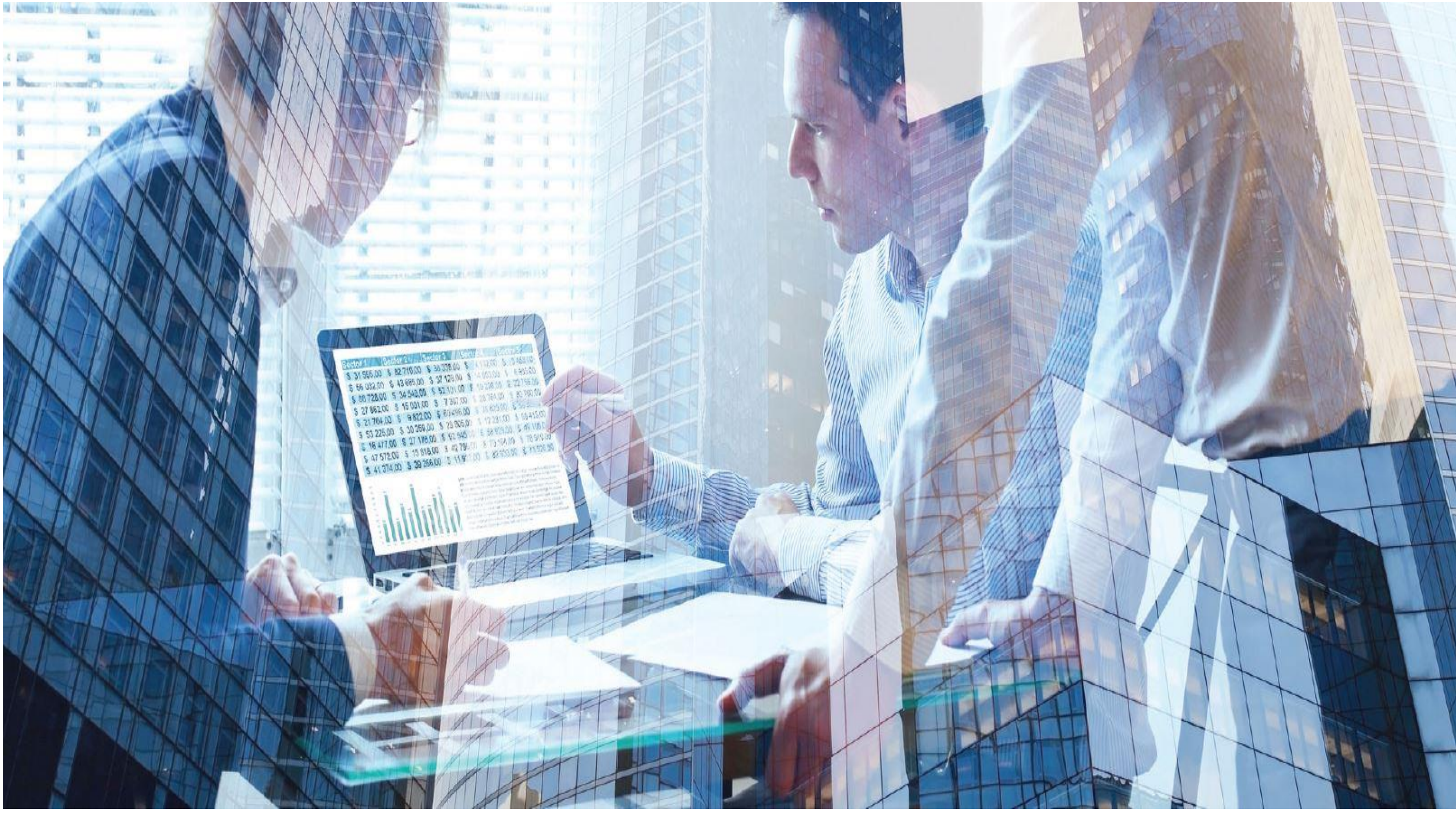


Hype Cycle

Bullish on REITs, bearish on gold

Joachim Klement, CFA
Head of Investment Research

10 April 2019

The first quarter 2019 has seen a strong recovery in most risky asset classes. We address the question as to whether this recovery can continue over the coming three months by focusing on two different real assets: gold and REITs.

Our analysis shows that investor sentiment about gold is probably too optimistic given the expected headwinds in the second quarter 2019, while REITs should be well supported by positive sentiment and persistent price momentum.

© Fidante Partners Europe Limited, 8/04/2019 9:21:20 AM

This communication contains written material that is generic in nature and not related to a specific financial instrument. It is not personalised to reflect the circumstances of an individual client and therefore does not amount to a personal recommendation to any person. It does not contain any substantive analysis and does not and is not intended to recommend or suggest any investment strategy or opinion as to the future value or price of financial instruments of any kind. This communication is also made openly available at the same time to any investment firms wishing to receive it or to the general public on the Fidante Partners Europe Limited ("Fidante Partners") website www.fidante.com. Recipients of this communication based in the EEA who are subject to regulation under MiFID should note that while they must make their own determination Fidante Partners Europe Limited ("Fidante Partners") is of the view that this communication constitutes a "minor non-monetary benefit". This communication will not be regularly updated.

Introduction

In the last edition of our Hype Cycle publication on 9 January 2019 we had to put ashes on our head for not having warned of the correction in the fourth quarter 2018. However, we redeemed ourselves somewhat in the last report because there we analysed the sentiment of retail and institutional investors and concluded that while retail investors were panicking about stocks and other risky assets, institutional investors were holding the course. Such a divergence in sentiment is usually followed by strong equity market returns and as it turned out, this was again the case in the first quarter of 2019.

US stock markets have just finished the best quarter since 2009 and global stock markets rallied 13.3% in US Dollar terms (Fig. 1). Other risky assets showed strong performance as well, with high yield bonds advancing 7.4% and emerging market equities 12.0%. The best performers were, however, listed diversified private equity investments (up 17.3% over the last three months) and renewable energy stocks (up 17.9%).

Given this extremely strong performance, it is no surprise that the momentum signals in our hype cycle are positive for most of the asset classes we track, meaning that they appear on the right-hand side of the hype cycle in the "Recovery" or "Boom" stages (Fig. 2).

Only a select few asset classes, like gold and cat bonds, currently show a negative momentum signal. In the case of gold this is important, however, since in our last report we said that the gold rally of the fourth quarter 2018 may come to an end soon. The advance in gold prices has indeed stalled for now, but investor interest in gold has not. This creates an overhyped situation in gold that we will investigate further.

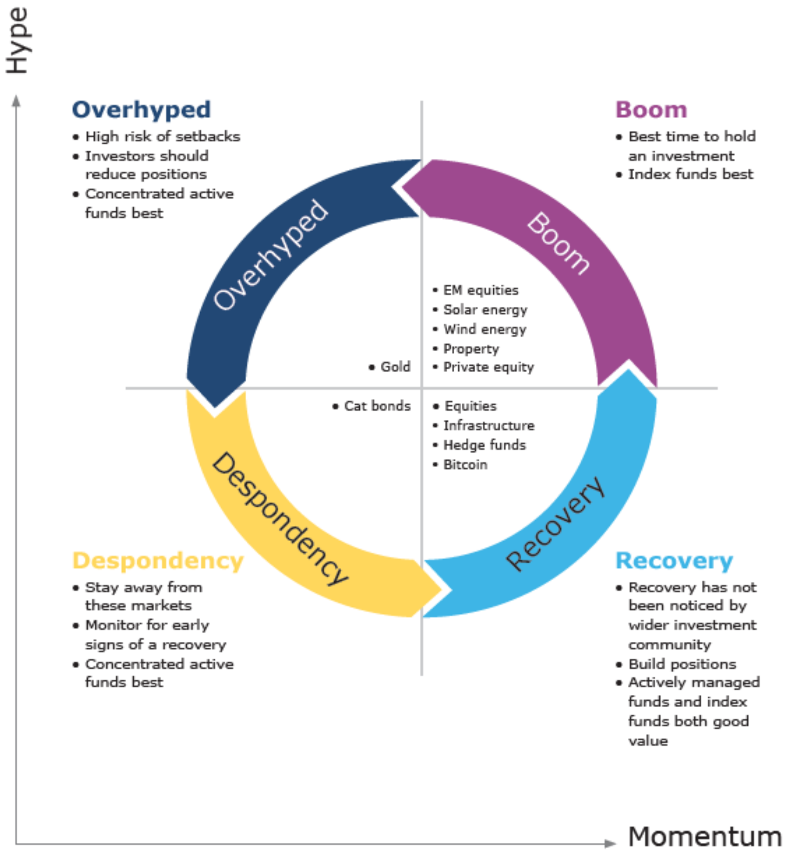
Another set of asset classes we will focus on in this report are property stocks, since REITs have shown strong performance despite their more defensive nature. This in turn has created renewed investor interest and improved sentiment. Whether this positive sentiment will translate into continued outperformance is something we will investigate in the second part of this report.

Fig 1: Asset class moves around the hype cycle

Asset class	Hype cycle Q1 2019	Hype cycle Today	Performance last 3M (%)
Equities	Overhyped	Recovery	13.3
High yield	Despondency	Boom	7.4
Hedge funds	Despondency	Recovery	2.3
Diversified PE	Despondency	Boom	17.3
Property UK	Despondency	Boom	11.3
Property EU	Despondency	Boom	17.0
Property US	Despondency	Boom	17.8
Infrastructure	Despondency	Recovery	13.5
Renewable Energy	Despondency	Boom	17.9
Cat bonds	Despondency	Despondency	1.6
Gold	Boom	Overhyped	0.2

Source: Fidante Partners. Data as at 2 April 2019. Past performance is not a reliable indicator of future outcomes.

Fig 2: Hype cycle overview



Source: Fidante Partners.

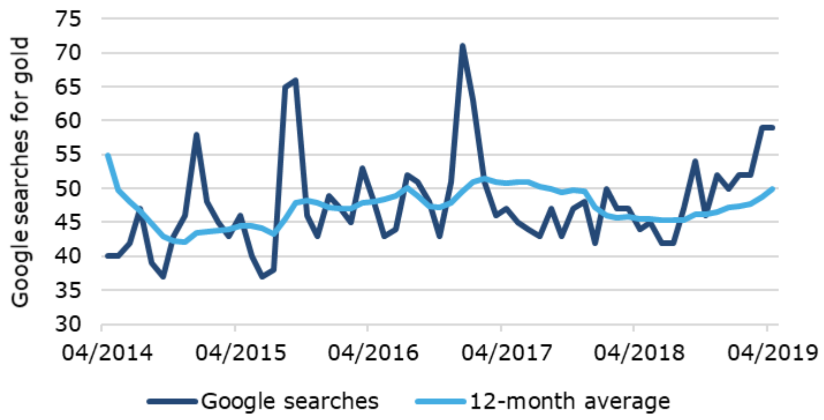
Everybody seems interested in gold…

While institutional investors have largely shunned gold in their portfolios, it has been a perennial favourite of private investors around the world. The World Gold Council reports[1] that in 2018 demand for gold bars and coins rose 4% and while the holdings of physical gold funds around the world grew a mere 2.9% in 2018, physical gold fund holdings have grown at an annual growth rate of 5.9% over the last five years. And this despite the fact that gold prices had an annual return of just 1.1% over the same time period.

Fig. 3 shows how investor interest in gold is reflected in Google searches on the subject. Note that in Fig. 3 we show only searches for the term "gold" using financial websites and not the internet overall. Internet searches for gold have been trending up for the last five years with occasional short spikes, but since October 2018, we have seen an acceleration in the number of searches that has only petered out in March of this year. Since gold is held as a safe haven investment in many private investor portfolios, it is no surprise that interest in gold spikes as stock markets correct, but this spike in Google searches has now lasted longer than usual.

[1] World Gold Council (2019). "Gold Demand Trends Full Year and Q4 2018".

Fig 3: Google searches for the term "gold"

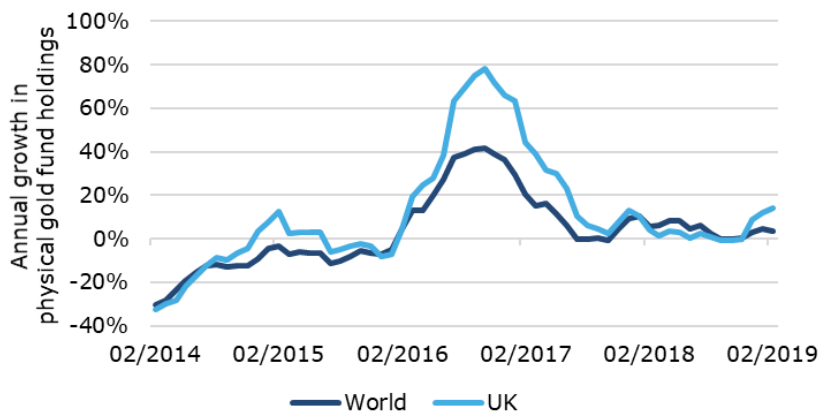


Source: Google Trends, Fidante Partners. Data as at 2 April 2019.

But while interest in gold as an investment has accelerated, investors seem reluctant to put their money where their Google search is. The annual growth in gold ETF and fund holdings has remained stable in recent months, hovering around 3% globally, there are regional differences, though. Every region in the world has seen fund holdings decline over the last twelve months except one. In Europe, physical gold ETFs and funds have grown their gold holdings over the last twelve months by 11.7%, from 1,000 tonnes to 1,117 tonnes. The main driver of this exceptional growth in Europe was for funds domiciled in Germany (gold holdings up 21.7%) and the UK (up 13.8%). Especially in UK-domiciled funds, we have seen an uptick in gold holdings since the beginning of the year that goes against the global trend. Whether this reflects rising Brexit uncertainty amongst private investors in the UK is anyone's guess, though.

But no matter what the drivers behind the inflows into UK-domiciled gold funds are, they account for only about 1.3% of total annual gold demand and are hardly able to move gold prices. In terms of global gold demand, the swing factors remain demand for jewellery, gold bars and coins, all of which have remained stable or declined slightly in 2018. In order to have a material effect on gold prices from increased gold holdings in ETFs and funds, one would need to see a spike in growth like the one seen in late 2016 (see Fig. 4) and at the moment, we are nowhere near these levels.

Fig 4: Growth in physical gold fund holdings



Source: World Gold Council, Fidante Partners. Data as at 2 April 2019.

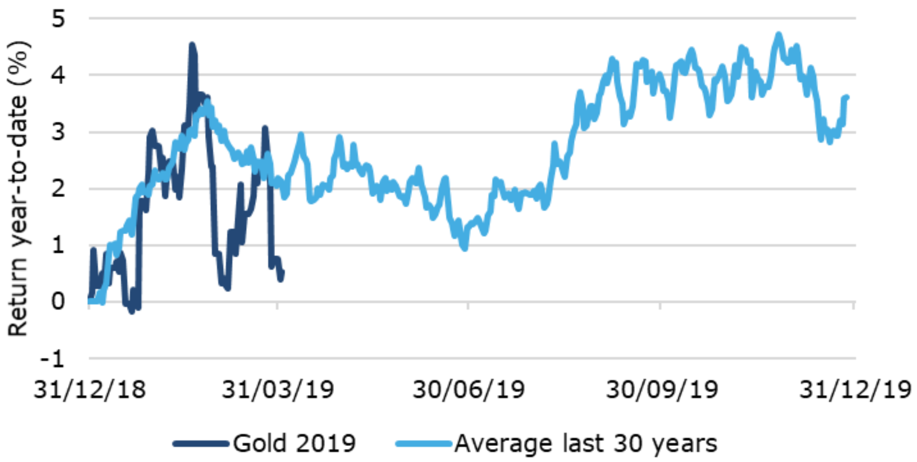
Seasonality not favourable for gold

Another reason why we think gold is overhyped and heading for a negative quarter is the seasonality in its price pattern. Fig. 5 shows the average seasonal return pattern over the last 30 years in comparison to the path the yellow metal has taken in 2019 so far. During the first quarter 2019, the gold price followed the typical seasonal pattern relatively closely with a peak in February and a decline in gold prices since then. Gold prices typically bottom out in June before rallying into year-end. The driver for this seasonality in gold prices are well-known fluctuations in global demand. On average between 2010 and 2018, global demand for gold declined by 3.4% in the second quarter compared to the previous quarter, while it increased in every other quarter.

The crucial factor in this seasonal pattern is no longer demand from India, where the wedding season starts after the Monsoon season is over in late summer and continues into spring. Today, demand for jewellery, gold bars and coins from China is what determines how much global demand fluctuates. Chinese demand for gold bars and jewellery typically declines by 20% in the second quarter of the year. This effect can be explained by the festivities around Chinese New Year, during which gifts are made to loved ones and gold is presented to friends and family on special occasions, such as weddings.

Given the current economic slowdown in China, consumers there have less money to save or invest. And since the Indian economy is slowing as well, it is unlikely that India will be able to close the gap due to lower Chinese demand. Thus, we expect the seasonal pattern for gold demand to hold in the second quarter of 2019 and, as a result, gold prices to drop.

Fig 5: Seasonality in gold prices



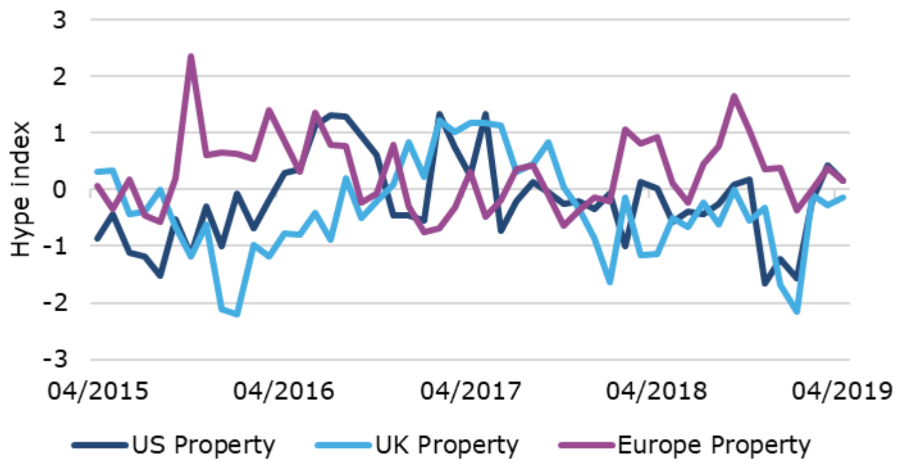
Source: Bloomberg, Fidante Partners. Data as at 2 April 2019. Past performance is not a reliable indicator of future outcomes.

Property hype in no way extreme

While we are pessimistic about the outlook for gold in the next three months, we remain optimistic about REITs and listed property companies in general. As we have seen in Fig. 1 above, US and European property stocks have outperformed global equity markets over the last three months while UK property stocks have lagged only slightly.[2] Normally, defensive assets such as REITs should underperform in an equity market rally like the one we have seen in Q1 2019. However, this time around, the equity market rally coincided with declining long-term interest rates which gave "long duration" stocks like REITs, infrastructure and utilities a boost. In our Quarterly Market Outlook, we explained that we expect these asset classes to outperform over the rest of 2019.[3] Here, we want to focus on a more short-term analysis of current investor sentiment and the question as to whether the strong recovery of the first quarter is likely to continue in the second.

In the case of REITs, we know that the strong price momentum of the first quarter puts these assets firmly in the right half of our hype cycle, but as Fig. 6 shows, our Hype Index signals no exuberance on the part of investors. Google search volumes for US and UK property have increased since the beginning of the year, while search volumes for European property have remained stable. More importantly, ETFs, which suffered from outflows throughout most of 2018, have seen their assets under management stabilise and some even record inflows this year. While investors are putting money back to work in REITs, our Hype Indices, which are a weighted average of sentiment indicators and fund flow metrics, have only recovered from the declines of the fourth quarter 2018. Typically, the Hype Index tops out around levels of one or above, so there is still ample room for improvement in sentiment and increasing fund inflows in the coming months. This in turn means that sentiment should continue to remain supportive for now.

Fig 6: Property hype indices



Source: Bloomberg, Fidante Partners. Data as at 2 April 2019.

[2] As always: past performance is not a reliable indicator of future outcomes.

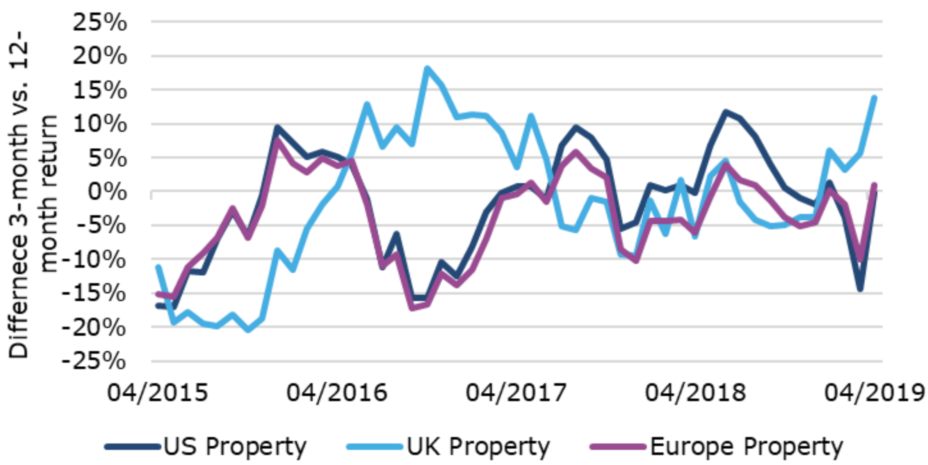
[3] https://www.fidante.com/resources/market-outlook-q2-2019

Property momentum should last

With only moderate investor hype, we should expect the current price momentum to have momentum, i.e. continue in the coming months. The typical pattern of a stock market recovery after a correction or a bear market is an explosive first leg up, followed by a small countertrend movement before a longer-lasting, but less explosive, second leg up. The rally in REITs during the first quarter 2018 had all the hallmarks of such an explosive first leg up.

Fig. 7 shows the difference between trailing 3-month and trailing 12-month returns for three major REITs markets. Values above zero indicate that the return over the last three months was higher than the return over the last twelve months. In other words, it shows a situation of accelerating price momentum. As we can see in Fig. 7, REITs in the US, the UK and Europe currently all show this accelerating price momentum.

Fig 7: Difference between 3-month and 12-month return

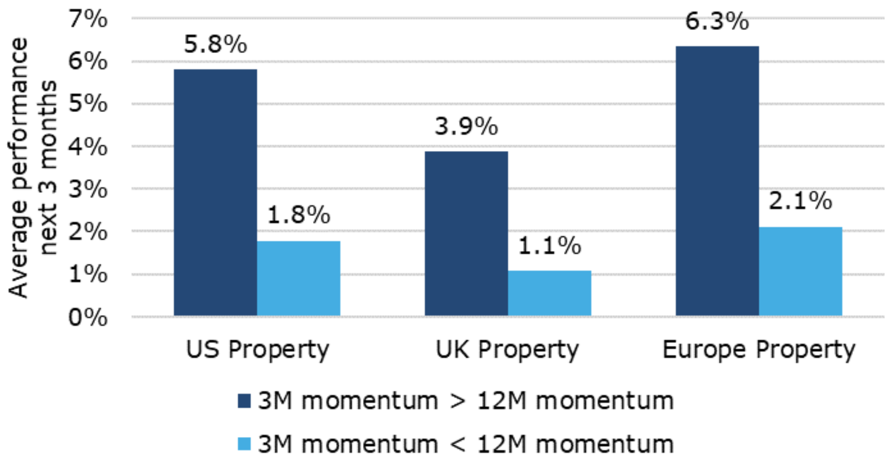


Source: Bloomberg, Fidante Partners. Data as at 2 April 2019.

In Fig. 8 we show the return of REITs in the US, UK and Europe over the next three months depending on the relationship of trailing 3-month and 12-month price returns at the beginning of the period. Dark blue bars show the subsequent 3-month return for REITs when trailing 3-month returns were above trailing 12-month returns at the beginning of the period (i.e. no forward-looking information is used in calculating these returns). The light blue bars show the returns in the opposite case. We use data since the end of the Global Financial Crisis 2009 as the basis for these calculations.

Fig. 8 shows the big difference in REIT returns in times of accelerating price momentum (i.e. when 3-month momentum is greater than 12-month momentum). The differences in average returns are not only economically significant but a t-test shows that they are statistically significant at the 1% level. Furthermore, the probability of having a negative return over the subsequent three months in the case of accelerating momentum is below 10% in all three regions but around 25% in the case of decelerating momentum. Thus, the odds are clearly in favour of continued positive returns in REITs over the next three months and, in our view, it is likely we are going to see above average returns as well.

Fig 8: Persistence of momentum in property stocks



Source: Bloomberg, Fidante Partners. Data as at 2 April 2019. Past performance is not a reliable indicator of future outcomes.

Conclusions

The first quarter 2019 has seen strong returns for most risky assets and most asset classes we follow are currently on the right-hand side of the Hype Cycle, defined by positive price momentum. In fact, since sentiment has recovered substantially in many asset classes, most assets are now in the "Boom" stage of our Hype Cycle. In our methodology paper that explains the details of our Hype Cycle approach, we have shown that returns tend to be high when asset classes are in the Boom stage and investors should be careful when assets enter the "Overhyped" stage.[4]

Given our assessment of the current sentiment and price momentum of risky assets, we expect the current market rally to continue in the second quarter 2019. As we have shown above, this is true in particular for REITs, which benefit from moderately optimistic sentiment and accelerating price momentum. These two drivers should continue to propel REIT prices higher in the next three months, so it is by no means too late to invest in these asset classes.

The one asset we are cautious about the returns for the next three months is gold. Sentiment for gold is too optimistic, in our view, and investors are not following through on this positive sentiment by investing into physical gold ETFs and funds. Given the seasonal decline in demand for physical gold in the second quarter, we expect gold prices to decline in the coming months.

[4] https://www.fidante.com/resources/hype-cycle

RESEARCH

Joachim Klement
+44 20 7832 0956
jklement@fidante.com

Martin McCubbin
+44 20 7832 0952
mmccubbin@fidante.com

MARKET MAKING

STX 79411 79412

Mark Naughton
+44 20 7832 0991
mnaughton@fidante.com

Anthony Harmer
+44 20 7832 0995
aharmer@fidante.com

UK SALES

Daniel Balabanoff
+44 20 7832 0955
dbalabanoff@fidante.com

Max Bickford
+44 20 7832 0934
mbickford@fidante.com

Hugh Ferrand
+44 20 7832 0935
hferrand@fidante.com

Mike Rumbold
+44 20 7832 0929
mrumbold@fidante.com

Justin Zawoda-Martin
+44 20 7832 0931
jzawodamartin@fidante.com

INTERNATIONAL SALES

Ian Brenninkmeijer
+46 8 1215 1361
ibrenninkmeijer@fidante.com

Yves van Langenhove
AAMYS* (Fidante Partners)
+34 468 29 08 04
yvanlangenhove@fidante.com

PRODUCT DEVELOPMENT

Nora O'Mahony
+44 20 7832 0961
nomahony@fidante.com

CORPORATE FINANCE

John Armstrong-Denby
+44 20 7832 0982
jdenby@fidante.com

Nick Donovan
+44 20 7832 0981
ndonovan@fidante.com

Will Talkington
+44 20 7832 0936
wtalkington@fidante.com

*AAMYS is a tied agent of Fidante Partners Europe Limited which is authorised and regulated by the Financial Conduct Authority of the United Kingdom and also trades as Fidante Capital

Important Information

This is a marketing communication and is not, and should not, be considered as independent investment research. It is issued by Fidante Partners Europe Limited ("Fidante Partners") which is authorised and regulated by the Financial Conduct Authority ("FCA"). Fidante Partners Europe Limited trades as "Fidante Partners" and "Fidante Capital". Fidante Partners Europe Limited is a wholly owned subsidiary of Challenger Limited, a company listed on the Australian Securities Exchange Limited.

This marketing communication is for persons who are Eligible Counterparties or Professional Clients (for the purposes of the FCA rules) only and it is not available to Retail Clients. It is being distributed (a) in the United Kingdom to, and is directed only at, persons who are (i) investment professionals as defined in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Promotion Order") or (ii) are persons to whom this marketing communication may otherwise lawfully be issued or passed on or (b) outside the United Kingdom to, and is directed only at, persons to whom this marketing communication may be lawfully issued or issued without compliance with any filing, registration, approval or other requirement in the relevant jurisdiction, and in each such case without the inclusion of any further warnings or statements as required by the Promotion Order, or other applicable law or regulation, which are not included in this marketing communication (all such persons together being referred to as "relevant persons"). Neither this marketing communication nor any of its contents may be received by, acted on or relied on by persons who are not relevant persons.

No part of this marketing communication may be published, distributed, extracted, re-utilised or reproduced and any attempt to do so may be restricted or prohibited by law. Recipients are required to inform themselves of, and comply with, all such restrictions or prohibitions and none of Fidante Partners or any other person accepts liability to any person in relation thereto.

Fidante Partners does not produce independent investment research within the meaning of the FCA Handbook of Rules and Guidance. Accordingly, this marketing communication is non-independent research within the meaning of those rules, which means it is a marketing communication under the Markets in Financial Instruments Directive ("MiFID") and it has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. However, Fidante Partners has policies, internal organisational and administration arrangements and information barriers to prevent or manage the conflicts which may arise in the production of non-independent research, including preventing dealing ahead. This includes physical and electronic information barriers procedures and the operation of a cultural Chinese Wall. For further information, please view the following policies: Chinese Walls Policy.

Fidante Partners acts as a market maker, corporate broker and, from time to time, bookrunner to companies in the closed-end listed investment company sector. A list of all companies in relation to which Fidante Partners acts as market maker and/or corporate broker and/or bookrunner (and the relevant dates of any closing of any such capital raise) can be viewed here: Market Making Stocks (of which Fidante Partners acts as market maker and accordingly Fidante Partners may own net long or short positions exceeding 0.5% of the total issued share capital), Corporate Appointments. The Market Making Stocks will indicate any other equity interests held by Fidante Partners or a member of the Challenger Group.

Fidante Partners or a member of the Challenger Limited group may have an economic interest (for example, minority equity interest or fee entitlement) in investment managers of the funds of which it provides services (such as corporate finance, listing sponsorship, market maker, corporate broker, bookrunner and administrative and support services). The Corporate Appointments also indicates whether Fidante Partners or any member of the Challenger Limited group holds more than 5% of the total issued share capital of the issuer. Fidante Partners is remunerated by fees for services provided and may be entitled to a share of profits from these investment managers and third parties. There is no direct link between the remuneration of individuals at Fidante Partners and the recommendations or transactions tied to services provided by Fidante Partners. Fidante Partners does not produce buy, sell or hold recommendations with respect to specific securities. Unless otherwise stated, this communication will not be regularly updated.

Please click here for the Fidante Partners research policy.

This marketing communication does not constitute a personal recommendation or take into account the particular investment objectives, financial situation or particular needs of any specific recipient. It is not intended to provide the sole basis for any evaluation of an investment decision. Your attention is drawn to the date of issue of this marketing communication and of the opinions expressed herein. Before acting on any advice or recommendations in this marketing communication, recipients should consider whether it is suitable for their particular circumstances and, if necessary seek professional advice, including tax advice. Recipients of this marketing communication should note that: All investments are subject to risk; the value of shares may go down as well as up; you may not get back the full amount that you have invested; past performance is not a guarantee of, and cannot be relied on as a guide to, future performance; fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

This marketing communication is for informational purposes only and does not constitute, and should not be viewed as, an offer, invitation or solicitation in respect of securities or related other financial instruments nor shall it be construed as a recommendation for Fidante Partners to effect any transaction to buy or sell securities or related financial instruments on behalf of any recipient nor shall it, or the fact of its distribution, form the basis of or be relied upon in connection with, any contract or commitment in relation to such action. The securities that may be described in this marketing communication may not be eligible for sale in all jurisdictions or to certain categories of investors.

This marketing communication is based upon information which Fidante Partners considers reliable, but such information has not been independently verified and no representation is made that it is, or will continue to be accurate or complete and nor should it be relied on as such. This marketing communication is not guaranteed to be a complete statement or summary of any securities, markets, documents or developments referred to in this marketing communication.

Any statements or opinions expressed in this marketing communication are subject to change without notice. Neither Fidante Partners, any member of the Challenger Limited group nor any of their directors, officers, employees or agents shall have any liability (including negligence), however arising, for any error, inaccuracy or incompleteness of fact or opinion, or lack of care, in this communication's preparation or publication; provided that this shall not exclude liability which Fidante Partners has to a customer under the Financial Services & Markets Act 2000 or under the Rules of the Financial Conduct Authority.

This marketing communication contains certain forward-looking statements, beliefs or opinions. These statements concern future circumstances and results and other statements that are not historical facts, sometimes identified by the words "believes", "expects", "predicts", "intends", "projects", "plans", "estimates", "aims", "foresees", "anticipates", "targets", "may", "will" and similar expressions. Such statements reflect current views with respect to future events and are subject to risks and uncertainties because they relate to events and depend on circumstances that will occur in the future. These forward-looking statements are based on current plans, estimates, projections and expectations. These statements are based on certain assumptions that, although reasonable at this time, may prove to be erroneous. No statement in this marketing communication is intended to be a profit forecast. No representations or warranties, express or implied, are given as to the achievement or reasonableness of and no reliance should be placed on, such statements, including (but not limited to) any projections, estimates, forecasts or targets contained herein. Fidante Partners does not undertake to provide any additional information, update or keep current information contained in this marketing communication, or to remedy any omissions in or from this marketing communication. There are a number of factors that could cause actual results, developments, financial targets and strategic objectives to differ materially from those expressed or implied by statements in this marketing communication. Fidante Partners, nor any other person intends, and no person assumes any obligations, to update information or statements set forth in this marketing communication. You should not place reliance on forward-looking statements which speak only as at the date of this document.

Where references to external resources such as internet websites are provided these are for reference purposes, and the external resources are not intended to be included as part of this publication; Fidante Partners plc has not checked and is not responsible for any external content, and makes no representation as to its reliability or accuracy.

Any dispute, action or other proceeding concerning this marketing communication shall be adjudicated within the exclusive jurisdiction of the courts of England. All material contained in this marketing communication (including in this disclaimer) shall be governed by and construed in accordance with the laws of England and Wales.

Fidante Partners Europe Limited

Authorised and Regulated by the Financial Conduct Authority

Fidante Partners Europe Limited trades as "Fidante Partners" and "Fidante Capital".

Registered Office: 1 Tudor Street, London EC4Y 0AH.
Registered in England and Wales No. 4040660.

FIDANTE
PARTNERS