset manager, and it also facilitates access to deal flow. Patrizia’s other competitive advantages include a strong track record, which aids in client retention; superior financing capability; and product offerings across all asset classes and risk profiles.

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Patrizia has roughly €40 billion in assets under management (AUM), making it one of the top four real estate investors in Europe and the largest in Germany. By region, 64% of its AUM is in Germany, the UK and Ireland is the second largest exposure at 11%, followed by France and Belgium, the Nordics and the Netherlands. Sixty-six percent of the assets Patrizia manages have maturities of 10 years or more, which provides a stable earnings environment. The company manages assets in all major segments of the market, the largest is office at 36% followed by retail and residential, both at 23%.

Patrizia's average yearly transaction volume since 2012 has been €5 billion, and the company believes it can do €5 billion to €7 billion per year, or even more. As the institutional appetite for real estate investment is still strong due to lack of supply and an under allocation to real estate globally, we also believe this is possible.

The company's growth strategy is to broaden its product portfolio in terms of sector and risk to meet investor demand, to expand its international investor base and strengthen its European expertise by keeping a strong local presence.

The spread between prime yields and the 10-year government bond yield is still at an all-time high, so even if there is an increase in interest rates, real estate should continue to be an attractive investment opportunity.

Have a great weekend.

The Global Alpha team