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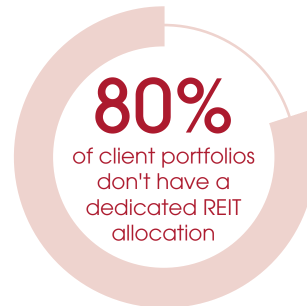
Janus Henderson INVESTORS

REITS: A DIVERSIFICATION TRILOGY

ADDRESSING KEY CONCERNS IN PORTFOLIOS WITH REITS

Market expectations for inflation and economic growth are rising as economies begin to recover post COVID. Inflation remains the topic du jour and probably for good reason. Having been in a downward trend since 1980, falling from 15% to around 2% in the last decade[1], inflation is now on the rise. Whether this rise in inflation proves to be transitory or not, it is a new environment relative to the past and requires careful examination of innovative frontiers in diversifying asset classes.



The Portfolio Construction and Strategy (PCS) Team partners with thousands of investment professionals, guiding the portfolio allocations of clients to best meet their objectives. Analysis of thousands of client portfolios in the PCS proprietary database shows that only 20% of models have a dedicated real estate investment trust (REIT) allocation. Furthermore, the team conducted a portfolio optimisation study going back more than 20 years, which suggested that REITs comprising 10% of an equity allocation resulted in the highest risk-adjusted return.[2]

According to the PCS Team, three of the most common concerns faced by investors today can be addressed by incorporating REITs in a diversified portfolio: REITs may be an appropriate solution for investors who are concerned about higher inflation, are seeking income in the extended low interest rate environment, and who may also be looking to diversify away from US growth and technology concentrations in the equity portion of portfolios.

1 Survive and thrive during inflation

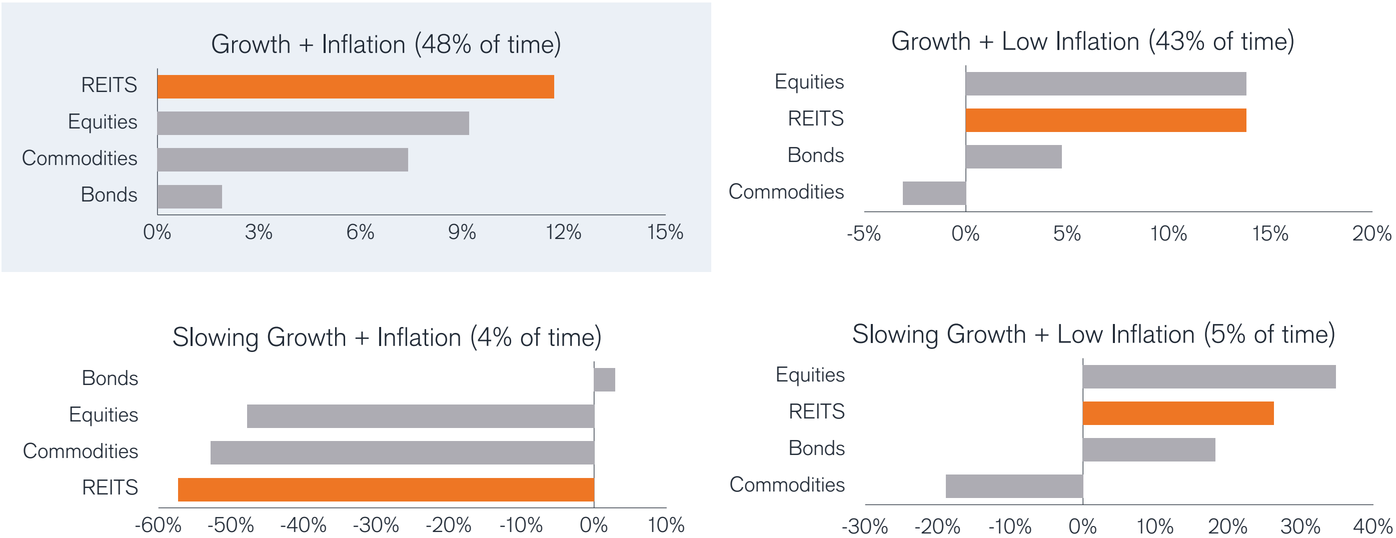
Historically, inflation and listed REITs have been positively correlated - as inflation expectations rise, so too have valuations for REITs, particularly in times of improving economic growth. As shown in the following charts, this relationship has existed over the long term, demonstrating the potential for real estate equities to benefit from rising inflation expectations when accompanied by economic growth.

In the PCS Team's analysis of the time period since the end of the tech bubble (2003) to date (end September 2021), REITs have performed nearly as well as broader global equities (MSCI World Index). But we have experienced periods of growth accompanied by low inflation 43% of the time, which has been a conducive environment for global equities to outperform REITs (see chart in the top right quadrant). Looking forward, if we are more likely to experience a period of growth and high inflation over the medium term, then this is an environment where REITs have historically tended to perform well (top left quadrant) compared with other major asset classes.

[1] Source: OECD

[2] The portfolios in this presentation are hypothetical and used for illustration purposes only. Modern Portfolio Theory (MPT) was first proposed by Harry Markowitz in 1952 and centers around the assumption that investors are risk-averse. This means that given two portfolios with the same expected return, investors will prefer the less risky portfolio. Modern Portfolio Theory combined with Mean-Variance portfolio optimization techniques will be utilized to understand how a portfolio can be constructed to maximize the achievable risk-adjusted returns (i.e. maximum Sharpe Ratio). Average Balanced Portfolio and Portfolio optimization calculated from 1/30/1998 – 12/31/2020. This represents the longest historical time period common among all studied indices. All calculations in USD.

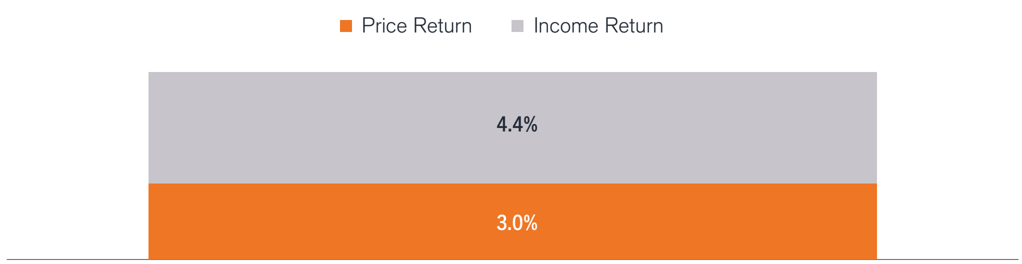
REITs have tended to perform well during high inflation and rising growth



Source: Janus Henderson, Bloomberg. Chart data from January 2003 to September 2021. Frequency in parenthesis. High/low inflation is defined as greater than/less than long-term US Fed target of 2.0%. Growth measured by US ISM Purchasing Manufacturing and Non-Manufacturing Blended Index. Global REITs = FTSE EPRA NAREIT Developed Total Return Index, Equities = MSCI World Total Return Index, Bonds = Bloomberg Global Aggregate Credit Total Return Index, Commodities = S&P GSCI Total Return Index.

One of the main reasons REITs have historically performed well during inflationary periods is that they typically provide a reliable and growing stream of income. The income generated by REITs via dividends tends to contribute more than half of its total returns.

Income has contributed 60% of global REIT total returns



REITs have historically provided a reliable stream of income during inflationary periods

Source: Janus Henderson, Bloomberg. FTSE EPRA NAREIT Developed Total Return Index USD from I January 1990 to 30 September 2021. Past performance is no guarantee of future results.

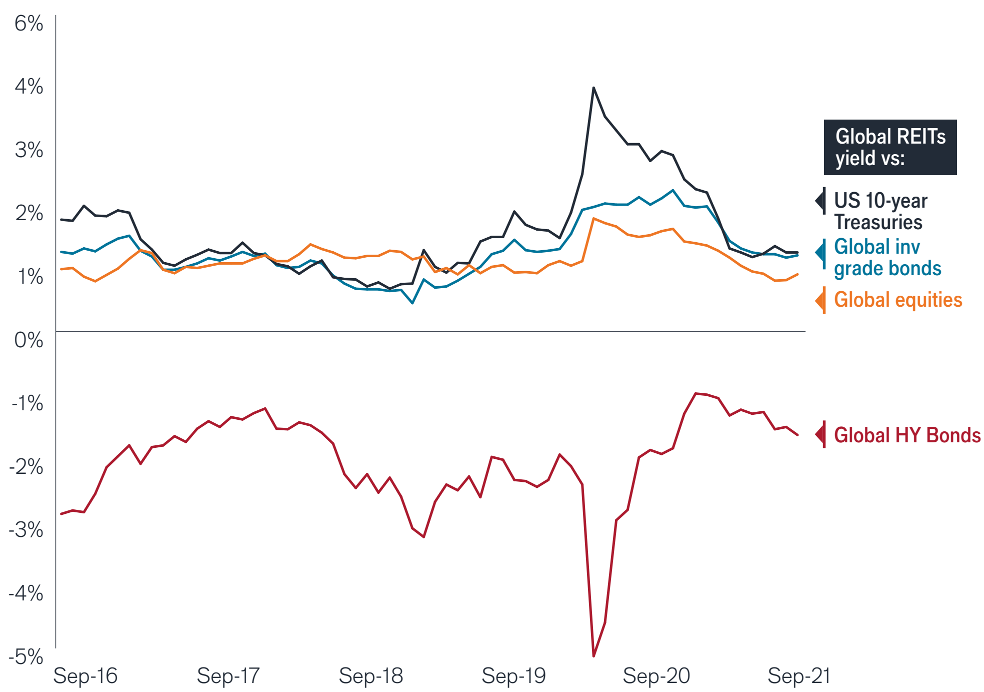
The reason for this is that a recovering economy typically leads to rising rental income coupled with increases in the value of underlying real estate assets. Rental contracts are often linked to inflation through annual escalators and are reset when they expire. Landlords owning assets with rental pricing power are well positioned to grow cash flows in this type of environment. REITs can also generate growth from existing assets, acquisitions, and developments, which historically has enabled their earnings and dividend growth to outpace inflation over time.

2 An income source in a low-rate world

The case for REITs is compelling in the continued search for yield in a low-rate environment.

Despite some initial concerns, cash flow (via rent collection) for the majority of real estate types has remained resilient throughout the pandemic. This has resulted in a durable, high-quality income stream for global real estate stocks, making them attractive versus other major asset classes, such as general equities and bonds (see chart). The dividend yield of REITs remains highly attractive, particularly versus high yield bonds where the relative spread remains historically narrow. Global REITs overall yield is 3.16% which is competitive with global high yield at 4.66% and easily outpaces both global investment grade bonds at 1.54% and US 10-year Treasuries at 1.49%*. The additional risk in fixed income an investor can bear to generate additional yield in a low-rate environment is limited. Investors looking to diversify income streams within a portfolio could consider moving a portion of their income-generating allocation to global REITs, which can offer more predictable income and attractive yields while also providing growth potential in cash flows that can potentially match or exceed inflation.

REIT yields attractive relative to other fixed income asset classes



REITs' overall yield is 3.16% which is competitive with global high yield at 4.66% and easily outpaces both global investment grade bonds at 1.54% and US 10-year Treasuries at 1.49%*.

Source: Janus Henderson Investors, as at 30 September 2021. Note: Global REITs = FTSE EPRA NAREIT Developed Total Return Index; global equities = MSCI World Index; global investment grade credit = Bloomberg Global Aggregate Credit Index; global high yield = Bloomberg Global High Yield Index. Yields may vary and are not guaranteed.
*Source: Janus Henderson, Bloomberg as at 30 September 2021. Yields may vary and are not guaranteed. Past performance is no guarantee of future results.

3 Diversification from US technology and growth

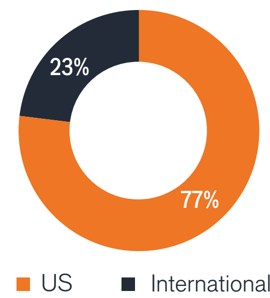
Investors have also had to contend with the issue of portfolio concentration given the extended run of US equities' outperformance. Top of mind is not just the dominance of US exposure in equity portfolios (almost 68% of the MSCI World Index) but also the corresponding dominance of US growth. As an example, in the US the average adviser portfolio has around 77% exposure to the US. Given the structure of the MSCI World Index with around 23% weight to the technology sector, investment professionals need to be cognisant of the potential dangers of their implicit (or explicit) overweight to technology.

For investors not only concerned with concentration in US stocks but also with its corresponding technology overweight, REITs have the potential to offer diversification that meaningfully improves the investor's experience if or when there is volatility in the technology sector.

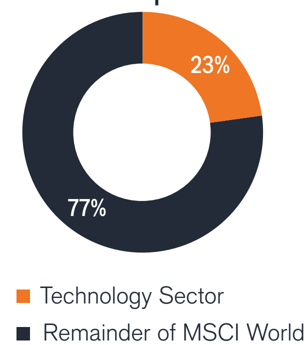
Using global REITs to illustrate the ten years surrounding the March 2000 "dot-com" peak, global REITs returned 11.7% versus 11.1% for the S&P 500 Index and did so with a lot less drama along the way: REITs' 10-year annualised return was accompanied by a standard deviation more than 8% lower. This performance difference, plus REITs' broader equity portfolio diversification potential via lower correlations, underscores the attractive potential of REITs as a portfolio diversifier.

While history is not expected to repeat itself, the dot-com era serves to illustrate the potential benefits of REITs diversification. REITs may offer similar or improved returns but more importantly, a 'smoother ride' accompanied by lower volatility.

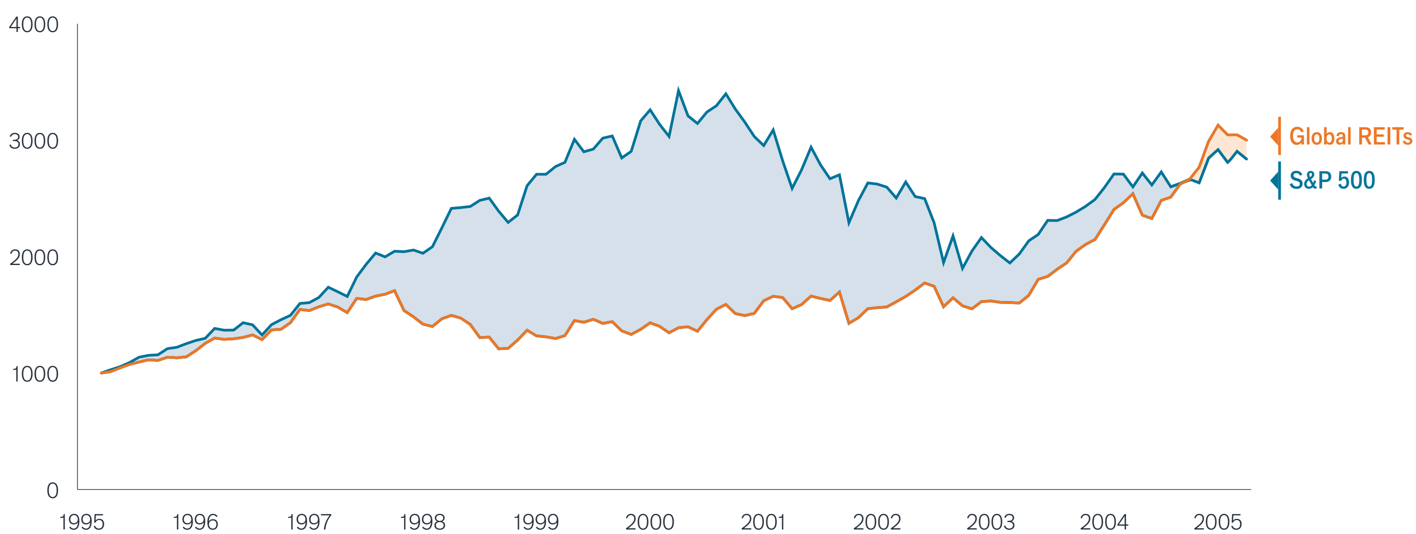
Average US advisor equity exposure



MSCI World Index breakdown at 30 Sep 2021



REITs in the 10 years surrounding the "dot-com" peak



5 years prior return
S&P 500 **24.8%** Global REITs **5.4%**

5 years after return
S&P 500 **-2.7%** Global REITs **17.3%**

Full 10 years
S&P 500 return **11.1%** Global REITs return **11.7%**
S&P 500 volatility **22.0%** Global REITs volatility **13.8%**

Source: Janus Henderson, Bloomberg. Period covered 24 February 1995 to 24 March 2005. The "dot.com" peak refers to 31 January 2001. Global REITs = FTSE EPRA NAREIT Developed Total Return Index; S&P 500 Total Return Index.

Conclusion

Given the uncertainties on the horizon, an allocation to REITs within a balanced, diversified portfolio can help address the three biggest concerns we see in client portfolios today as they have the potential to:

- Survive and thrive during inflation
- Provide an income source in a low-rate world
- Diversify from tech and US growth concentrations

ABOUT THE PORTFOLIO CONSTRUCTION AND STRATEGY TEAM

The PCS Team performs customised analyses on investment portfolios, providing differentiated, data-driven diagnostics. From a diverse universe of thousands of models emerge trends, themes and potential opportunities in portfolio construction that the team believes will be interesting and beneficial to any investor.

FOR MORE INFORMATION, PLEASE VISIT **JANUSHENDERSON.COM**

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S&P 500® Index reflects US large-cap equity performance and represents broad US equity market performance.

FTSE EPRA NAREIT Developed Index is designed to track the performance of listed real estate companies and REITs worldwide.

MSCI World Index captures large and mid-cap representation across 23 developed markets (DM) countries.

Bloomberg Global Aggregate Credit Index tracks the performance of global investment grade fixed rate bond markets.

Bloomberg Global High Yield Index is a multi-currency flagship measure of the global high yield debt market.

Index performance does not reflect the expenses of managing a portfolio as an index is unmanaged and not available for direct investment.

Sharpe Ratio measures risk-adjusted performance using excess returns versus the "risk-free" rate and the volatility of those returns. A higher ratio means better return per unit of risk.

Standard Deviation measures historical volatility. Higher standard deviation implies greater volatility.

There is no assurance the stated objective(s) will be met.

Real estate securities, including Real Estate Investment Trusts (REITs) may be subject to additional risks, including interest rate, management, tax, economic, environmental and concentration risks.

Concentrated investments in a single sector, industry or region will be more susceptible to factors affecting that group and may be more volatile than less concentrated investments or the market as a whole.

Actively managed portfolios may fail to produce the intended results. No investment strategy can ensure a profit or eliminate the risk of loss.

Diversification neither assures a profit nor eliminates the risk of experiencing investment losses.

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